Audiocast transcript: Half-year Report Jan-Jun 2023

Time 01/08/2023

PRESENTATION

Samu Heikkilä
Good morning and welcome to YIT's Q2 and Half-year 2023 Results Audiocast. My name is Samu Heikkilä, and I'm YIT's Investor Relations Manager. The results and highlights of YIT's second quarter will be presented by our CEO, Heikki Vuorenmaa; and our CFO, Tuomas Mäkipeska. After the presentation, we will be taking questions from the conference call line.

At this point, I would like to hand over to our CEO, Heikki. Please go ahead.

Heikki Vuorenmaa
Thank you, Samu, and welcome all to the Q2 Audiocast also from my behalf. What you can see actually here on the front page is one of our projects in Poland, Żurawie that won several awards during the quarter. And I'm very pleased to have such projects in our Central Eastern European countries.

Let's go to the first half year result and a deep dive on the Q2. During first half of the year, the business environment was exceptional. Geopolitical uncertainty, increasing interest rates, high inflation, and increased construction costs created almost a perfect storm to the market. Consumers postponed the purchase of the new homes, while increased material costs created challenges to the contracting business. Market turmoil also postponed some of the infrastructure investment and changed the financial equation for many investors on our sector. Consequently, our second quarter result declined compared to previous year as housing market headwinds continued and impacted negatively to our profitability during the quarter.

On the positive side, demand for our housing units both in the Finland and Central Eastern European countries improved quarter-on-quarter, and our transformation program contributed positively already to Q2 results and cash flow. We responded to the challenging market, and robust cost and cash flow controls are undertaken across the operating countries. I'm also pleased that our order book increased in the contracting segments, and our total order book amounted to €3.5 billion at the end of the quarter. In this market environment, both segments performed well on that metric. During the quarter, we also announced plans to reallocate capital from investments and certain businesses to optimize the use of the capital and create the best value for shareholders going forward.

If we quickly look on the total group key financial metrics and we can see that during the second quarter, our sales actually remained at the same level as the previous year. Our comparable EBIT decreased to €14 million and the margin moved from 4.5% to 2.4%. Additionally, to the residential market headwinds, comparison period included also positive one-offs.

And as we deep dive more into our results to the segment levels, we can clearly observe the market headwinds impacting on our Housing segment, both in absolute euro amount and EBIT margin level compared to last year performance. Sale-and-leaseback transaction of the plots and a bundle deal executed during the quarter diluted the Q2 margin level. However, operationally, Housing segment continued to execute on very good level. And as there were no completions during the quarter in the Central Eastern European countries, overall segment profitability declined by €12 million compared to last year.

Business Premises continued to improve operative underlying performance. However, segment results continued to be negatively impacted of the increased construction costs on the project with fixed prices. And as I mentioned, the comparison period also included completions of two self-development projects.

Infra segment improved performance by €2 million, Finland being on a normal level, while our operations in Sweden continued to be burdened by the sector – continues to burden the segment profitability. As announced during the quarter, we have initiated strategic review on our assets in Sweden.

Like I said, our Housing demand improved on the second quarter, compared to the previous quarter, both in Finland and Central Eastern European countries. In fact, this was the first quarter on the whole segment with a positive development since the fourth quarter of 2021. We did observe some positive signals during the first quarter, which now realized an increase in sales on comparable quarter. However, as we compare the sales with the previous year's quarters, there was the overall lower level of consumer sales on this segment.

During quarter two, we continued to observe that the uncertainty over interest rates development, energy prices and negative sentiment have moved consumer decision making closer to the housing unit completions. Additionally, the option of consumers to consider the decisions longer as they carefully assess their own financial situation. During the quarter, we had 522 new startups on the countries with favorable market conditions in Central Eastern European countries. As Finland market is now balancing the demand and supply during the 2023 and the overall industry startups are estimated to reach multiyear low level, we see a risk of market supply shortages in coming years in growth cities.

During the quarter, we were very pleased to announce multiple new contracts such as the renovation of Hotel Kämp in Helsinki, Jätkäsaari Circular Economy Block and Prysmian Group's cable tower construction project in both of our contracting segments. As a result, our confirmed order book increased on both segments. Our overall order book remained strong despite Housing decline and our selective tendering approach.

