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Q3 2018 NKT A/S Earnings Call

EVENT DATE/TIME: NOVEMBER 16, 2018 / 9:00AM GMT



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PRESENTATION

Operator

Good day, and welcome to the NKT Q3 Report 2018. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Roland Andersen. Please go ahead.

Roland M. Andersen *NKT A/S - CFO*

Thank you very much, and welcome to NKT's Interim Report Q3 2018. And before we start, I'd like to just point to our forward-looking statements on Slide 2. With me here today is Chairman of the Board of Director, Mr. Jens Due Olsen; and Basil Garabet, CEO of Photonics; and myself, Roland M. Andersen, Interim CEO and CFO of NKT. So let me hand over to Mr. Olsen.

Jens Peter Due Olsen *NKT A/S - Chairman of the Board*

Thank you, Roland. This morning, we have decided to ask Michael Lyng to step down as CEO of NKT, to start a search for his replacement and to have Roland Andersen assume the responsibility as interim CEO.

We are today also announcing that our 2018 forecast is negatively impacted by external factors outside our control. Furthermore, since our Q2 report, we have announced key wins in our Solutions business, however, with limited or no impact in 2019. Therefore, we find it necessary to pinpoint that our current estimate 2019 EBITDA is significantly lower than in 2018, but also that we do expect improvements in 2020. Roland will come back to this.

On the back of these developments and in order to ensure that we are diligently addressing any shortfalls we may have, we have concluded that we need to bring new energy and skills into the CEO position. Michael Lyng has done a tremendous job for NKT in the journey from conglomerate to stand-alone business and lately, in professionalizing NKT Cables. A new CEO can build on these strengths and add new capabilities. I would also like to thank Roland Andersen for stepping up. The full leadership team is behind Roland and are committed to continuing implementing the communicated strategy.

NKT is a great company experiencing headwind at the moment. We are strong believers in the electrification of society and in bringing green energy from the windmill farms to end users. We are a market leader in offshore and in DC in general. We have great people, great technology, great products and solutions and a lot of intrinsic and institutional knowledge. We are currently impacted by temporary market slowdowns and by self-inflicted issues. We are committed to deliver on our strategy.

With this, I would like to hand over to Roland again.

Roland M. Andersen *NKT A/S - CFO*

Thank you, Jens. And with that, I think we can jump to Slide 6 and focus on Q3 2018. So in broad strokes, our earnings for Q3 2018 in the Solutions business were in line with our expectations. Profitability in our Applications business line remained unsatisfactorily low, partly due to weak Swedish Nordic markets and partly due to our ongoing transformational initiatives in that part of the business. Our Service &



Accessories business were performing satisfactory during the quarter.

During the quarter, we also completed an issue of EUR 150 million hybrid security and finalized a full refinancing with the new revolving credit facility of EUR 300 million that all concluded in September. Since end of Q2, we have seen a pickup in high-voltage project awards. Activity level in the remainder of '18 and '19, however, will not benefit massively from that as the majority of these projects will only hit production in late 2019 and into 2020. And thereby, we ended with an organic growth of minus 1%, operational EBITDA of EUR 26.1 million and our high-voltage order backlog went up to EUR 650 billion.

And then lastly, we have updated our 2018 guidance, and let me turn to Slide 7. And there's 2 external factors that is impacting our 2018 expectation. And the first one is the extraordinarily low water level in the Rhine River that has now tracked on for more than 2 months and is now expected to last at least through the end of the year and into January. And for us, that means that a project that are currently -- or cable project that are currently ready to ship out from our Cologne factory to our logistic center in Rotterdam will be delayed. It also means that in order to keep the flow in the factory running, we will need to add additional storage capacity, river barges and potentially turntable capacity in the Cologne factory. So that's one project that has been negatively impacted.

The second one is a project that we're doing where installation work with a third-party contractor had damaged our cables. And that means that we have now decided to do that part of the installation work and coverage work of that project with a different supplier. In doing so, we will incur extra costs for safeguarding that cable once we are contemplating how to do the new solution.

