

Corporation:	Amer Sports Oyj
Title:	Amer Sports Interim Report January-September 2018
Speakers:	Heikki Takala, President & CEO Jussi Siitonen, CFO
Date:	25.10.2018
Duration:	00:32:04

Operator: Hello, and welcome to the Amer Sports Q3 results 2018 call. Throughout the call, all participants will be in listen-only mode and afterwards there will be a question and answer session. Just to remind you, this conference call is being recorded. Today, I am pleased to present Heikki Takala, CEO. Please go ahead with your meeting.

Heikki Takala: Okay. Good afternoon, good morning. This is Heikki. Welcome to the Q3 earnings call. Just to be sure that we talk the right quarter here, we will focus on the company results for the quarter and the full year, and, just as a reminder – as indicated in the invitation – we will not make any remarks concerning the indication of interest from the consortium comprising ANTA. So, no comment on that one. Only talking about Q3, which was a solid quarter for us. We had broad-based progress and our strategic focus areas continued to deliver. So going a bit more in detail, profitable growth continued in Q3. Net sales were up 9%, and, in organic terms, 3%. The cycling business, as we indicated in the CMD, we now reported as discontinued operations. I'll get back to that in a second bit.

A reminder of Q3, Q4 as every year, the shift between September and October is always a bit unclear before we read the results, and it's important to remember that it's really wholesale deliveries which either peak in the last week of September or early October. Especially this year, the start of October was significantly stronger than the last week of September, hence we – again we saw that the shift between two quarters – and especially Arcteryx wholesale shipments were impacted. The Q4 started exceptionally well there.

Gross margin for Q3 was basically in line with last year, and EBIT was up quite well to €117 million. Free cash flow was down, and that reflected our inventory build-up for Q4. The order positions are solid and the orderbook is expected to be strong, hence we've built field inventories for Q4.

Next page. We had solid focus across the portfolio. I just want to mention here a few areas. First for winter sports equipment, up 8%, and, as indicated in the pre-orders, we continued to have strong momentum in all of the product categories and in all of the continents. Suunto sports instruments was up 15%. We have again very good momentum at the moment, that across the product lines, the technologies, the market [xxx] with consumer and the market is responding very positively to our initiatives there. And then we have a robust new commercial strategy and that seems to give us good gains. In ball sports, we grew 4%, which is a good quarter for us and demand was healthy, especially in baseball, which was up 16%.

Apparel up 31%, of course now boosted by Peak Performance which was included and in our numbers for the first time for Q3. Arcteryx was up only 7%. However, we expect a good double-digit growth here again, and again just to confirm this quarter, the shift more than the underlying momentum, underlying momentum remains very healthy and strong.

In the fitness was we delivered a bit disappointing. Top line, the [xxx] is strong for Q4, as indicated already earlier, we have good new customers, big new customers, and for the first time, we expect to be able to ship to them for the first time in Q4, and we still believe that year is going to be a solid year of growth in fitness.

Next page, the strategic company priorities continued to deliver, as mentioned already, the apparel business is now in 31% growth and, of course, that's boosted by Peak Performance, but that's strategically important growth for us. The footwear EMEA distribution renewables continues, and we see long-term improvement. Already inside we have a better line-up, we have more differentiation in the market, that we are able to run a more sustainable commercial strategy there. Importantly, at the same time as we fix the [xxx] situation, our USA business is very strong, and continues with a very good outlook in 2019, and of course, in footwear, our direct consumer both on retail and e-commerce are growing very strongly, so indeed, we have a commercial construction site in EMEA more than anything. Direct consumer overall for us, organic growth 17% on retail, up 13%, and like-for-like [xxx] growth, which is very good indicator of the health of the platform, up 7%. E-commerce continues 23% growth, and, as indicated at the CMD, the modern channels, which is a combination of own-retail, own e-commerce and e-sales is already about 30% of the company sales, reflecting the significant transformation we have

gone through and which we continue going through. China up 20% for the quarter, and importantly, the United States now firmly returning towards single-digit growth. And, then, finally, a comment on the portfolio. As we have mentioned it at the CMD, we put cycling as the review, and now we are actively finding a buyer for [xxx]. Next page, a few comments on the balance sheet. So, I hand over to Jussi.