In addition to the contracts with clients of the contracting segment, our order book includes service revenue with more than €300 million value that will provide recurring revenue to the Business Premises segment in the future years. On such a market environment, we have adapted our housing production to match the market conditions and today we have approximately 30% less apartments under construction than a year ago. As a result of improved sales activity on second quarter and bundle deal, our unsold apartments decreased slightly from the previous quarter to the level of 730 units. Sales rate of the apartments under construction is at 59%, which is close to our historical average. If you look our sales rate of units to consumers under construction, we are on the similar level than our long-term average or slightly below. As mentioned earlier, consumers have been postponing their decision-making closer to the completion of the apartments.

Then a few words about our transformation program. During the quarter, we continued the good progress with our transformation program. Our program is running ahead of schedule with a lower than anticipated costs. Total gained annualized cost saving by end of 2024 amounted already to €18 million and program costs realized year-to-date are €5 million. This program includes more than just adjusting the level of our fixed costs run rate. We are addressing holistically the company performance to build long-term success for YIT. As an example, the program includes investments and capabilities to improve our operational efficiency, reduce our lead times and focus on systematic project management, total renewal of the supply chain management and procurement capabilities to name a few.

Part of the transformation is also efficient capital allocation. During the quarter, we announced plans to release up to €400 million capital from selected investments and assets by the end of 2024. Our aim is to improve our capital allocation and increase return on capital employed of our operations during the coming years. Plans are replaced. However, since we are on the early days, there are no further details or results to be shared yet.

Another important element of our strategy and long-term competitiveness is sustainability. We continue to invest in this topic and show leadership in the industry as we became the first Finnish construction company to have emissions reduction targets validated by the SBTi. Additionally, we are very pleased to see our ecosystem partners continue to invest in new products to reduce emissions from the construction materials during the second quarter. We are observing increasing interest from customers towards these sustainable solutions across all segments.

But now it's a time to look more in the details of our financial performance during the second quarter. Over to you, Tuomas.

Tuomas Mäkipeska
Thank you, Heikki, and good morning, everyone. The second quarter of the year was really all about adapting to market conditions and taking determined actions to improve our performance, both in the short- and long-term. Our profitability decreased, but more importantly, cash flow was turned to positive track.

Let's have a look at the main financials of the quarter. Here we have the Q2 key performance indicators. The order book amounted to €3.5 billion despite the challenging market situation in Housing and our selective approach in tendering. Adjusted EBIT decreased to €14 million from the strong comparison period. Cash flow after investments was turned to positive track and amounted to plus €14 million, mainly due to the planned measures according to the transformation program. And the net debt increased year-on-year, mainly driven by weaker cash flow from Housing sales. But on the other hand, the net debt remained relatively stable compared to Q1 when it amounted to €791 million.

I'll go through some of these KPIs a bit closer, starting with EBIT. Heikki presented the segments adjusted EBITs and here you can see the overall change in our adjusted EBIT split by segments. The adjusted EBIT decreased, especially in Housing, which accounted actually for roughly 100% of the drop. And the main driver behind this development was the weak consumer sales of our apartments, especially in Finland. As Heikki already mentioned, the demand in CEE countries has been clearly higher, which is also strategically important for us going forward this year and in future. As Housing segment suffered from the challenging market conditions and the fact that there were no completions in CEE countries, the underlying performance improved in Business Premises and in Infra segments.

In Business Premises, the comparison period included sale of two self-developed projects, but actually, our project management improved during their last quarter, which resulted in better underlying performance in Business Premises. In Infra segment, our performance continued to improve in Finland, which is our main market. However, certain legacy projects in Sweden are still burdening the segment's overall performance. The Other segment was positively impacted by the cost efficiency measures taken in connection with the operating model change and the transformation program. These measures supported our profitability on the group level as well. So, even though EBIT decreased in Housing, the other segments were able to offset this impact slightly.

