Final Transcript

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Corporate Participants

Martti Yrjö-Koskinen

Sanoma – VP IR

Harri-Pekka Kaukonen

Sanoma – CEO

Kim Ignatius

Sanoma – CFO

Conference Call Participants

Participant list not provided

Presentation

Operator

Thank you for standing by and welcome to the Sanoma conference call. At this time all participants are in a listen-only mode. There will be a presentation followed by a question and answer session (operator instructions). I must advise you that today's conference is being recorded today, Friday, 22 March 2013. I would now like to hand the conference over to your first speaker for today, Martti Yrjö-Koskinen. Please go ahead.

Martti Yrjö-Koskinen

Good morning and welcome to this conference call of today's announcements regarding Sanoma's revised outlook for 2013 and impairment. I am Martti Yrjö-Koskinen, Head of Investor Relations, and with me here are Mr Harri-Pekka Kaukonen, our President and CEO and our CFO, Mr Kim Ignatius.

In the conference today we will be making forward-looking statements regarding the future business and financial performance of Sanoma and the media and learning industries. These statements and predictions involve risks and uncertainties and there can be no assurance that actual results will not differ materially from those expressed or implied by these forward-looking statements, due to many factors, many of which are outside the control of Sanoma. The aim is to finish this call in 30-45 minutes. The replay will be available on the web at the end of this conference.

Now I would like to hand over to Mr Harri-Pekka Kaukonen, our President and CEO, for his remarks.

Harri-Pekka Kaukonen
Good morning, ladies and gentlemen, also on my behalf. The announcement earlier today to lower the guidance and the impairment is really driven by two factors. The main one is the deteriorating conditions in the advertising market and, secondly, the performance of SBS in Holland has been below what we expected. I will go through these points and also what we are doing to counteract the impact of these two factors in a bit more detail in the following 10-15 minutes.

If I start with the market side, we are living in extremely turbulent times in our main markets, specifically in Finland and Holland. We are seeing advertisers very hesitant currently to make decisions. The advertising markets in our main operating countries are clearly more depressed than what we expected early in the year. I will go to more specific numbers later in my presentation. I would also like to point out that consumer confidence in the Netherlands is at its lowest level in more than 25 years, in February.

This has a big impact on our top line and we are trying to mitigate it by price increases and also introducing bundled and digital offerings, but the business is not enough to counteract the negative impact development in advertising markets that we are seeing currently. Our €60mn cost-savings plan is moving according to plan and we have also taken other auxiliary actions as the markets have deteriorated but it is clear that these actions are not able to compensate for the drop in the top line. That is simply mathematically the reason why we have revised our outlook for 2013.

Then there is another point on top of the market impact, which is that the change in discount rate for calculating pension liabilities affects us negatively in 2013 compared to 2012. In 2012 the used discount rate was 4.8, whereas this year the discount rate is lower, at 3.6%, and the lower rate and the impact on our pension expenses is on an annualised basis €9mn, which is divided evenly between the quarters, so that is in addition to the market development.

Let me now go to the specific markets in a bit more detail. If we take the Finnish Media market, the total net advertising market declined in January by some 13% according to TNS Gallup; Newspapers by 18; Magazines by 19; TV by 9; Radio by 22 and Online (excluding search) by 2%. In February the trend continued and the market decreased by some 16% in total. Newspapers went down by 19%; Magazines by 18; TV by 15; Radio by 17 and Online (again excluding search) was the only medium that grew in February by 8%.

The print circulation sales are continuing their decline, compared to previous year, however here I would say that on the negative we still are feeling the impact of the VAT introduced a bit more than a year ago, but on a positive note the circulation volumes in Helsingin Sanomat is so far, year to date, decline clearly less than what it did last year, and this is thanks to the introduction of the new format changing that includes also the tabloid changing in the print paper. Helsingin Sanomat has been able to lift its circulation sales during the first two months of 2013.