Jussi Siitonen: Thank you, thank you. Our net debt was up €340 million from a year ago, [xxx] €240 million. The remaining roughly €100 million is coming from the dividends and share buybacks that we had. That was slightly offset then by our free cash flow for the last 12 months, some couple of millions. I think you already mentioned working capital, it's now up €150 million versus a year ago, mainly due to higher inventories, which are reflecting our few [core deliveries]. And, now that we have Peak Performance also in our portfolio, the similar type of seasonal pattern as we had in the rest of the [xxx] category. The seasonalities in working capital will be further year-end basis, or year-end [buyers/bias]. Capital turnover remained practically at last year's level, and with improved profitability, our return on capital employed went up by 150 basis points. Both net debt EBITDA and net debt equity reflects the year-end-loaded cash flow [xxx] and to mark the year end, we expect balance sheet to deliver it back to the below three times EBITDA levels. Take it back to you for outlook.

Heikki Takala: Indeed, outlook is confirmed unchanged, and net sales and local currencies as well EBIT, excluding items affecting comparability, are expected to increase from 2017, and as stated already, going into the year, the quarterly growth and improvement are expected to be uneven and that's basically the outlook. Just to comment on that, indeed, 2018 follows very much the same pattern as 2017. We saw it coming into the year already, and we've confirmed that that's the view we have of the total year.

Moving on to the next page, just a couple of more comments per category. So, first the outdoor category. I commented already on the individual businesses there, maybe worth paying attention to the positive trend on both net sales and EBIT, it's a trend... are solid, they continue, and they give us confidence that the business area is [xxx] trending in a positive way.

Next page, ball sports. We see that we had a good quarter, and we are especially pleased by the baseball category sales. We have a strong [xxx] position there, and we see that the fundamentals are working to our advantage, and the EBIT trend for the ball sports category continues to be solid and good, exactly in line with the unit growth in the company portfolio. Maybe worth mentioning as well is that on top of the organic growth there, we tested during the quarter some

learning pilots. Through lifestyle expansion, we had few, interesting collabs, for example, with Forever 21 in the US. We also testing with [xxx], a footwear line, and we also tested a tennis lifestyle type of a promotion with [xxx], all of them with very encouraging and interesting results, and of course these could become building blocks for our future expansion.

Anyway, moving onto fitness. We were not exactly in line with our own expectations on top line for the quarter, but for the full year, we confirmed our growth expectation, and indeed, we know that the building blocks are mostly in place. As of Q4, we won several new customer contracts, and we know that we will start shipping against those contracts as of Q4. So, basically, the expectations for the full year are confirmed. And, once we get back to a top line rebound, we will also see a rebound in EBIT, so clearly we need to get that top line back up, and Q4 is where all of our expectations are positive for Q4, and then onwards.

Then, finally, the kind of last page key takeaways from the capital markets day, which we hosted in September. I just confirm the key lines from there. Number one, we continue to grow and create value, so the company's firmly on a growth and [xxx] that, as we've been for the past eight/nine years already, the strategy is working, and the organic growth rises remain largely unchanged. We talked about a sustainable growth model, we talked about a clear portfolio [xxx], and how we allocated capital in the company. Growth scale and synergy providing a scalable platform for units to grow in a profitable way, and then the [xxx] priorities, which include soft good, direct consumer, China, United States, and now overall, digitalisation of the company. We talk about transformation, and we continue to transform the company towards areas of faster growth, higher profitability, and added efficiency, and of course, it's soft goods direct-to-consumer, and China which weigh heavily in this transformation.

