Deco Media
Sanoma Jan/March Interim Report
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Chaired by Martti Yrjö-Koskinen

Martti Yrjö-Koskinen

Good afternoon ladies and gentlemen and welcome to Sanoma's January/March 2013 interim report presentation. My name is Martti Yrjö-Koskinen, Head of Group Investor Relations. Today present from management, we have our President, the CEO, Harri-Pekka Kaukonen and our CFO, Mr Kim Ignatius. After the presentation, you will be able to ask some questions and with these words, I would like to hand over to our President and CEO, Mr Harri-Pekka Kaukonen.

Harri-Pekka Kaukonen

Thank you Martti; ladies and gentlemen, welcome to the studio here in Sanoma House and also for those of you listening and watching on the internet, you are heartily welcome to our interim report presentation.

I will start off with a few highlights; Sanoma has been undergoing a quite fundamental transformation already some two plus years and about a month ago we also made some changes in the visual identity and appearance but, also more importantly, we launched our new vision and our brand identity and along with it, our values or the Sanoma way of working. The new big idea, or slogan if you want, is getting the world, which really combine media and learning through the combination of two desires, where we want to help our customers, it's to access and better understand the world and then also to improve yourself when you want to learn new things. I'm very happy with the look and feel and I think it's very dynamic, it's fresh and it supports our transformation in many ways and it's really an important step also to support the culture transformation in Sanoma, so I hope you like it too.

Going into the numbers in Q1; Q1 is a soft quarter by just how the way our businesses are set up and because of the annual cycle of our business. This year, it was also unfortunately softer than we'd like it to be and it was really about the very soft advertising market out there. On the other hand, learning showed some very solid numbers; the first quarter is a very small quarter for learning, so what really we saw was about 10 million shifts between the quarters, which really contributed to a stronger top line and also a bottom line in learning. But overall, a soft quarter for us continues drop in top line; the organic growth rate was about 8% negative and correspondingly, also the bottom line was suffering. We came at the negative EBIT, as we had forecast before, at 3 million is the exact number.

Cash flow follows, of course, top line, but you will also have to bear in mind that there are a number of shifts between quarters and seasonal elements of it, which Kim will then go through in more detail, so the weakness of our cash flow is not an indication of that dramatic change in the underlying performance beyond the drop in top line.

Very happy also to announce again that our cost programme is moving according to plan. You remember it's a €60 million programme and in Q1, absolute numbers hit about 3 million and this year, we're looking at about 20 million hard savings.

Our outlook is unchanged it's what we communicated in March and thus, no changes there.

A few words then about the environment. I think our Q1 has been one of the toughest ones in media in a long, long time. You can see the numbers here, pretty dramatic numbers if you look at it; it's across all media basically, even online is not growing the way it has before and you can see the softness and if you look at the total advertising market growth, it's double digit negative in Q1 and the drivers are very well known to you, so I'm not going to reinstate, but what is really worrisome is also the late drop in consumer confidence, for example, in Finland. So no quick relief in sight and we're planning to basically a continuation of this type of environment also for the remainder of the year.

We're not staying still; I already mentioned about the cost programme, but transforming the company and investments thus into digital and TV is really important for us and we continue doing it. There is a significant investment in time and resource and capital going in a number of fields. First of all, I'd like to mention a programme that we launched some while ago, which is really around strengthening our ability to gather and use data in our business. It is to become more efficient, to do better up and cross-selling, to turn management, better sales optimisation and so on and in that way improve our business, but it will also be the foundation of new services and a better targeted offer, involve the consumers and advertisers. It is, by the way, equally important learning where also when you talk about personalised learning outcomes, it needs to be based on well analysed data on individual learners.

The other core element is around content. You are fully aware that multi-channel is the way we're going in everything we do and therefore we need to also build the enablers, the platforms, the back office, if you want, a digital operating system and we're investing into content libraries and digital distribution. But we're also coming out with new services; good examples are the tabloid and the Helsinki Sanomat multi-channel publications and those products and then, for example, Liv and later this year we will launch the Finnish Hockey League concept, which is another good example of true multimedia designing in new services.

