Deco Media
Tuesday, 3rd May 2011
11h:30 Hrs UK time
Chaired by Harri-Pekka Kaukonen and Kim Ignatius

Harri-Pekka Kaukonen

So, ladies and gentlemen, welcome to our Q1 results presentation session. We have coined or given this session the general headline of Transforming Sanoma for the Future. And I think, indeed, if we look back at some of the structural events that have taken place in Q1, I think we have seen quite a lot activity in alignment with the strategy that was announced already at the early part of 2009, i.e. that Sanoma will strategically focus on two core businesses, consumer media and learning.

The first step of that journey during Q1 was the formation of the media division, combining the Entertainment and Magazines assets together. And then during Q1 a number of acquisitions have taken place; the main one, of course, being the acquisition of the SBS free-to-air TV operations in Netherlands and Belgium that was announced a couple of weeks ago. Secondly, last week we announced another step forward in our strategy, and that was the acquisition of learning operations in Sweden and also in Finland, the Tammi Learning from Bonnier. And in that sense, we opened up a new market, Sweden, to our learning portfolio.

The other side of activities has been then divestment of some of the non-core assets. We announced the divestment of Finnkino movie operations some while ago; and then quite recently we also divested kiosk and distribution operations in Romania. And then as part of the Bonnier deal, we also announced the divestment of our general literature business. And with these steps, clearly we've taken some big leap towards realising our strategic vision.

If we then go back and look at the numbers as such for Q1, if we look at the top line development, there's a clear decrease to comparable numbers. Here I have to point out that there's a substantial impact of divestments: it is the Welho divestment and the title Humo, which both were part of the comparable numbers last year.

Q1 sales, if you look at the consumer media part of it, advertising sales came up by 6 %. I think that, as such, is an okay achievement but I think, you know, we're clearly somewhat lower than the numbers that you had seen in a couple of previous quarters. Circulation sales came down by 3 %; again, if you split it, first of all, with comparable numbers, it's close to last year's levels. And then one has to distinguish between subscription sales and single copy sales. Single copy sales were clearly on a declining path, which has been the trend line already for a few quarters here, whereas circulation sales on a comparable basis were pretty much on the previous year's levels.

Operating profit, EBIT, was clearly lower than last year; a big part of the deviation, however, again can be explained as Kim Ignatius will show you later in his presentation, is due to actually the changes in group structure, i.e. Welho and Humo. On a general level I would say that news performed really strongly whereas the other divisions were slightly below last year's levels, but more or less came at that level as before, our last year.

I am happy to tell you again that during Q1 we continued to keep a close eye on expenses; the total operating expenses were 4 % - we saw 4 % reduction. Paper prices were still in Q1 lower than in previous quarter; that, of course, is something that will change. And in a way, again, same story: top line reasonably stable but then we were able to manage the cost base to secure profitability.

If you look at our business environment, we could say that in our core markets there's a moderately positive vibration, of course with a lot of uncertainty. We're also seeing picking up of inflation, especially in the Eastern European markets. And then also the rising interest rate may have some impact on consumer demand. But all in all, I think we're currently seeing Q1 being a moderately positive environment in most of our key markets.

Our biggest challenge in the consumer media business is really around circulation. The trends have been there for quite some time and we're seeing them continuing. In this picture, you can see the total newspaper circulation market in Finland, showing clearly the declining trend, which we also see in our titles, Helsingin Sanomat in particular.

In consumer magazines we're seeing a slightly different development. You're seeing a decline in circulation, that's true; but what is not visible in this picture, if we, for example, look at some of the top titles, let's say top five titles in a given country, then, you know, the rate of decline is actually not at least speeding up, and in some cases we were able to reverse the trend a little bit when it comes to circulation. The positive news so far at least has been that we've been able to compensate the decline in circulation by price increases and increasing also providing supplemental content that provides some buffer to the declining circulation trend.

A couple of words of the acquisitions, just in terms of repeating the key messages. The SBS acquisition was clearly one major attempt to mitigate some of these underlying trends in the print business. It was really based on fundamentally strategic thinking. First of all, very much in line with consumer media and learning, this is a big step forward in the consumer media business. It is really about creating a similar kind of position in Holland, in the Dutch market and the Belgian market, as we have today in Finland. We are now, with these acquisitions, the number one - we're the biggest consumer player in The Netherlands, and we're substantially improving our position in Belgium as well, where we are the biggest magazine player and the second largest commercial TV operator in the Flanders area.