Finally, as part of the transformation, we also say that we will broaden our toolbox to include strategic portfolio choices to become a more focused company, and we took to have an increasingly attractive business model as part of those portfolio choices, we first put the [xxx] business under review, and now we move into the next level with this, and with that, I actually conclude the presentation, and then I hand it over for Q&A, which we take together with Jussi.

Operator: Thank you, ladies and gentlemen. If you wish to ask questions, please press 01 on your telephone keypad. And, if you wish to withdraw your question, you may do so by pressing 02 to cancel. There'll be a brief pause while questions are being registered. [pause] Our first question comes from the line of Panu Laitinmäki from Dankse Bank, please go ahead, your line is now open.

Panu Laitinmäki: Thank you, I would have a couple of questions, firstly starting from Arcteryx growth, which was 7% and, you mentioned this was due to the shift to Q4, and you expect double-digit growth, but was that referring to Q4, or the full year 2018 – the double-digit growth expectations?

Heikki Takala: I know, it's a full year comment, but of course, we expect a strong Q4. But, the double-digit expectation which I commented on is for the full year.

Panu Laitinmäki: Okay, thank you. And then, still on apparel, a question on Peak Performance. Can you give a number of how many euros it did contribute to Q3 revenues, and then how did it perform separately? How much did it grow year-on-year in local currencies?

Heikki Takala: Yeah. Panu, you see here, so Peak Performance contribution to our top line was roughly €40 million, and then on [pro forma] basis compared to last year, slightly up there – very slightly, I would say almost flatly on [pro forma] basis, but in our books, €40 million up.

Panu Laitinmäki: Okay, thank you. And, then, on the ball sports business, which looks better after a while, how sustainable do you see this kind of growth rates, or what are your expectations going forwards?

Jussi Siitonen: The focus on the – in that business unit, has been profit and cash first, so our key focus has been on growth margin improvement target level, now it's starting to be there, so then it's, of course, all about the gradually reigniting profitable growth. We haven't really gone for growth for growth's sake because we know that that's typically eating into the gross margin, so we've been prudent and we've been rather protecting and building margins, but once we get to our internal target level, we might grow, then of course, we have plenty of growth initiatives in place, which we can then start to trigger as we see them working I mentioned a few learning plans here. Earlier I said we had many collabs, which we haven't talked about because they are almost future-related. We equally have the same as we have for the balance of the company, so clearly, direct-to-consumer, China is one, and then we have significant initiatives in the United States per sports where we play, including direct-to-team, including new logistics systems, things like that, which will further give us growth and margin building blocks.

Panu Laitinmäki: Thank you. My final question would be about footwear, where local currency sales were down slightly, more than in Q2. What is the progress with the consolidation of distributors? When do you expect that to be done, and growth improving that business?

Heikki Takala: We still expect that 2018, throughout the full year, that distribution market consolidation continues and then we start to see improvements in 2019, especially for the second half of the year. In the meanwhile, we also know that – I mentioned United States, I could also mention Japan, I mentioned our own direct-to-consumer, and own e-tail, own retail, own e-commerce, all of those channels are working well and contributing positively, but of course, where it has been heavily wholesale-driven, and there is still a bit of transformation to do before we see a proper rebound, but we see especially the second half of 2019 quite positively already.

Panu Laitinmäki: Okay, thanks a lot.

Operator: Thank you. Our next question comes from the line of Jutta Rahikanen from SEB. Please go ahead, your line is now open.

Jutta Rahikanen: Thank you, and good afternoon. Actually, my questions – two of them would be along the same lines as Panu's. If I just go back to apparel first, to double check, so I know you gave the number for Arcteryx, and for Peak Performance, so that the indication that [xxx] did have a sales decline on the apparel side in this quarter, is that correct? And, if so, was there anything specific in the business underlying, or was there also some timing issues in that part of apparel?