So, as mentioned, we were able to turn cash flow to positive traction during the quarter. Main drivers of the positive cash flow were improved working capital efficiency, the sale of apartments to Finland's – Finland toward this joint venture rental housing portfolio, and the sale and leaseback transactions for 11 plots. We were able to maintain the capital employed roughly on the same level as in Q1. In Housing segment, capital employed even slightly decreased as a result of the actions taken. In Business Premises, the capital employed increased just a bit due to progress of self-developed projects, mainly Maistraatin portti in Pasila.

As mentioned, our completed unsold apartment inventory decreased slightly during the quarter. And it is very important to note that more than 80% of the apartments are in the capital regions or university towns in Finland and Central Eastern European countries, meaning that they are very current apartments to be sold as the demand recovers. I'm pleased to see that our transformation program results are visible in both cash flow and capital employed. Also the actions to manage our housing and plot portfolio have been successful.

When we have a look at our asset base compared to interest-bearing debt, we can see that we are in the stable situation with our balance sheet. On the left hand side, you can see the distribution of key assets and on the right hand side, you can see the distribution of our interest-bearing debt. Due to rapid market change, we see short – let's say short-term timing-related challenge in our balance sheet. At the same time, our underlying asset base is very strong. Our debt structure remains well-balanced, but the timing challenge has forced net debt to increase in the short-term. We have a land bank of nearly €800 million to enable future operations and profits. The assets tied in production at the end of Q2 amounted to €635 million and the inventory of completed apartments stood roughly at €260 million.

Our investments were worth of nearly €300 million, our biggest single item there is Mall of Tripla, but also includes our investments to JVs and associated companies. These components all together amount nearly €2 billion. And on top of this, we have a valuable wind power portfolio of which we do not have significant assets in our balance sheet and we are currently reviewing its strategic options as announced earlier.

On the right-hand side, you can see approximately €490 million of our gross debt is related to IFRS 16 lease liabilities, including leased plots and housing company loans that are transferred to buyer at the point of sale. So, this leaves us roughly €330 million adjusted net debt to bear with nearly €2 billion asset base. So, to conclude, our underlying asset base is very strong. Our debt structure remains well balanced. But the timing challenge has forced net debt to increase in the short term.

Gearing development was relatively stable, ending up to 99% during the quarter. YIT's target is to return to below 50% level in the long-term as communicated in our strategy. And regarding the maturity structure of interest-bearing debt measures are ongoing. In May, we announced that we decided to withdraw from the contemplated issuance of the new green notes due to the prevailing market conditions. As a result of that and the overall maturity structure of the IBD, we have refinancing negotiations currently progressing, and when we reach the final solution, we will of course communicate it accordingly.

To conclude our financial position in Q2, we have adapted well to the challenging market conditions. Our asset base is strong. The capital efficiency measures are already visible in the cash flow. And most importantly, we are well on track in improving our short- and long-term competitiveness through the holistic transformation program. Now back to you, Heikki.

Heikki Vuorenmaa
Thank you, Tuomas. Let's then look a little bit forward. And as we look there, the Housing market developments continued to be a major source of uncertainty for us. If we go through segment-by-segment under different markets, we have made some changes on our outlook or a view on the market development. And as a result of increased sales activity, we upgrade our outlook on the Central Eastern European countries from weak to normal level. While the Slovakia market is yet to be fully recovered, we see normalized activity in Poland and Czech. Good situation in Latvia market continues however, we observe weak sentiments in Estonian and Lithuanian market, hence maintained short-term market outlook weak on Baltic countries.

Finland Housing market is still balancing itself and it's yet to show a definite recovery. We continue the observe signs of recovery with a lot of uncertainty. We maintain our view of the weak market in Finland. However, we estimate that the market will gradually improve during the second half of the year. And it looks like that the second half of the year could be better than the first half. But as mentioned, the Finland Housing market continues to be a major source of uncertainty for us.

On a Real Estate market, we see normal market conditions to continue. Demand will rise between the sub-segments, however, we see demand on our addressable market on a normal level. The Infrastructure market in Finland remains on the normal level and Sweden Infrastructure market continues on the good level driven by the state, municipality, and industry activities.

Based on this market outlook, let's look our guidance. Over to you, Tuomas.