This acquisition also extends our region free-to-air TV and that position is really important for us to have even better access to mass market customers. And then combining this position with our strength in the magazines and online business we're confident, in the future, that will give us opportunities to cross-promote our media assets. And then, down the road, also combine our assets content to create new phenomena, that is, to become stronger in the digital world.

The third element of this acquisition was really we believe that there is a strong, sustained value in free-to-air TV. As you know, the advertising markets have rebounded back in TV and the short to medium term outlook is quite positive. We, like other players, also acknowledge the trends that are going from linear to non-linear TV, but we also believe that free-to-air TV is a good platform for also taking part in that development. And then finally this opportunity in our core markets is a unique opportunity. And we had the opportunity to grab it and with the strategic rationale, concluded the transaction.

Where is value creation then coming from in this acquisition? Already mentioned that it is really a combination of what Sanoma brings to the table combined with the strong free-to-air TV position. And then I would like to pinpoint that we didn't go in alone; instead we chose to partner with the best content providers, with John de Mol's Talpa, which is an internationally renowned content house. And then also in Belgium, De Vijver and Wouter Vandenhaute and his team are one of the best local Belgian content providers. And bringing that into the mix will give us an opportunity to improve the free-to-air standalone position.

Which is the first part of the value equation; it's really that we believe that with this combination of capabilities, we can run these channels better. The second one is that combining these digital assets that we have in online with our knowledge of the readers, the consumers, for example, in the women's segment - combining that with the channels that SBS is bringing, that we can create a new type of offering. And also create strong non-linear TV platforms in the key markets.

And then, very specifically, we also as has also been evidenced in Finland, have good experience of really the benefits of cross promoting in for instance our media assets across the different channels. And then later on also thinking about new types of concepts, themes, phenomena, which, for example, in the Dutch market is quite important. It's a community that evolves very much more about key personalities and thus gives opportunity for this kind of thinking.

So that's about value creation in consumer media. And really just to reiterate the forward looking opportunities: it is first, shorter term really to extract the benefits in marketing across the different channels. And then promoting different new concepts and themes across the different channels - channels meaning the different media platforms that we have, including magazines online and TV. And then, in the future, what we need to do is really be able to transform Sanoma from a classical, print-based and online-based company to the digital world and also take our position as the world is changing around us.

That was the consumer media side and that is clearly a big part of Sanoma's business. But we have also the other core business, which is learning. And a few points, reminders of the recent acquisition where Sanoma gained by getting Bonnier Utbildning in Sweden and Tammi Learning in Finland. And with that opening a new market for learning and strengthening our position in Finland. And at the same way, selling the general literature business of WSOY to Bonnier.

Why was this done? I think, simply put, it was just a really good deal for both parties in the sense that the core businesses of Sanoma and Bonnier were strengthened with this transaction. And for us, particularly, opening up a new interesting market, combining that with our capabilities in learning and the learning solutions gives us a potential for good value creation; so made a lot of sense.

What does Sanoma look after all these transactions? I can share the pain, it probably is a bit difficult to follow up what is going to happen when all the underlying numbers. We will do our best to give you the proper information here, going forward, but as you can see, sometimes we also have a bit of difficulty keeping up with all these rapid changes. But, in broad strokes, a couple of things on - if you look at the revenue profile.

Media, consumer media, is growing in the share of portfolio because of this bigger acquisition, and also because part of the trade portfolio has been divested; that's clearly visible on the left hand side. The second big change is that if before Finland was clearly the dominant market, it was about half of Sanoma sales, now The Netherlands is almost as big of a market. And if you just look at the consumer media it is a notch bigger than Finland. So we have now the two core markets, Finland and Netherlands, almost three quarters - I think if I make the numbers right, it's even more than three quarters of Sanoma's revenues. And in these two markets we are clearly the leading players in consumer media, and we also have a leading position in learning.

Then if you put into that mix Belgium, where we now have, as I already mentioned, we have the number one magazine position and then the second commercial position in TV in Flanders, it gives us a strong platform to execute our multiple-media strategy in Belgium as well. And then we have learning, where we are one of the bigger players in Europe, present in six countries with clearly strategic ambition to continue growing and participating in the development of the learning business. So I think it's a fundamental big shift and it's also a shift we will continue pursuing going forward.

With that I thank you for my part and give the word to Kim and then later on ready to answer any questions, thank you.

Kim Ignatius

Thank you Harri-Pekka. My name is Kim Ignatius, I'm the CFO of Sanoma Corporation. It's very good to see all of you here today.

So we've done quite a few transactions during the spring, all in line with the strategic thinking and planning of the company. And of course the transactions that we've done are having a big impact on the financials as well, now seen in Q1, and of course to be seen in the coming quarters as well.