Also, in addition to Helsingin Sanomat, Ilta-Sanomat has been successful in online advertising sales which closely compensated for the loss in print advertising. Also, the online display advertising is growing strongly in Finland. Our numbers show a 34% growth actually in display advertising in February. The introduction of Helsingin Sanomat's paywall specifically has also developed well.

In TV in Finland, in the early part of this year, we've continued to face declining unit prices, due to the increasing competition from the new players. After a relatively soft January our operation is gaining momentum in terms of viewing shares and that is specifically true for our theme channels, Liv and JIM, which are almost compensating for the decline in the main channel, Nelonen. Another point which is important to understand is that we are making strategic investment this year for implementing new services based on the acquired Finnish hockey rights, and they will impact financial performance especially in the second half of the year.

Then, moving from Finland to Belgium, we are estimating that the total net advertising market has declined during the first two months by some 10% and Magazines specifically by 12%, whereas TV and Online (excluding search) were at last year's level. The volumes in the Magazines business continued to decline in Jan and Feb, and the decline has been around 7%. To give you a comparison, in 2012 the decline on an annual basis was 6%. We have introduced new pricing packages and bundled offers to our customers but it is clear that these actions so far are not able to offset the declines in volume. TV operations in the Flemish part of Belgium have improved in terms of the market position. We have increased our share of viewing and share of advertising during the first couple of months in Belgium. Unfortunately the decline in the TV advertising market is impacting our sales and our profitability is under pressure also in Belgium.

Then, moving on to the Netherlands, our estimate is that the total net advertising market has declined year-to-date by around 7% and Magazines by 25%, so a dramatic change taking into account that Magazines is our biggest platform in Holland. TV is down by 5% and Online (excluding search) is pretty much flat. Consumers are more price-conscious and, as I mentioned, the consumer confidence is at its lowest point in 25 years in Holland. Magazine volumes have declined in Jan and Feb by around 5%. It's slightly less than the annual decline rate last year but it is still 5% minus, and again despite the price increases they are not enough to fully offset the volume decline. Furthermore, print and display advertising reservations, if we look at the near future, are at a low level.

SBS performance has not been up to our expectations last year and also the beginning of the year and, as a result, on March 7th we announced changes in the management of the company. Viewing shares are on the rise so actually the early part of the year we're the only TV group that is actually growing in share of viewing and we are currently at the 21% level. However, what is important for the operating performance is the share of advertising and that is where we have been unfortunately declining. That has impacted our performance in the early part of the year. As we mentioned on previous calls and quarterly releases, again, 2013 is a year of investment so we continue investing in the programming in the Dutch operations, which then impacts the EBIT of our TV business.

These negative developments in the markets, specifically in Holland, trigger an impairment test and, as a result, Sanoma has taken a non-cash goodwill and other intangible asset impairment charge on the group level of about €35mn, and this is really then the whole Sanoma Media Netherlands, which is a combination of the Magazines; TV and Online operations in Holland. This impairment charge will be reported in Sanoma's Q1 Consolidated Financial Statements and is classified as a non-recurring item which no effect on cash flow.

On a local level, in Image B.V. (the legal entity in Netherlands of which Sanoma owns 67%), an impairment test has been done for local statutory accounting purposes. Image B.V. (or SBS Netherlands in other words) has taken, on a local level, a non-cash goodwill and other intangible asset impairment charge of €391.6mn, out of which 201 million was already taken in 2012. This impairment in Image B.V. has no additional impact on Sanoma Group's financial figures.

To summarise what I have just said it is clear that the underlying market conditions really have a material impact on our outlook; the decline in advertising and circulation sales falls to our P&L and impacts our profitability and we are taking action, and the ongoing cost savings and other mitigation activities will offset partly this decline but by no means all of it, hence we have revised our outlook for 2013. This revised outlook is based on the assumption that the European economic environment remains subdued and the advertising markets remain depressed in our main operating countries.

In terms of numbers, we expect that our 2013 net sales will decline by 2-4% compared to 2012 and that the operating profit, excluding non-recurring items, is estimated to be between €180 and €205 million. Finally, I would like to point out that the first quarter for the group is seasonally the weakest and this year we are investing materially in the Dutch and Finnish TV operations and digital developments, and the operating profit excluding non-recurring items will be negative for the group in Q1.