Now that will negatively impact EBITDA with about EUR 20 million. Now 1/3 of this EUR 20 million is a delay of recognized revenue because we can't recognize revenue-wise. These projects are on hold, so to speak. So these earnings will come back in '19 instead of '18, and that means that 2/3 of this is real cost, so to speak.

If we jump to Slide 8. As already mentioned, we have seen a pickup in projects awarded since Q2, but it's also clear to us now that this will not have any significant impact to earnings in '19 nor the remainder of '18. And especially, the Karlskrona factory is suffering from reduced capacity utilization as it looks now. So of the 4 projects we've been awarded, only Hornsea 2 and Moray East will have significant impact in '19. All other projects, both in the backlog and in the pipeline, will only hit after 2019. And that means that we're now estimating '19 preliminary to be between EUR 10 million and EUR 30 million EBITDA.

And in the low end of the range, we will reach -- if we don't get any more projects from now on with '19 impacts, it also assumes that applications will start to improve but not significantly. And that we, on the other hand, are executing satisfactorily on the ongoing projects, both in Karlskrona and also in Cologne. In order to reach the higher end of this, we will need to secure additional high-voltage projects with financial impact for '19.

So if we jump to Slide 9. For Q3 2018, execution-wise, actually, a quarter in line with expectations. We wrapped up a few projects that has been ongoing for some months, Johan Sverdrup in Norway 1 was installed and delivered to the customer. And also, the Walney Extension in U.K. and our Rentel project in Belgium were finalized and handed over. Then an additional 400-kilovolt frame contract in Germany was awarded, an onshore contract, which is, in principle, is positive for our onshore market and business in Germany is still unsatisfactory. Also, the ship did quite well in Q3 with various deployments, and that all leads to an EBITDA for the Solutions business in Q3 of EUR 27.5 million.

If we then jump to Slide 10. We have been awarded 4 large projects since end Q2. And some of you have already seen this, but one is the Hornsea 2 that we will do for Ørsted, a 220 kV AC project. Triton Knoll in the U.K. has been firmed up, also 220 kV AC project. Both awarded in Q3 and added to the backlog. And after Q3, 2 more projects has been awarded. Moray East has been firmed up from preferred supplier status and Johan Sverdrup 2 with Equinor has been awarded, and that's another EUR 260 million to add to the backlog during Q4.

If we jump to Slide 11. If we look at the high-voltage market, we have seen project awards improve during second half of '18. Both '17 and '18 has been impacted by significant postponements of especially large interconnect DC projects. Each project has their own reason. There's been political reason. There has been legalistic reasons, reasons for land rights and so on. So no trend or systemic reasons for



these postponements. But nevertheless, quite impactful also for our capacity utilization in Karlskrona. However, the high-voltage market, we still view as attractive in the medium and longer term. We do spend quite some energy on tender activities on a number of projects that hopefully will be turned into the backlog over the quarters to come. Now, however, the limited number of awards during the last 12 months, as already discussed, will have an impact for the remainder of '18 and also for '19.

If we jump to Slide 12, now an updated view of our backlog. EUR 650 billion by the end of Q3, 45% expectedly in '19 and 35% in 2020. So with the recent awards in Q4 awarded here, we basically have coverage in '19 similar to 2020. And that's also what is leading us to now believe that 2020 will be better than 2019 because already now, in the Solutions business, there's almost coverage similar to '19.

If we jump to Slide 13, the Applications business. The Applications business was clearly unsatisfactorily low in Q3. We were negatively impacted by competitive sales situation, market situation in Denmark and Germany, primarily building-wise, significantly impacted by installation restrictions in Sweden due to digging restrictions out of risks of wildfires and fires. That reduced our sales in the medium voltage segment in Sweden. Satisfactory performance in Poland and Czech, however. But in combination with our continued transformational initiatives in the operations business in this part of the business, that led to a 0 result in Q3 of a revenue of EUR 97 million, which is clearly not satisfactory.