With that bridge, I think I can go to the future of TV. One hand it is to take care of our TV business and the turnaround in SBS is really what's needed and that still this year requires higher spending per share of viewing. Actually the absolute spending is going to be about the same level as the previous year, but it's still on a high level if you compare it to any kind of benchmark to a percentage point of viewing; and then already mentioned, the big investment we have in the cross-media offering here in the Finnish Hockey League, which we already tested the platforms in the last finals here some time ago in Ässät-Tappara event.

Then e-commerce is really an interesting field for us also, because we can use our media power to drive conversions, so it is synergistic from a media power point of view and there are a number of initiatives that we have, that also some of them have international scalability potential, so once these initiatives get to be at scale, we're very happy to talk more about them, but mind you that many of these services are today already profitable and they're growing at good pace.

Learning; the digitalisation is going on there and what we're doing, on one hand, we're building the learning platform, so that we can use the functionality across the different markets, but we're also bringing in new elements into our offering and testing and assessment is a good example of that. Last year we bought Bureau ICE, which is company focused on testing and assessment and we're rolling out that capability in our different subjects in various countries.

We're also doing serious piloting around tutoring in Belgium and Holland, combining there our media reach with our learning capabilities and it will be quite interesting to see how that will develop.

And then last, but not least, we're transforming also the innovation culture internally and one of the elements there is venturing and we're doing both internal and external ventures, where the first one is really around innovating new ways of developing from idea to concrete service and through accelerator programmes. We did one last fall around mobile accelerator, which was around creating new services and products utilising mobility and this spring theme is really around new content properties, so how can we use our own and other parties' content in coming up with new services; very excited about those.

And then last, we, as many other media companies, are using our media as a currency to get also foothold in the interesting start ups and we've done about 10 of these types of investments during the last 12 to 18 months. All in all this is a substantial investment in time and capital that we're putting into new development to be able to transform.

Going to the group outlook, there's not much new here; it's basically what we said in March. Our top line sales will decline between 2% and 4% as we see it and our EBIT guidance is a bracket between 180 and 205 million and that must have been the signal, and it is based on the outlook in the economic market continuing as is, which means tough weather conditions out there and that we need to deal with.

With that, our very brief overview of where we are and what Q1 brought us. I'll hand it over to Kim, who will take us through the numbers in more detail and after that, I'm happy to also answer your questions. Thank you.

Kim Ignatius

Thank you, Harri-Pekka. Once again, my name is Kim Ignatius. Happy to have you all with us again. Here, I will walk through the Q1 financials and I will also try to address some items that we think that are of importance or good deal of interest to you.

Starting with the income statement, we had sales of 505 million, so down around 7%, compared to last year, no real impact from any structural changes. The market environment around us is very tough and it impacted our sales naturally; our advertising sales are down 13% year-on-year and circulation sales down by 9%.

Our EBITDA was 75.9 million, and as a percentage of sales the level of 15, coming down a bit from last year. Still I do feel that we have done a pretty good job in getting a lower cost base, improving efficiency and working with both the cost of goods sold and the fixed expenses and with that help, there's still a fairly good margin.

The amortisations relating to programme rights are higher; it originates to both the Dutch market and operations there and the Finnish operations. It is partly about timing, but mainly about investing in the quality of the programming.

Our EBIT excluding non-recurring items was minus 3 million and I do know that the consensus was at the lower level, but with the help of the learning shift in time, we have reached the 3 million level, learning was really the delta between the market consensus and the final outcome.

Profit before taxes was at the level of minus 55 million and that includes a 34.8 million asset impairment charge that we took in March and I will come back to that matter.

Net sales development in media, we came down by 10.8%, really driven by both the advertising markets and the circulation trends and all in all, media came down in sales by 30.6 million. News, down by 8.2% - 9 million - and that what comes to News, it was mainly driven by advertising sales and particularly the printed recruitment ads; Learning, doing well as we have already mentioned a few times. EBIT logically follows the net sales. Development and the main drop in the EBIT is in the Media entity of 28 million and the drop in News is 2.9 million and again the improvement in Learning 10.6 million.