Ladies and gentlemen, this ends my summary and I will now hand over to Martti for Q&A.

Questions and Answers

Panu Laitinmäki – Danske Bank Helsinki

My first question would be on the impairment; I was wondering, why are you doing it now and not in December when you did other impairments - if it is due to the advertising markets, I would assume that would not trigger a write-down and audience shares are increasing, as you mentioned, so could you please open this a bit more? Thanks.

Kim Ignatius

Good morning. We test according to IFRS, all assets where we have goodwill on an annual basis, as you know, and we did test all our cash-generating units also during Q4 and reported the outcome of that testing round. Also in Q4, Image B.V. (our Dutch entity) including SBS TV and Print operations, did impairment testing and, as it said in our release, Image B.V. did record in their local statutory books an impairment of 200 million, so we did do a full round. What has happened now, after that, during Q1 this year is that the advertising markets have performed much worse than we anticipated and also the share of advertising in SBS did not reach the targeted levels in Q4. That had an impact also then on the Q1 performance.

In addition to this, we saw some deterioration also in the Print and Digital businesses in the Netherlands. All in all, there were enough triggering events for us to do an additional round of impairment testing for the Dutch entities. This we did and, at a group level, we test Sanoma Netherlands as one cash-generating unit and that test then led to the €35mn impairment. Again, as required, another test was done in the statutory accounts for Image B.V. (the SBS operations), so there have been two rounds of testing; a completely normal practice for us. We test every time during Q4 all the units, including goodwill, as we need to and then, whenever there is a triggering event, we need to do an additional test.

Panu Laitinmäki – Danske Bank Helsinki

May I continue with a question on the visibility – I was wondering, you gave the guidance on 7th February and by then you should have known that January (which we saw) was pretty weak, based on TNS figures, and there were already some in February going on by then, so how short visibility do you have and did the TNS figures that we got two days ago impact the guidance downgrade?

Harri-Pekka Kaukonen

The visibility depends on the markets and platforms, and on 7th Feb we had the January view, but January is normally a very small advertising market and, in many markets, almost a non-existing one, so you have 11 months really to work with. We saw then obviously some concerning trends in the bookings but now, when we are close to the end of March, we also have a feeling for April, which means that we have 4 months out of 12 already looking quite depressed. Then it's just a matter of prudency not to continue hoping for a reversal or anything like that, so instead of one month (which is a weak month), maybe something like Feb, now we have a look at a 4-month period and it's obviously a bit unfortunate that's after 6 weeks but really there is materially more statistical bases on which to base your estimate, and that is why we are here in terms of the guidance change.

Mikael Doepel – Handelsbanken Capital Markets

Sorry, I might have missed some questions in the beginning (I had some problems with the line) but, regarding the write-down it seems like an additional €192mn write-down in Image B.V. and I guess you have an ownership share here of 67, so I am a little bit puzzled by the fact that the impact on your group consolidated level goodwill write-down is so small, compared to this big write-down in this company. Hasn't this goodwill been on your books? How should I understand it? Again, sorry if you have already answered this question.

Kim Ignatius

Good morning. It's okay, I did not answer it from that angle, actually. The reason for these numbers is that the testing units are different, meaning that when Sanoma Group looks at its business portfolio it defines the cash-generating units that it bases its decisions on, the management decisions; investment decisions and how it reports them to the external world, and for us Sanoma Media Netherlands is one cash-generating unit (that is the test unit for us in the Group), so that comprises of the print media assets that we have, the digital assets and the TV assets. That is one big media operation in the Netherlands.

Then, for the statutory purposes, the SBS operation being Image B.V. needs to do a separate testing because they have goodwill in their balance sheet, and the 390 million is the test result for the statutory purposes for Image B.V. in the Netherlands. That is not a cash-generating unit for the Group at all. There are also differences in the discount rates used under the equity beta factors etc, because when we look at the Dutch business then we of course define the discount rate which is impacted by the risk premium, etc, by the nature of the business. It's a different business if it is a total media business or if it's a pure TV business.