And if we jump to Slide 14, what is it exactly we're doing in this part of the business. And as you may recall, we changed our operational structure a year, 1.5 years ago from a more regional-based factory structure to a structure where production planning is now done by a supply chain function under a global COO. And that means the way we work with processes and planning of the factories in the entire supply chain is changing quite dramatically. At the same time, we are rolling out an operator of the production IT platform, ERP and production across all sites. We have initiated process improvements, new operating system standardized the way we work on all factories.

And at the same time, we have entered into a partnership agreement with an external provider to start running our maintenance and repair programs on the factories. So all these initiatives, there's a lot of initiatives. And whilst we are getting in place in the new processes and the new set up, performance has declined. And I think we're the first to admit that it has declined more than satisfactory and will most likely also last a little longer than we would have wanted. But we expect that the impacts and benefits will materialize gradually during 2019 and onwards.

If we jump to our Service & Accessories business for Q3, I think the quarter was satisfactory. Operational EBITDA of EUR 2.1 million, out of revenue of EUR 31 million. We had a number of onshore projects and maintenance and repair projects, but we did not have a major offshore cable repair like we had in Q1 and part of Q2, while our earnings and margins in this quarter is different, though in line with our expectation and satisfactory.

And with those words, I'll give it over to Basil to run off to Photonics.

Basil Garabet NKT A/S - CEO & President of NKT Photonics

Thank you, Roland. Good morning. We're now on Page 17, go through the highlights of our third quarter. Our revenue came in at EUR 15.2 million. That is a EUR 4 million increase against Q3 of 2017. The driver for this increase came from a broad base across all our market segment, which is a very healthy segment at the moment, and we're very pleased with that development. That increase represents a 21% organic growth over 2017. It basically underlines the trajectory in 2018 of growth over 20%, running at 22%.

Our EBITDA came in at EUR 1.5 million. This is an increase of EUR 2.3 million on Q3 of '17, again driven mainly by the growth in revenue. The other healthy part of the business came in from our order intake, which is running at 22% improvement over the same period of last year.

The continued market is improving for us right across all our business segments. We are investing heavily in creating a stronger organizational platform, especially as we grow from a small startup that we were in -- a few years ago to a more sustainable company. We're adding a number of people in the organization, and we are strengthening our presence in the market over many geographical sections. With that, we've also strengthened our management team with the appointment of Mads Bodenhoff as CFO. Mads has been

with us for a number of months at the moment as interim, and he's now permanent. We welcome Mads to the exciting team at NKT Photonics.

The financial outlook for 2018 is unchanged. We're guiding in revenue between EUR 65 million and EUR 70 million and EBITDA of approximately EUR 10 million.

To move on to the business development in the segment of Imaging & Metrology. This is a segment which is our largest segment. It's 56% of our revenue so far this year. The markets that we serve are in the semiconductor, in bio-imaging, medical and industrial metrology. The revenue and order intake has grown solidly in Q3, and the growth has come right across all markets. There's no leading contributor here. They're all at the same levels.

In the Sensing & Energy segment, this is our second largest market. It represents 31% of revenue. This market is in the energy, security and structural monitoring side. The main growth has come from our Koheras line, which has done exceedingly well this year. The main markets growth are coming also from the sensing and various scientific segments.

And finally, in the Material Processing segment, this is the market that is the smallest at the moment but has a lot of our focus. It's about 13% of our revenue. The markets are very active in micro-machining, in medical, especially in ophthalmology and in R&D. This focus area will continue into Q4 and into next year. And we have launched new products, especially a very high-power ORIGAMI line that is now available on the market.

The -- moving on to the final slide. The strategic priorities in 2018 have not changed. They're the same priorities that we've working diligently on for the last 3 years. We are moving up the food chain. We're expanding from supply components to complete optical systems. That's one of our drivers. The new Onefive lasers are helping with that. We are focusing on organic growth at the moment, which is coming in quite satisfactorily. We have completed the acquisitions -- or successful acquisitions of both Fianium and Onefive. Fianium was acquired in 2016 and Onefive in 2017. We are implementing lean operations and lean manufacturing right across the organization. And with our Chief Operating Officer, who was -- came to us in 2017, that lean manufacturing is being put across all the segments. And finally, the fast introduction of new products, which is our lifeblood, we continue with that, especially with the launch of our new ORIGAMI lasers for industrial femtosecond applications.