Let's have a look at Media and News in a bit more detail. In Media, the net sales came down from 364 to 323 and as you can see here, the biggest portion of the decline is from the advertising sales; advertising dropped by 18 million and circulation by 10 million.

These declining sales levels directly impact our EBIT performance; where we have been able to then offset some of the decline is in cost of sales here by 7.9 million. Clearly, the paper costs are coming down; the paper costs of the group all came down by over 15% this quarter year-on-year. Also, fixed expenses, the category that is more in our own hands; I feel that we've done a fairly good job here and been able to save 5.5 million compared to last year. Even the personnel expenses are 2% below on the group level where we were last year.

Then depreciation and amortisation, this is clearly by the programming spending as we already discussed.

In News, it is really the advertising part that has taken the sales down and how we have been able to offset some of this decline is mainly in the fixed expenses against savings in the personnel costs and other categories. Cost of sales, down only by 400,000, so the paper costs there again are coming down very nicely, but what is increasing here are distribution costs, which then offset part of the savings that we get from the paper.

The other operating income improvement here 2.2 million, that is actually an internal item, it is the News services that the business unit News is providing to our Nelonen TV operations.

Free cash flow; if we look at the components there, so EBITDA 75.9 million, 11 million down from last and in this number we need to remember that we do have the better performance of Learning in the figures.

TV programming, cash-wise, again 11 million higher than it was last year. Cash versus P&L, it's mainly a question of timing on an annual basis, there shouldn't be any bigger differences.

Change in net working capital, usually negative for us in Q1, now a bit more negative than last year and this is again the Learning impact, so if you get a time shift in sales, it is your accounts receivable and that's why you have this development here.

Interest paid, 27 million versus 7.7 last year. This is an annual payment of the coupon interest on the bond and this is the first time we pay it, so it is again purely a timing matter to go on an annual basis no changes to be expected. The same goes for the taxes, now minus 3, last year minus 23, so the number in Q1 last year it included some taxes paid for previous years and also some higher advanced taxes than what we are booking now. Still, all in all, cash flow from operations 62 million negative when it was 22 the last year, but as I went through, a big portion is just a timing matter.

I would like to come back to the impairment charges just to once again walk through it, so that we all understand what we booked when we took the write-down on the assets. We look at the asset values from two different perspectives (1) the one which is important for us is naturally our consolidated numbers and in Group we test the predetermined cash generating units and for us, in this case, the cash-generating-unit is Sanoma Media Netherlands, and it includes all the operations we have in the media business in that country; and when we did the testing, we ended up with a 34.8 million impairment need. So in addition to this group effort, the goodwill is in the Image BV company in Netherlands, so Dutch Holding company, and for local statutory purposes, they need to test it separately and this testing has no impact on the Group numbers. Also, the testing methods or components vary, so the discount rates, the discount rates we're using are different when you look at the standalone TV business in Netherlands, compared to a full media operation from the Group perspective. In the local testing, the impairment was actually then 392 million, which as already said has no impact on the Group numbers, so it's cancelled in the Group accounting and the upper part testing here is then taken into consideration.

Savings targets and our 60 million programme was already mentioned here. I'm very pleased with how this programme is developing, so we have clear lists of projects that are included in this. About half of the projects we have already a firm decision to go forward with them and we start seeing the first impact on our annual P&L numbers as well so in Q1 the savings that we already had reached was 3 million for the quarter. On the right hand side of this slide there's some information for, on the cost structure for your benefit.

Capital structure; the funding is in place for the coming years so we can be satisfied with this situation. Our net at the end of the quarter was 1.3 billion and our net debt to

EBITDA adjusted was 4.1 times, so this is naturally something that we are not happy with; our long term target is to be below 3.5 and we would like to be in lower to have some financial flexibility going forward, so this is a matter that we continue to work on. Average interest rate around 3.5% which I think is a satisfactory level.