Also, we base our testing on the Group's balance sheet structure, etc, and on the other hand the Dutch statutory testing is based on the SBS operation only, so there are differences; from the Group's perspective the important thing is really the Media Netherlands testing which led to the 35 million write-down. Hopefully you got the picture?

Mikael Doepel – Handelsbanken Capital Markets

Yes, but just a follow-up on that – how much goodwill is still left in this Image B.V. company, after these write-downs?

Kim Ignatius

Total goodwill that we now have left there, at the beginning of 2013, is 595 million for the TV business and 97 million for the Print business.

Mikael Doepel – Handelsbanken Capital Markets

Yes, but now you refer to Sanoma Media Netherlands, right?

Kim Ignatius

You asked about Image, so that was what I answered. Image is just the pure TV and Print SBS operation; at the end of 2012 the total goodwill amount in Sanoma Media Netherlands was 1,665 million, of which we have now written down 35 million.

Mikael Doepel – Handelsbanken Capital Markets

Thank you. One final question on covenants – could you just remind us what your covenants are and where the critical levels are?

Kim Ignatius

We have two loan covenants; one is net debt to EBITDA which is 3.75 and the other one is an equity ratio covenant which is 30%, and there is currently no risk regarding either one of them.

Mikael Doepel – Handelsbanken Capital Markets

Thank you. That's clear.

Mark Braley – Deutsche Bank

Good morning. Three questions, actually – first of all, can you just clarify whether these circulation trends are a factor in the warning? In the statement you do refer to them in the first paragraph, but I got the impression from your remarks that this is much more about advertising, specifically TV advertising in the Netherlands, so I just want to clarify whether circulation volumes getting worse than expected are a factor in the warning.

The second is: do you want to remind us of your thinking on the dividend? Obviously you pay the 2012 dividend in a couple weeks' time. How should we think about 2013 and, perhaps, how should we think about that 2012 dividend as well, in light of where earnings for the current year are likely to be?

My third question, just to clarify on the covenants, the 3.75 net debt to EBITDA is calculated on the basis of an EBITDA figure before amortisation of programme expensens and pre-publication?

Harri-Pekka Kaukonen

I'll take the first couple. The circulation trends were not a material factor in the guidance. It was really the decline in advertising markets, not only in TV but also in print and in online, i.e. not anticipated growth in online but flat, so that's how to look at it. Another factor is the worse-than-expected performance, so under-performance in SBS compared to flat, so those are the two factors behind today's announcement.

Regarding the dividend, I don't really have anything to comment at this point. You have seen the call for the AGM meeting, where the proposal is, and it is supported by major shareholders. That's in the statement and you are welcome to come to the AGM, to see how that plays out, if you are an owner of course, but there is still time to fix that, and the 2013 dividend I think it is very premature to say anything about.

Kim Ignatius

With regard to the last question regarding the net debt to EBITDA covenant of 3.75 that is before amortising programming and pre-publication costs.

Sami Sarkamies – Nordea Markets

I have two questions. The first one: I am still trying to understand the factors behind this warning that comes only 6 weeks after your Q4 report. Obviously you've gotten 6 weeks of additional data on the advertising market. You mentioned the 9 million additional pension liability payments that you need to make this year. Was there anything surprising related to SBS, given the recent CEO change and, also, is there something related to Learning that you have not mentioned in the call?

The second question is related to the investments that you're making in various areas. Is this really the right time to sort of raise costs? Are the advertisers able to respond positively to the new products you are putting in, as they are currently in cost-saving mode themselves?

Harri-Pekka Kaukonen

Thanks for the questions. If I could repeat the factors in the profit warning, the first one which I mentioned was, instead of some 1-2 slow months visibility, we now have 4 months including some bigger months (March and April) in the factor, so that is number one. Number two, clearly the share of advertising in SBS came out worse than expected so, before you ask, the early part of the year is a time when annual contracts in Holland are being made and our Q4 weak share of viewing performance led to the fact that our share of advertising outlook came too optimistic, so that was a negative surprise in the performance.