And with that, I finish my part of the presentation and pass on to Roland.

Roland M. Andersen NKT A/S - CFO

Thank you, Basil. And with that, let's jump on to Slide 21. 21 is basically showing, for the group, flat revenue development when adjusting for metal impact and for currency effects. There's no significant acquisition or divestments in this quarter. The organic growth is minus 1% in NKT and it was 21% in NKT Photonics. And the currency adjustment is mainly the Swedish business in the Cables. NKT is part of the business.

If we jump to Slide 22. This is basically the financial highlights in number terms. As we discussed, operational EBITDA is lower in Q3 than last year's, primarily because the Solutions business now has less projects and also slightly lower margins. And also, the Applications business is performing less than last year. On one-off costs, we are still continuing to integrate ABB and had a few costs according to that. Our EXCELLENCE 2020 continue, and we have had costs related to the EU cartel case that NKT has decided to appeal.

If we jump to Slide 23. Operational EBITDA, the margin LTM and also, actually, is declining somewhat. Just the historical reasons are the increase in margin during '17 was driven primarily by the Solutions business, and I think that's what we have to touch upon here.

So let's jump to Slide 24. And working capital in NKT is moving up. We'll be coming back on the next slide. And also, remember that in Q3 '17, Nilfisk was still part of the group's consolidated debt. And lastly, the total equity here increased in the quarter due to the issuance of the hybrid security that we treat as equity.

So if we move on to Slide 25. Working capital is up by EUR 46 million from end Q2 2018. And this is primarily because Solutions is now

finalizing a few of their projects. So evening out cash positions from those projects, that will increase working capital in that business line. And Applications is negatively impacted from higher inventories that is generated from the lower-than-anticipated sales, especially in the Nordics but also somewhat in Poland.

So if we jump to Slide 26. The cash flow statement and the cash flow from operating activities in this quarter is negative. The EBITDA is not able to compensate the change in working capital that we just discussed. Cash flow from investing activities, down compared to Q2 but -- and remained in a lower level for Q2 '18.

If we jump to Slide 27. Our debt here is -- net interest-bearing debt was EUR 308 million at the end of Q3, down from EUR 410 million in Q2, primarily driven by the issuance of the hybrid security. Leverage ratio then comes out at 2.6x by end Q3 compared to 3x by the end of '18. And again, remember that Nilfisk was part of the group's consolidated debt by end of Q3 '17.

If we jump to Slide 28. Just recapping the refinancing we did during Q3. We issued a hybrid security with a coupon of 5.3%. The first call date, 2022. Following the issuance of that security, we did a EUR 300 million RCF with 4-year maturity also with our bank group. And that means that this financing here replaces everything else we had and basically established a new financing structure for the company.

And we've been asked to comment a little bit on the terms in that financing agreement. And I know I may get questions on it, but this is what we're going to say about this. So the revolving credit facility agreement is subject to financing covenants with agreed remedies in the form of securities over NKT Photonics and the vessel NKT Victoria. Key covenants will not apply when the ratio of loan to value of collateralized assets meet agreed thresholds. And with this, we expect to have sufficient financial headroom to manage the lower activity level expected in '19 and the subsequent uptick in 2020 based on the current outlook for the business.

And that leads us to Slide 29 with our new guidance. So we are maintaining our revenue guidance of EUR 1 billion to EUR 1.5 billion in NKT and an operational EBITDA now of approximately EUR 70 million. In Photonics, guidance is unchanged, EUR 65 million to EUR 70 million and around EUR 10 million in EBITDA. One-off costs are expected now to be approximately EUR 27 million, EUR 28 million compared to previously approximately EUR 20 million. We have accelerated our cost to organizational changes a little bit. And we have incurred additional costs related to the EU cartel case, and then we will provide for severance costs related to the departure of the CEO, Michael Lyng.