Jussi Siitonen: Salomon apparel follows partly – is not largely – the work we do in footwear, so they kind of go hand-in-hand. Secondly, our focus has clearly been on getting our gross margins to target level, so we now build gross margins 500 to 800 basis point. Depending on the time horizon, we look historically, and we start to be at gross margin levels, which make the business attractive to business investment again. So, within the portfolio we have not prioritised the investment there yet. We will once we get the target gross margins, and that's being an internal transformation or transition we have gone through in very quiet way. The brand is helping – the brand fundamentals are healthy, but of course we need to make sure of course that there is enough building blocks to drive us to the top line. It makes sense to drive that top line once the gross margins are attractive. If they are not attractive, you end up leaving nothing to the bottom line, so it's a sequenced and prioritised programme we're going through on Salomon.

Jutta Rahikanen: Okay, thanks. And, the second question is on footwear, and this is maybe a bit of a [xxx] to again double-check now you've been talking about growth coming back in 2019, and that's what you just said. However, you said it's also more maybe H2 2019. So, could you just help us really to understand this – what is happening in 2019, and how confident you are on what's happening in the first half, and then on the other hand what's happening in the second

half? Earlier on I think you mentioned that you had some trade agreement with Amazon, for example, so all kind of data points I think with specific clients, and similarities would be very interesting for us to understand the dynamics. Thanks.

Heikki Takala: Yeah, we'll not talk specific customer agreements. Typically we don't. But, I could say that for 2019, the collection is broader and wider and the ranges are deeper, which allows for better consumer driven commercial strategy, so we have the right products in the right channels, and we drive the right ranges in the right places, and that gives us appropriate channel differentiation, and the consumer finds exactly what he or she is looking for. We also keep focusing on who we see as the equity drive into winning customers in the market place, so the quality on the distribution continues to go up, and when you focus the commercial game plan, it also means that we reducing our distribution, we cleaning it up, and you get the adverse impact figures, you physically... if your number of distribution points, but then you of course expect that to give you positive impact because yourself, through your fundamentals, are better in those distribution points where you are. So, in this current year, we talk about the hundreds and hundreds of distribution points that we are using, but by early 2019, that is in place. From a fundamentals point of view, I am cautious to give a top line expectation, based on that. We know what we have achieved by the fundamentals, but of course, the market is yet to respond to the clean-up, but we see that our pre-orders are getting better, and we expect for the second half of the year ever-increasing pre-orders. Having said all of that, in the countries where we believe our fundamentals have been healthy all along, like the United States, the business is expected to be up next year, up to double digits. So, we see quite significant momentum in various places.

Jutta Rahikanen: Okay, thank you. No further questions on my behalf.

Operator: Thank you. Our next question comes from the line of Justin Wayne from Morgan Stanley. Please go ahead, your line is now open.

Justin Wayne: Thanks for taking my question. My first question related to the operating cash flow. It was pretty negative for the third quarter. You mentioned that's because the inventory build-up for the coming fourth quarter. So, does that imply you have a very strong sell-in, or sell-through, for the Arcteryx in the fourth quarter? And, related to probably the negative working capital, your net debt increased to €92 million, so making the EBITDA ratio about the three times, which is sort of your target – towards the year – so what's your thought around it? And, what's the pay down schedule for the current net debt?

[xxx]: Yeah. Jussi, if I start first on the EBITDA. The specific financial targets we have set the company is that year-end net debt to EBITDA is below 3. We are not yet at the year end. What I just referred is that, based on the visibility, that we have, for strong Q4 cash flow, we believe that we are below the three times by the end of the year, the working capital has increased, if you take year-to-date numbers, it's up €220 million, out of this €240 million, came in in Q3 only. The good thing is that it's healthy. Working capital is very fresh, receivables is very fresh, which will be now shipped mostly in Q4, so therefore I'm pretty confident having a strong cash flow in Q4.

Justin Wayne: Thanks. So, my second question is related to the footwear. Could you comment on the year-to-date growth outside Europe, which I think is the key area you are focused on the [clean-up] or consolidation of this channel, but could you comment that... outside the Europe was the [xxx] maybe some of the number in terms of [range], and also the Arcteryx year-to-date... where is the strongest [xxx] market for you?