In the Q1 it's mainly the divestment side having an impact, then moving towards the latter half of the year, also the acquisitions mentioned in Harri-Pekka's presentation start having a clearer impact on our numbers. Our sales for the first quarter were 610 million, down 4.3 % comparing to last year. Adjusting to the changes in the Group's structure, the sales were at last year's level.

The same applies for EBIT excluding non-recurring items, divestments having a clear impact on the numbers, EBIT declining by 25 %. Our earnings per share and also our cash flow per share are naturally impacted by the EBITDA development. The positive thing on our earnings per share and also of course on our net income are clear improvements in our income from associated companies, which improved by 4 million compared to last year. And also continuing lower interest expenses versus last year. On cash flow, in addition to the EBITDA impact, the cash flow was impacted by higher programming right purchases and also higher paid taxes versus last year. Both these items are to a great extent timing matters.

Looking at the divisional performance, and here first correcting for the structural changes, which are at the level of 6.7 million, media being 1.8 million below last year. The division started with a bit of a slow start into the year, plus having impacts from some timely matters like viewer issues during the period.

News had a strong performance, again adjusting to some structural changes, news grew a bit over 2 %; advertising sales being the main driver, advertising sales growing by 7 % compared to last year. In addition to the good sales performance the division also continued with good cost control and ended up with a 3.3 million improvement on EBIT level versus last year.

The first quarter is a fairly small quarter for learning and literature, as you know; learning performed very strongly. The slight negative that you can see in this slide comes from the other businesses, namely language services as well as literature and some other businesses. Trade keeps struggling a bit, mainly in the domestic markets; the sales in kiosk operations continued to come down, they came down by 7 % versus last year. Also declining trends in the bookstores and even in the very well earlier performing movie operations.

When it comes to the movie operations, in 2010 the first quarter was one of the highest quarters ever and the trends seen here is a natural development of that. When it comes to the kiosk operations there are a lot of activities being taken in enhancing the profitability of the operations. And some positive signs from the concept development and from other activities are already to be seen.

I would like to come back also to the SBS transaction, look into the capital structure and our debt portfolio. As you remember, the enterprise value of this transaction was 1.225 billion; the Dutch part being 1.050 billion, clearly the bigger part of the transaction, and the Belgian part being 175 million. Our ownership in the Dutch operation in 67 % and we will fully consolidate the numbers; in the Belgian part we will own one third and are planning on line by line partial consolidation. The transaction is fully debt financed, so both the equity that we are putting in, as the Sanoma Corporation, into these entities plus the additional debt financing needed for the transaction.

What you can here is two pies; on the left hand side the current debt portfolio and that we have the two biggest sources of funding being the syndicated revolving credit facility, which, at the end of Q1, was in use to a level of 380 million. And then the other big source for funding being the commercial paper market in Finland, at the level of 434 million at the end of Q1. What we have tried to do here is to give an estimate of how the debt portfolio will look at the time of closing. And on the right hand side pie you can see two new parts into the picture, one being the syndicated term loan combination adding up to 609 million and then a bridge-to-bond facility at the level of 250 million. The bond facility will be - or the bridge-to-bond will be then replaced by a bond issue in a fairly short period of time.

Looking at the development of financial covenants for Sanoma, the net debt/EBITDA levels have, during the recent months - quarters - been at a fairly low level. Now, at the end of Q1, at the level of 1.5, even before this transaction is closed, you will see a change in the net debt/EBITDA level from the 1.5 levels into let's say 2.5, 2.6. Which is the impact of the gain of the Welho transaction disappearing from our rolling 12-month covenant calculation. Then, at the transaction, during that point of time, the net debt/EBITDA ratio will then go a bit over 3. A similar development in the equity ratio can be seen in the picture as well.

Sanoma will stay very well within its financial policy, and when it comes to the covenants there is still ample headroom left. So the covenants will not really be the restricting factor when it comes to financing, going forward; it's more the management of the cash flows to service the debt portfolio and also the overall level of the leverage we will have at the time of the closing.

Then there are two other things we would like to mention here, calculation practices that we will use. When calculating the net debt/EBITDA, the programming rights are capitalised and amortised then below the EBITDA level. This is the current Sanoma practice already before the transaction and is according to the IFRS. The other thing for you to understand is that we will actually consolidate the full amount of the goodwill from the transaction. And then, on the other hand, also put (?) the minority portion of the goodwill, as equity in our balance sheet.