Finally, a bit of a reminder to you it is about the volatility that we always have in our quarterly numbers; if you look at the chart in the middle EBIT development, first of all you see the differences between Q1 and Q4 versus Q2, Q3. This is to some extent, or to big extent, driven by the Learning business which really makes it P&L profits during the second and third quarter and then the right hand side chart which shows the cash flow shows that the whole group actually generates most of its annual cash during the latter half of the year. So this is a normal structure we have. Still within this structure you can see that there are quite big differences in the EBIT for example in Q2 and Q3 between the years and that depends on how the learning sales come in, so we have no way of really knowing before when some part of it hits the P&L so this as a reminder and this finalises my part of the presentation. Over to you Martti for questions.

Martti Yrjö-Koskinen

Thank you Kim and we're ready to take some questions and before you ask questions please wait for the microphone and state your name and the company, so who would like to start.

Questions and Answers

Sami Sarkamies, Nordea

I have two questions; the first one is related to the efficiency improvement programme, are you planning on additional measures on top of the €60 million programme? I think in the report you are referring to additional actions; this would be justified given the weaker than expected trading conditions during the first part of the year. The second question is related to the outlook of the advertising media market; can you comment a bit on how the second quarter has started? Do you see any differences in comparison with the first quarter and anything you can say regarding the second half this year?

Thank you; regarding the efficiency measures, two elements that are on top of the 60 million; first of all there's a number of tactical things that can be done, I mean partially related to you know, part of it you know, cost of goods sold also adjusts you know, when times are bad then you normally don't carry the full risk you know, the whole chain, for example paper costs tend to go down when the market so there's a little bit of a natural adjustment there and you know, we also contribute to the weaker marketing environment by cutting down sales support and all kinds of costs so there's also natural things that when the times are bad discretionary spending that we move forward and we do that. Then times like this, you know, then obviously we look at other things that we can do but there's nothing I can communicate now; so I mean, you shouldn't put anything in there but the 60 is really hard structural stuff which is really changing the way we work and that leads to people you know, losing jobs and all kinds of very tough decisions that we have to take so that's a way to answer that. Then outlook, regarding fall, I mean it's impossible to say I mean, I'm curious to see what your view on it is; April, pretty much the same, no big change. What I think is maybe helping us then is that the comparative numbers you know from the previous year were weaker as we move along so hopefully the delta will shrink but that doesn't mean that the environment is getting better in absolute terms but the bar is somewhat lower, at least if you take a previous year as a measure.

Matti Riikonen

Just a clarification on Learning, when you say that there was a 10 million revenue recognition earlier than expected. Is it fair to assume that if we take cost of goods sold out of that your EBIT also in Learning was improved by that number?

Close to that number yes.

So taking cost of goods sold out of the revenue that's pretty much that.

Yes.

So is that a way from directly Q2, or does it go further into the whole year?

Alright if you go back to our original plans it would've been away from Q2 but what happens then when Q2 goes into Q3 I don't know, so there might be again shifts between the quarters, but that's the way to think so on an annual basis no changes in our thinking.

Okay thank you, then further to TV, there was about 10 million in TV programming amortisation; is this related to the TV content inventory that you had last year, or is it the new investments that you have communicated to make but have you been doing that in Q1 already?

It's a combination; in Q1 there was an uplift, both in Finland and in Holland to compare it to previous years so Q1 was one of the quarters where this additional investment was targeted at.

Panu Laitinmäki – Danske Bank

Just a question on the TV business in the Netherlands, the market share of advertising was down from last year but the viewing service up slightly from last year so how soon will you expect to see any employment in the market share if this trend in viewing service continues?

Excellent question thank you; there is a part of the market which is locked according to these advertising share, it's the annual contract so then how much is sort of cushioned in which is then moveable in full is largely dependent also on the economic development, so there is a part of the market that can be impacted by stronger performance with viewing share in the fall, but a big part of the market is locked so having even a substantially higher viewing share in the fall might have less than one could estimate impact on our top line in there, but it would also create more inventory for cross promotion so it can be then used in other ways. But viewing share is absolutely critical to get it up in the fall to avoid a similar dynamic as we had in the beginning of this year, where we actually are not getting our fair share of advertising because we were not able to deliver on the promise that we gave in the sales cycle into this year unfortunately so that's really what's hitting us now in this year in the advertising share.