It was based on the fact that the advertisers were then looking at the Q4 share of viewing performance as an indicator for 2013 and not fully having, you know, getting them to allocate their advertising spend based on expected future share of viewing, so that is in there, and then there are no negative indications that we now see regarding the Learning business. Learning, though, we're so early in the year that practically a very small part of the sales is realised. There is not much we can say about Learning but all indication is it is continuing its solid performance that it had last year, so no negative indications for Learning.

A big part of the investment is going into building platforms that will enable us to introduce new products, so it is to build the BOD capability in Finland, to go into more subscription and consumer TV basis, to be able to leverage our hockey rights; it is to build a data analytics infrastructure in the company and digital distribution, etc. There is not a lot of capital that is short-term geared at getting extra revenues.

On the other hand, I would say to the contrary that all the developments we are doing in creating a new type of advertising solutions are the ones that advertisers are currently looking for so, if there is anything there is a demand for, it's a new type of digital advertising solutions. I think it's an even bigger need than ever to continue investing in capabilities, so that is the situation we are in and that is why we are also very determined to, on one hand, continue the €60mn programme to take out costs in the core print operations, but continue investing in being able to generate the future revenue. That is something we are not going to cut.

Matti Riikonen – Carnegie

I have two questions and I might have missed the first question, so my first question relates to the impairments in SBS Netherlands and the Group; excuse me for that, but I just wanted to confirm that if you are now making impairments in SBS Netherlands for 392 million in total and the Group level impairment related to the whole Sanoma Media Netherlands cash-generating unit is 35 million roughly, is the difference which is 357 million the level of positive buffer that you had from magazines and online businesses that exceed book value in the impairment testing? Related to that, does this mean that if there is any further negative deviation on the cash-generating unit level, they will have 100% impact on your Group P&L going forward, so that is question 1.

Question 2 is, if we look at your current guidance for net sales and EBIT it would mean roughly 48-95 million deviation in net sales compared to 2012 and on EBIT level the decline would be 27-52 million so, if you have the current savings plan which is about 20 million annually, there is basically a 43 million gap to the negative scenario where your revenues drop 4%, so my question is: do you expect to make some further savings in addition to the 20 million annually that you have so far announced, to make this equation happen, or should we expect that there will be a new cost-cutting round in excess of the current one to make the figures meet each other? Thank you.

Kim Ignatius

First the impairment – the first question and the first part, the delta between the 392 and the 35 – it is not that straightforward that you could say it's a matter of a buffer because the testing parameters are different between the entities. When we do the Sanoma level cash-generating unit testing, we naturally base it on the Sanoma capital structure, the Sanoma equity beta and Sanoma weighted average cost of capital, and when you then do it for the Image SBS business in the Netherlands, then you do it for a separate standalone TV operation and print, but maybe driven by TV, which means that the discount rates are much higher for a standalone TV business than they would be for a full media operation, plus you have the Group structure on the other hand, versus a standalone TV business in the Netherlands.

The components are different, so it is not that straightforward, but naturally any decline in a business plan and future cash flow generation in the TV business has an impact on our Media Netherlands testing as well, and your second part of the question, i.e. have we now eaten up the buffer, the answer is yes, we have now eaten up the buffer, so any negative impact on the future cash flow expectations or any other components impacting the testing would lead to another impairment. Naturally, what we are aiming to do is to take corrective actions and improve the performance of the company which you have seen some indications already taking place, so let's aim to start building buffers again.

The second question where you did an analysis on the numbers, we do say in our press release also that, based on the current situation, we are taking additional measures outside the €60mn project, to be able to give this guidance that we are now doing. We have gone through all categories in our operating costs and are taking additional actions.

Matti Riikonen – Carnegie

In your annual report regarding impairment testing, you say that you use 5-year management estimates when making the cash-flow pattern, and I just wanted to clarify whether today's write-down was based on 2013 estimates alone, or did you also cut or lower 2014 or maybe 2015 estimates in that management estimate?