As Harri-Pekka mentioned, it might be every now and then difficult to have a clear picture of how these pieces all fit together. When it comes to our guidance we would like to point out a few things on both of the recently executed transactions. When it comes to the SBS part, as mentioned earlier, the pro forma net sales level of the acquired operations are at the level of a bit over 400 million and the EBIT around 110 million. Of course how much of these sales and EBITs will end up in our books this year depends on the time of the closing of the transaction.

What is important to understand that there are costs related to this transaction, some of them having annual effects and some of them having effects only during the first year. These are purchase price allocation-related; part of the transaction price will be allocated to trade names, to customer and distribution relations. You can see the numbers here on the slide. And these will be annually amortised, going forward. Also, the finance cost related to the financing of this transaction will be amortised - will be capitalised and amortised during the coming years.

More importantly, during the first year, we will book, as operating expenses within our recurring EBIT, the transaction cost that are not financing-related, at the level of 10 million. And also the amortisation of an order backlog at the level of 32 million. So both these number, the 32 and the 10, will hit our EBIT number, and of closure have an impact on the guidance that we have given to you.

Then looking at the transaction regarding the general literature and learning assets. As a reminder, here are the net sales levels for the assets. For the learning assets an annual net sales at 28 million and general literature at the level of 33 million. The timing of this transaction is expected to take place somewhere around October, which means that also this will have an impact on our full year guidance. As you know, for the learning, the second and third quarter are the quarters where we really make our profits, meaning that the timing of the closing for this deal means that we will add a quarter, which typically, for the learning business, is not a strong quarter. And, at the same time, we will lose one quarter with general literature, which, fourth quarter is always the strongest quarter for that business.

So taking into consideration the guidance for both, the SBS transaction and the learning and general literature transaction, on the Group level, we are expecting our net sales to increase somewhat and are expecting our operating income to improve slightly.

This ends my part of the presentation and if I could ask Harri-Pekka to come back to the front and we are now ready to take any questions you might have.

Questions and Answers

Sami Sarkamies, Nordea Markets

I have two questions. The first one is related to media division: if you strip out impacts from all the divestments and also sort of exclude all the other non-recurring items, do you think that we will see the same revenue trends in the different operating countries throughout 2011?

Kim Ignatius: Well, as I mentioned earlier, that some of our main markets started a bit slow when it comes to the advertising sales. Could mention the Benelux countries and also the Finnish marketplace. Partly due to the timing issues, as I mentioned to you, having a smaller number of issues. At the same time we should remember that the first quarter is a fairly weak quarter when it comes to the magazine business and advertising, comparing to the other ones. So personally hoping for a stronger performance going forward.

Harri-Pekka Kaukonen: Maybe adding to that we had a quite strong quarter in Russia; the other CEE markets were not doing as strongly. So it depends a lot on the underlying fundamentals in the economies of the other countries, how that will develop. Our Nelonen did very well with the rebound of advertising, so again, how that will develop will of course have a significant impact.

Sami Sarkamies, Nordea Markets

And the second question is related to profitability development: if you strip out structural changes, only news division was able to improve on EBIT level from last year. Are you sort of targeting an improvement in any of the other divisions during this year?

Harri-Pekka Kaukonen: I think what we're saying is that already before the transactions that, you know, this year will be, you know, more or less the same level as before. So you can put that in the model and calculate it. I think it depends a lot on the advertising market. So, I guess, it's fair to say that in Q1, in some of our bigger markets, they came a bit weaker than we thought. Our view it is that possibly it is just a shift in the way our customers are managing their budgets. But then again that remains to be seen; if it happens, you know, it's a bit positive. And if it doesn't then conversely...

Kim Ignatius: Maybe if I can continue a bit. Of course you certainly know very well that this is a weak or a small quarter for the learning business. So a little bit difficult to draw any conclusions on that yet, but good performance there. Trade I think it's definitely an area and the kiosk operations, where there are tons of efforts put in place to improve the profitability. But they will of course take a bit of time.

Andrea Beneventi, Exane

Yes, good afternoon, thank you for taking my question. I have three of them, if I may. The first one is on advertising trends: you mentioned medium-long term trends on TV that are good. Could you please update us on how TV advertising trends are evolving right now in the countries where SBS operates, according to the visibility you have?

And my two other questions are on the acquisition. If you could please help me to understand the terms of the agreement between you and your partners in The Netherlands and Belgium? And what should we expect from the acquisition in terms of cash outflow from Sanoma: is it the total amount of 1.23 billion or something less, please?

Harri-Pekka Kaukonen: Okay, so if I take the first two and you can take the … think about the third one. Advertising has been rebounding in TV; in both the SBS markets TV has been the one that has shown the strongest rebound. So I think there is no deviation from the general trend in that sense.