Niklas Kristoffersson – Cheuvreux

A couple of questions; first a follow up on the TV question in the Netherlands, obviously we've seen some small uptake in share of viewing but how do you feel generally your programmes performed and should one expect that going into next year that you would basically be using the same format i.e. that cost growth will be quite limited in 2014?

Q1 was…we introduced a number of formats in Q1 and there were some successes, but we didn't succeed in all the formats, but there are again a few building blocks that can be used as we also had in the fall, but you know we've ended up in 21 and it's not where we would like to have so we slightly underperformed from here as well. As discussed before in these meetings it is like assembling a puzzle piece by piece, you need to get the building blocks and there are a few in the spring that we were able to get that we will bring back and the same is true in the fall, there are a few that we can build a grid on. I mean, there are very few changes that will be made in this quarter and summer is typically a time when not a lot of new formats are introduced because it's a slower part of the TV year and then the team is working very hard on building on the cornerstones and the successful ones from the fall and then recreating again a new revised grid around it. This time around at least one thing is for sure that we have more time to also prepare for the launch of this new format so I hope that we will have also an uptick in the execution which should also improve. It's a very fine art of optimising the grid and flows and many things need to be done correctly to get the impact on the investments and last fall we didn't get the full impact on the investment in pure content so it's not that easy that you just put more money in and you get viewer share obviously so. I don't know if that answers the question. Of course, then you've got a second question also.

Yes it's just a reminder because a Dutch TV guide made substantial profits at the time of the acquisition; how is that one performing today and how much roughly of earnings in SBS is derived from that asset?

Well we haven't split it out; it is still a very nicely profitable asset for us but it is suffering from the decline in the reader's market so TV guides are impacted by double digit decline in volume so that's what's going on there. But we also have been adjusting for it so we have integrated the back office so we're in the process of integrating to our magazine operation so we're driving also costs out which to some degree also compensates for that so you know, it is on a stable decline unfortunately like the rest of print but it is still…we are earning a nice return on that asset.

Okay thank you.

Nina Berging, Åbo Akademi

On this innovation and digital development investments, barring now the venture part of it, I mean, how do your calculations go in terms of you know some kind of payback period or you know let's say building capabilities and infrastructure on these analytics? You're investing now but do you need to continue investing while they are sort of cost diminishing or gross enhancing, if you could give us a little bit more about the plans behind please.

Thank you, to give you a really good answer I would have to break it down because it's a portfolio.

Great thank you.

Yes but I'm not going to do that so not at this time, maybe sometime later, but I would say that in terms of the impact on our numbers this year we can see you know, clearly next year it will be bigger and then year three we hope that it will start to be more or less self funding and thereon and because what we're doing now is also we have to build a lot of enabling platforms, the data capability, it's a lot of software investment. We are actually recruiting a number of people, we have hired four or five data scientists, so it is EBIT negative now and cash flow burning for this year and next year, but then, according to our plans it should then start to fund its development, that's kind of a quick and dirty answer.

And if I may, if you think about the benefits you will get, say a year three onwards, is it through being able to access growth perhaps better, or to cut the rest of the 60 million costs or just you know…

No, the benefits are not part of the 60 million programme so it's efficiency improvement through…I will give you an example that we, in magazines we spend a lot of money on telemarketing just calling people to sell subscriptions and if we can do that better, more targeted you know, using the data that will you know, cut down that cost and that is a benefit for example. If we want to really be good at cross and up selling then you know, having a better understanding of what your interests are will help us do it better and that I mean, is also and efficiency important but it starts to be a revenue improvement, and then what is really important is that we can then hopefully be able to target our products better so we can also in an ideal world you know create tailored new service for you when we know your interests better and also for advertising targeting, we have a lot of data so we will be able to do that in a better way but that takes analytics capability, we need to have people who are good at understanding what data you need and how to analyse it and then we need to create the infrastructure to be able to support that and all that takes time and money so it's both but it's not in the 60s so it's efficiency in the front line processes and revenue improvement.

Any follow up question from the floor? If not and if there is no follow up questions from the floor I thank you for your participation and have a very nice spring going forward thank you.