And with that, I think we will open up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will now take our first question from Kristian Johansen of Danske Bank.

Kristian Tornøe Johansen Danske Bank Markets Equity Research - Senior Analyst

Three questions from my side. The first one is on Slide 28, in your covenants. So I mean, the current value of Photonics and Victoria, is that fair to assume that, that meets this agreed threshold, which you state considering you say that you see sufficient financial headroom in '19?

Jens Peter Due Olsen NKT A/S - Chairman of the Board

So question, we're not going to say so much more than what we're saying on Slide 28. So it's a revolving credit facility, and we have collateralized a few assets. And that means that certain covenants or key covenants will not apply when values of these meet agreed thresholds.

Kristian Tornøe Johansen Danske Bank Markets Equity Research - Senior Analyst

And who sets the value of these 2 assets? Is that the banking group or...



Jens Peter Due Olsen NKT A/S - Chairman of the Board

No, that will be done by external parties.

Kristian Tornøe Johansen Danske Bank Markets Equity Research - Senior Analyst

External parties, okay. Fair enough then. A second question on this guidance for '19. You also highlight that you are looking into reducing costs. So just to clarify, any cost reduction, that is not part of this EUR 10 million to EUR 13 million you are guiding. Is that correct?

Jens Peter Due Olsen NKT A/S - Chairman of the Board

That's a little bit included, but not a massive program. So that means if you run a more heavy program, it is not included. We're still calibrating on what we want to do on this because we don't want to hinder the future growth. On the other hand, we need to be fast and more agile in the way that we adjust our cost base to less capacity utilization. I think that's the challenge.

Kristian Tornøe Johansen Danske Bank Markets Equity Research - Senior Analyst

Okay. And then my last question on sort of investments and net working capital development for 2019, what should we expect for that?

Jens Peter Due Olsen NKT A/S - Chairman of the Board

I think you would expect that we would be a lot more tied with capital allocation to investments, that is clear, but there will be a minimum level for maintenance CapEx. Now on the working capital side, we still -- the Solutions business must be able to run negative working capital. And the Applications business, you will always expect that they run positive, the working capital inventories and so on, but to a less extent than what you currently see. So the working capital level in the Applications business are currently too high, especially inventories in certain of the plants.

Kristian Tornøe Johansen Danske Bank Markets Equity Research - Senior Analyst

So the working capital for Applications should come down, that's what you're saying.

Jens Peter Due Olsen NKT A/S - Chairman of the Board

Yes.

Kristian Tornøe Johansen Danske Bank Markets Equity Research - Senior Analyst

And the same goes for Solutions if you get the orders you hope to get?

Jens Peter Due Olsen NKT A/S - Chairman of the Board

Yes, that's true.

Kristian Tornøe Johansen Danske Bank Markets Equity Research - Senior Analyst

And then on the maintenance CapEx, what level are we talking about? Group maintenance CapEx, how much is that?

Roland M. Andersen NKT A/S - CFO

We're not guiding on that Kristian, but it'll be lower than what you see in Q3 in this quarter.

Operator

We will now take our next question from Artem Tokarenko of Crédit Suisse.

Artem Tokarenko Crédit Suisse AG, Research Division - Research Analyst

I'll have 4 and we'll go one at a time. My first question is around covenants. Can you maybe elaborate a bit more about what type of covenants you have? And can you please confirm that if the bottom range -- the bottom end of your current guidance for 2019 clears the covenants?

Jens Peter Due Olsen NKT A/S - Chairman of the Board

Yes. So currently, we expect that we have the financial headroom we need to run through '19 if that was the question.

Artem Tokarenko *Crédit Suisse AG, Research Division - Research Analyst*

I guess the question is if you hit just the low end of your guidance, does that still mean that you are within the covenants?

Jens Peter Due Olsen *NKT A/S - Chairman of the Board*

Well, then I have to refer to the other bullet line. So key covenants will not apply when the ratio of loan to value of the collateralized assets meet agreed thresholds.