Tuomas Mäkipeska
Thanks, Heikki. Our guidance remains intact. The 2023 group adjusted operating profit is expected to be lower than in 2022, but at least €50 million. However, we have made one elaboration in the outlook regarding the Housing market. The gradual Housing market recovery in Central Eastern Europe is expected to continue in the second half of the year, while the recovery in Finland is expected to become more pronounced only towards the end of the year. Previously, our outlook was concerning the whole Housing market in all our operating countries, stating that the demand outlook remains weak for the first half of the year, but is expected to gradually recover in the second half of the year.

Heikki Vuorenmaa
Thank you, Tuomas. Let's then look at the historical and the forecasted completions of the housing unit. As I mentioned, we only had completions in Finland during the second quarter and the total amounted to 432 units. On the third quarter, we expect similar amount of completions in Finland and approximately 600 completions on the Central Eastern European countries. Overall second half of the year, more than 50% of the apartments are to be completed in the Central Eastern European countries. We do continue our promotional activities during the third quarter and execute the best alternatives from our sales playbook to optimize the return to our shareholders.

If further bundled deals are needed, those are also on a playbook remained at the level of unsold inventory on a reasonable level. I mentioned earlier the potential consequences of this ongoing market situation to the demand supply balance during the 2024 and 2025. And as you know, our first half 2024 completions in Finland are estimated to be approximately 150 units or one month's normal sales.

If we double click little bit on our current unsold completed apartments, we know that already that the total amount declined slightly quarter-on-quarter. Of those 730 units we have, a total of 623 units were in Finland at the end of that second quarter. The portfolio continues to include a relevant offering in the major cities in Finland. Those unsold completed apartment locates in 51 different projects across the country, of which only seven project sales rate is below 50%, and average sales rate of those 51 projects is over 70%. And as you note, for example, in Tampere, we had only 18 unsold apartments at the end of the quarter.

Another lens we can apply on this portfolio is to look it from the size distribution viewpoint. What we can clearly observe is that the portfolio is balanced between different sizes. Apartments with less than 40 square meters represents 28% of the portfolio, and more than half of those are located in Helsinki Metropolitan Area. As mentioned earlier, portfolio of unsold completed apartment is higher compared to the situation year ago. However, we continue to be on top of the situation and manage it accordingly.

Let me finally summarize our next steps during the second half of the year before opening to the questions. Firstly, we continue robust cost and capital efficiency measures to secure our competitiveness, maintain our cash and liquidity position, and capability to invest in future. Secondly, we focus on serving customers with the marketleading capabilities and investing to more sustainable future of our whole sector. Thirdly, we do expect the market uncertainty to continue, yet are prepared with the multiple scenarios and ready to take necessary actions to navigate through this market cycle.

Samu Heikkilä
Thank you, Heikki, and thank you, Tuomas. Operator, we are now ready for the questions.

QUESTION AND ANSWER SECTION

Operator
The next question comes from Svante Krokfors from Nordea. Please go ahead.

Svante Krokfors
Good morning. Svante from Nordea. Thank you, Heikki, Tuomas and Samu for the presentation. First question regarding your cash flow, which improved €146 million year-on-year. Obviously, there's a number of items there, the plot sale, JV sale, internal improvements. Could you elaborate a bit on the composition there? How much, for example, cash flow from the plot sale?

Tuomas Mäkipeska
Yes, I can answer that. Thank you, Svante, for the question. First of all, we do not give forward guidance on our cash flow. But as mentioned, so we have taken several actions to improve our capital efficiency, which is already visible in our Q2 cash flow. And we, of course will continue to implement these actions to mitigate the negative impact from the Housing market headwinds. But we can say that without any actions, our cash flow would have likely be a negative still during this quarter, but it is very good to know that we have systematically improved our cash management, cost discipline, and net working capital efficiency in addition to the bundle deal and the plot sale, – sale and leasebacks.

Svante Krokfors
Okay. Thank you. The second question regarding the JV sale of 119 apartments that you have – had, so should we assume a zero margin on that or are we in negative territory and a follow-up on that, do you believe you can dispose any apartments to other investors than your own JVs?