Kim Ignatius

Yes, what we have done is we have done a completely new 5-year plan for all our Dutch operations, both for Group testing and for the statutory testing, so a completely new 5-year plan.

Niklas Kristoffersson – Chevreux

Hi there, a couple of questions if I may. Firstly, I just wanted to hear if there's been any change in your expectation with regards to programming amortisation for 2013, i.e. that some shows have not developed good or that you would have to take more amortisation charges over the P&L than you previously assumed?

My second question: I am a bit curious regarding your covenant of 3.75X; I presume that's on EBITDA before programming amortisation and pre-publication costs? Just to finish off that question, how would that 3.75 look in an environment where you take the amortisation and pre-publication above the EBITDA?

Kim Ignatius

Niklas, on the first question on the amortisation on the programming costs, there is no change in any of the principles or no surprises to be expected, so no variations there. Secondly, the covenant of 3.75; that is the covenant in the loan documentation and it is, as you said, before amortising programming costs or the pre-publication costs, so that is how it has been defined and that number I cannot change to anything else. We do report to you on an ongoing basis net debt to EBITDA ratios where we have lifted the amortisations above EBITDA as a cost, to give you a picture of the cash-flow situation, and we were around 3.6 at the end of last year but that has nothing to do with the covenant, because that calculation is completely different. When it comes to the loan covenants we have adequate buffers there so no worries.

Niklas Kristoffersson – Chevreux

But just doing a back-of-the-envelope calculation it seems to me that for the covenants to be an issue you have to have a gearing of close to 10X net debt to EBITDA; is that correct, if you take the amortisation above the EBITDA?

Kim Ignatius

... I don't think we can go into that because the loan covenants have many aspects of how we deal, so there are many features and I don't think we should try to work those into a different format – the most important thing here to say is that is the covenant that we have and I can assure you that for Sanoma Group there are absolutely no challenges with it. When we report in different formats that's just to give you a better picture of the actual cash flow based performance.

Niklas Kristoffersson – Chevreux

Just a follow-up on the loan – are you referring to the bond loan or are you referring to bank loans?

Kim Ignatius

All our documentations are pretty much based on the same covenant; in the bond loan there is no financial covenant, so it's bank financing.

Jutta Rahikainen, SEB Enskilda

I have two questions and the first question is regarding SBS' profitability. You said that in 2012 the EBIT margin was below 15% and now, in your new guidance, would you say the EBIT margin is in a similar magnitude or is it actually moving lower; in that case even below 10%? The second question has to do with the EBIT delta in your previous guidance and the new guidance – it would be great if you could give an indication on Q1 losses and the magnitude – you say it's loss-making but probably it's quite heavily loss-making, so just that when we go into the figures analysts have a ballpark feeling on Q1 earnings in the new guidance? Thank you.

Martti Yrjö-Koskinen

We'll start with the question regarding the EBIT guidance... I am not sure if I followed you in the EBIT calculation – what's your question? Is it specifically regarding Q1-

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Jutta Rahikainen

What I am trying to figure out is how much of a change in guidance is actually attributable to the first quarter and how much of that is expectation that you have in the following quarters, or to put it simply, could you give a more specific indication on what kind of loss you are expecting in Q1?

Harri-Pekka Kaukonen

Let me take SBS first – I think we are looking at annually roughly similar performance as previous years, so the change is that instead of improving this year, given the fact that the share of advertising dropped as we experienced (that's what happened), we are not expecting any substantial further deterioration from the previous year, and

Kim Ignatius

On your second question regarding the Q1 EBIT levels, we have indicated to you that we will have a negative quarter. I don't want to give a breakdown by unit or guidance on it in a more accurate format, but I would say the market environment that we are experiencing now is probably not fully reflected in the consensus levels that you guys are having.

Operator

There are no further questions.

Martti Yrjö-Koskinen

Thank you for everybody's participation in today's conference call and IR will be at your disposal for follow-up questions.

Harri-Pekka Kaukonen

Thank you.