[xxx]: This first question, is it related to footwear, or the broader portfolio?

Justin Wayne: Just the footwear, because that...

Heikki Takala: Right, right. Well, we have up to double-digit growth in the United States, in Japan, in non-EMEA continents or countries, so, I think that answers the question. And, the second question was related to Arcteryx. The strongest by far, the strongest growth is in China, so we're clearly growing rapidly and significantly, and that's also where we investing the slowest is in EMEA, to EMEA market overall, is lower, and rather than push-and-pop promotions, and being promotional, we have focused on protecting our gross margins across the portfolio, and so we have accepted lower growth here, still remaining intact and in line with the company target for the full year, so we always balance the portfolio, and we balance the geographic areas. But again, Arcteryx by far the fastest growth in China. Also, good, solid momentum in Japan, and also United States, Canada, as you would always expect.

Justin Wayne: Thank you. My third question related to the cycling business. Understanding is under the strategy review, so in this third quarter you sort of disclosed the profitability for the cycling business, which probably is not profitable. So, I'm just wondering what kind of [appropriate] evaluation methodology to look at this, is it look at the price-to-sales ratio? Or, any thoughts around it?

[xxx]: As we said, we are actively signing a buyer, and we have a formal process in place. As we are in the middle of the process at the moment, we wouldn't like to speculate on any valuation there. Let the process run, and then when we know, then we are much wiser.

Justin Wayne: Okay, thank you. My final question is regarding to the fitness. So, the profit margin this year has gone down quite significantly, you mentioned that because of the new customer gain in the fourth quarter, you are expecting the rebound in the EBIT margin. But, is there a little bit more fundamental issues, that, sometimes you already don't have the new customer, and then you have this kind of lower margin, or if you take a longer term view, say to three years, do you think this segment would need more restructuring to restore the margin?

Heikki Takala: Every time you start something new, like we now started new, where we're playing with new segment with new products, with new line-ups, there is always the time before you get your top line, bottom line model right. Clearly, we will like the fact that when the factories are running at good capacity utilisation, we have not been there, we invested into new products lines to play in the new segment, but the growth is so gradual that it doesn't give us the production varieties and the production efficiencies that we're looking for before we reach a scale that's a matter of fact, that's the name of the game when you run a company, and you need to be a bit patient. Of course, not too patient, but we see that once the order book is confirmed, then we can land with much more confidence. Also, the second fact is that once you move into new segments, those new segments are lower priced, you will get a negative pricing mix in that, and then we'll balance that over time. But, it's easiest to optimise once you have the top line, it's hard to optimise, so first you need to get that momentum and that's exactly the sequencing we're going through. Once the momentum is there and we have a physical top line in our hands, then we move into optimisation stage. That's the way we've run the company, and it's proven to work almost every single time when we do that with good mid-term view, not a quarter-to-quarter view, but the mid-term view. Having said that, we have now practiced long enough in this one, we are confident about the building blocks coming in, we see the order book, we see our ability to produce, so all of this is now confirmed. So then it's all about executing, executing with the [xxx].

Justin Wayne: So, could we expect that the EBIT margin for fitness will be significantly higher for next year versus this year?

Heikki Takala: Once we get that rebound, once we get that top line back, we will go back to an improving trend in the EBIT, and it should not start with zero. It should start from a healthy mid-single-digit EBIT level.

Justin Waye: Thank you very much.

Operator: Thank you. Ladies and gentlemen, just to remind you, if you wish to ask a question, please press 01 on your telephone keypad. There will be a further pause while questions are being registered. [pause] As there are no questions being registered at this time, I will hand the call back to you, speakers, for closing comments.

Heikki Takala: Thank you very much for joining and now looking forward to a good winter, cold weather. The cold weather seems to be coming everywhere in the world at the moment. We are very pleased with that after a very warm summer, and with cold weather comes good business. So, it's all about delivering now. Thank you very much, and see you next time.

Operator: This now concludes our conference call. Thank you all for attending, you may now disconnect your lines.