Heikki Vuorenmaa
Yeah. Thank you, Svante. This is Heikki here. We do not disclose or comment specifically on the price or profitability of such a transaction. What I can say is that there are several players still in the market keen on – on the discussion and have the conversation about the unbundled deals so there are alternatives available as well.

Sante Krokfors
Thank you. And then on consumer apartment sales, what kind of negotiate the discounts are you giving consumer? And has there been a change in your approach to that?

Heikki Vuorenmaa
So, we have now expanded and extended the promotional campaigns, where we are providing support for new home buyers for first two years, where we are supporting on in terms of debt payments and the costs there. So, I think that is a one very concrete and clear, let's say campaign or you could call it a discount that we are, at the moment, running in Finland.

Svante Krokfors
Thank you. Couple left still. You used €45 million of your RCF. Do you have any comments on this?

Tuomas Mäkipeska
Yes. Thank you, Svante. I can comment on that. Yes, we utilized RCF just as a part of our normal liquidity management. And as the commercial paper market has been or was mixed during the quarter, impacted by the headwinds in the sector, so we decided to utilize RCF as a source of liquidity.

Svante Krokfors
Thank you. And then the final one regarding your off-balance sheet debt situation. Is that something you want to comment regarding the JVs and Mall of Tripla, I guess there is – there the biggest part of the off balance sheet debt?

Heikki Vuorenmaa
Well, this is something that we don't want to specifically comment. In a big picture, the debt, which is in our own balance sheet, is our debt and we basically do not have it off balance sheet debt. But anyway, I can comment that no major changes there from that perspective.

Svante Krokfors
Okay, thank you. That's all from me.

Operator
The next question comes from Mika Karppinen from Danske Bank. Please go ahead.

Mika Karppinen
Hi, this is Mika. You have been selling during the last two quarters these housing apartments to your own rental housing JVs. Do you still have financing room in these JVs to buy even more in the coming quarters if needed?

Tuomas Mäkipeska
Yeah, that – thank you, Mika. We don't want to specifically comment on behalf of the finance situation on behalf of our partners. What we have observed overall on the market is that the rental activity actually has been a little bit picking up and improving during the first quarter, which kind of gave the confidence also in the second quarter there. I think, maybe that's all we want to comment specifically with the notion that we do still continue to have multiple options available on our toolbox to be executed on the Q3 if needed.

Mika Karppinen
Okay, good. Thank you.

Operator
The next question comes from Lauri Petrell from Alma Media. Please go ahead.

Lauri Petrell
Hello. This is Lauri. You haven't started any new housing project in Finland. Can you tell a bit more about this?

Tuomas Mäkipeska
Yeah. Thank you Lauri for the question. We are considering all the startups based on the market situation and the outlook and what is the financial responsible and during the second quarter, we decided – we didn't

make any decisions to have a startup in Finland. Our startups were only on the markets with the favorable market conditions and those 500-plus startups were made on the Central Eastern European countries.

Lauri Petrell
Thank you.

Operator
The next question comes from Venla Kuokkanen from Helsingin Sanomat. Please go ahead.

Venla Kuokkanen
Hello. This is Venla Kuokkanen from Helsingin Sanomat. I would like to ask about the net debt. How concerned are you about the net debt increasing to 99%? Could you please give which level is your target?

Tuomas Mäkipeska
Yes. Thank you for the question. It's Tuomas here. I can comment on the net debt situation and as I mentioned in the presentation so the net debt increased year-on-year, but quarter-on-quarter it remained pretty stable. And if we look at the structure of the net debt, so as I mentioned so there is adjusted net debt of €330 million since there's so big amount of ours – IFRS 16 lease liabilities and housing companies – housing company loans that are then transferred to the buyer. And of course, this is in connection with our gearing situation. And as I commented, so in the long-term, our gearing target is to be lower than 50%. Now we stood at 99%.

Venla Kuokkanen
Thank you.

Operator
There are no more questions at this time, so I hand the conference back to the speakers.

Samu Heikkilä
Yeah, it seems that there are no further questions. So I would like to thank you all for participating. Going forward, YIT's third quarter results will be published on the 1st of November. Thank you all and have a great day.