The second question… The partner agreements I think in specifically, we are expecting, and also that the partners will have a big contribution in the content and the programming grid, so that's where I think the key thing is when it comes to partner agreements. Other than that, Sanoma is clearly in the driver's seat and a majority control in The Netherlands. And in Belgium it's more of a three party symmetrical set up.

Yes, Andrea, as Harri-Pekka was saying, the partner agreements reflect our roles and ownerships in these businesses. And that applies for the financing as well, and the overall risk taking, meaning that having two thirds of the company in The Netherlands, that's the part that we will also finance when it comes to the acquisition. And when it comes to Belgium, it's the one third of the transaction that is financed by us. And those will be the cash flows at the time of the signing. And the signing can take place during different time periods for these two markets.

Panu Laitinmäki, Danske Markets

Thanks, I would have two questions. Firstly, about Netherlands segment of the media division, which is your biggest business. In Q1 sales fell 2% and in the past three years there has been only one quarter of positive sales growth. Could you comment on what is the main reason for falling sales here, and could you comment on the decline in single copy sales: what was the magnitude of that and how does it compare in Q1 versus Q4?
And my second question is about the balance sheet: would you consider a share issue to reduce debt and should we assume you would have announced that already, if you are planning to do one? Thanks.

Harri-Pekka Kaukonen: Okay, first the sales question in The Netherlands. It is really a combination of the underlying decline in circulation. And then what has happened also during the last couple of years, we have done let's say pruning of unprofitable titles. So there has been a structural shift, which also contributes to it. I think, generally speaking, you have to separate the circulation from single copy. And I think in circulation that's much more stable and we've been able to more or less compensate the decline in circulation with price increases and supplementary products. Whereas in single copy it has been also a decline in absolute numbers. Single copies is a much smaller part than the circulation numbers

Kim Ignatius: When it comes to the funding there is no equity issue in any form planned, as part of this transaction.

Mark Braley, Deutsche Bank

Yes, good morning. I just wanted to confirm that I've understood the basis for guidance correctly. The first year effects of the TV transaction, so the transaction costs of €10 million and the order backlog amortisation, €32 million. Are those both included in your guidance for EBIT before non-recurring items? So are you treating both the 10 million and the 32 million as if they are recurring? Is that correct?

Kim Ignatius: That is correct, and at the same time, assuming that the transaction will be closed during the summer.

Mikael Doepel, Handelsbanken

Yes, hi there. I have one question regarding costs. There was a quite favourable development in Q1 with expenses declining year-over-year. What are your expectations in this respect, going forward, on an underlying basis? Because obviously the SBS acquisition will have an impact on the headline figure in the second half of the year. Thanks.

Kim Ignatius: Well, we haven't given any exact guidance on the operating expense development for the full year or for the quarters. But of course, as I have to say being the CFO, because of the leverage on our balance sheet, we need to really pay attention on cash flow and the expense development going forward as well. So let's hope that we can see similar trends going forward.

Andrea Beneventi, Exane

Yes, a more general question if I may, please. Are you happy with the asset mix that you have now, assuming that the SBS acquisition is approved by the competition authorities? Or should we expect something more to come soon please?

Harri-Pekka Kaukonen: I think the TV was the critical piece that we were looking for in our core market. So in that sense, yes. Secondly, I think we have to be also quite realistic with the debt levels we have now, to be quite prudent with at least any substantial acquisitions going forward. But I think we're quite happy now when it comes to Finland, The Netherlands, and Flanders, when it comes to that.

Sami Sarkamies, Nordea Markets

Two questions: the first one related to SBS acquisition. Are you happy with the current partnership model, where you have a majority position in Netherlands and a minority in Belgium? Is that the long term arrangement or are you intending to sort of increase your positions, going forward?

Harri-Pekka Kaukonen: I think we are quite happy as the partnerships are now. Specifically, if we take the Dutch situation, we have a very strong content partner and at the same time we have a clear driver's seat, the leading role in it. I think time will tell with Belgium; we're very happy with it now. We have the content partner, we have Corelio as a strong local partner. So we believe that's a good basis at least for the time to come.

Sami Sarkamies, Nordea Markets

And a follow up on that: do you have any contractual rights to increase your position going forward, maybe through some put-call clauses or anything like that?

Harri-Pekka Kaukonen: No, not in that sense.

Sami Sarkamies, Nordea Markets

And second question relates to role of DNA in your portfolio: can you say anything about how that sort of fits into your current strategy?

Harri-Pekka Kaukonen: No, there's nothing new to say since last summer where we concluded the strategic investment, and we're looking at that as such.