Artem Tokarenko *Crédit Suisse AG, Research Division - Research Analyst*

Right. I see, okay. And then my next question will be around how -- do you think that the change in your financial position or the erosion of your financial position will impact the decision of customers about awarding the contracts in the future to you?

Jens Peter Due Olsen *NKT A/S - Chairman of the Board*

We don't expect that to have any impact from our customers. We have not seen that at all. I mean, we are still -- we are fully functioning many of these projects, where we put out performance bonds and so on in exactly the same fashion as other players in the market.

Artem Tokarenko *Crédit Suisse AG, Research Division - Research Analyst*

Do you still be able to provide as much security in the contract as before when bidding for the contract?

Jens Peter Due Olsen *NKT A/S - Chairman of the Board*

Yes, absolutely. We have nothing -- we have no issues on that.

Artem Tokarenko *Crédit Suisse AG, Research Division - Research Analyst*

Okay, great. My third question is around net debt for this year. Obviously, we've seen sort of deterioration in Q3, and you should have pretty good visibility on prepayments and working capital developments in Q4. So what would you expect for net debt for the end of this year?

Roland M. Andersen *NKT A/S - CFO*

I believe we're not guiding on that, right, but now you know our EBITDA level approximately for Q4. I indicated the CapEx level, and then there's a little bit of swing in working capital, then I think you're close.

Artem Tokarenko *Crédit Suisse AG, Research Division - Research Analyst*

Is it fair to assume broadly flat versus Q3?

Roland M. Andersen *NKT A/S - CFO*

It's a little volatile, right, because it really depends on where the working capital position in the Projects business are by the end of Q4.

Artem Tokarenko *Crédit Suisse AG, Research Division - Research Analyst*

Where do you expect the working capital to end?

Roland M. Andersen *NKT A/S - CFO*

Yes, but we're not guiding on that. I was trying to give you a little direction on how to calculate it, right. So EBITDA minus CapEx and then the working capital in Solutions has a little bit to do with where we are in the project stages and obviously, whether there will be new awards.

Artem Tokarenko *Crédit Suisse AG, Research Division - Research Analyst*

Okay. And the CapEx for this year, you expect around EUR 40 million?

Roland M. Andersen *NKT A/S - CFO*

That will be a good guess.

Artem Tokarenko *Crédit Suisse AG, Research Division - Research Analyst*

Okay, perfect. And my last question is around the search process for new CEO. I just wanted to ask, what sort of competencies are you looking for in a new CEO? And shall we expect any change in strategy once the new CEO joins? Or do you have any clear view on what change in strategy is needed for the business?

Jens Peter Due Olsen *NKT A/S - Chairman of the Board*

This is Jens. I mean, first of all, we are very committed to the strategy we have. We are market leaders in the transmission of green energy. We think that is the right position to be in, so no change of strategy whatsoever. In terms of the third parties, that has been kicked off. And the competencies we are looking for, I would not volunteer that. I will share that when we have the right candidate. What I would like to say that, often, when we do change leadership positions in a company, we are not looking for an exact match of what we had before. In particular, when the former CEO has done a good job in certain items, we want to build on that. So we're looking for someone with maybe different capabilities, but let me come back to that when we're a little bit closer to a solution.

Artem Tokarenko *Crédit Suisse AG, Research Division - Research Analyst*

Okay. And maybe just as a quick follow-up then. What were the key competencies of previous CEO?

Jens Peter Due Olsen *NKT A/S - Chairman of the Board*

I think for a CEO, in general, not a new CEO because I will not share that until we get closer to it. But for a CEO, in general, in this company, I think you need to be a strong leader. I think you need to have project management skills. That's a big part of what we do. And then I think, of course, some financial capabilities, but in particular also some industrial capabilities I think matches quite a lot in this company. So a combination of those 4 things, at least.

Operator

We will now take our next question from Claus Almer of Nordea.

Claus Almer Nielsen *Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT*

Also a few questions on my side. The first question goes to your goodwill or the value out of the ABB Cables transaction. Should we expect some impairment charges with the full year report? That will be the first question.

Roland M. Andersen *NKT A/S - CFO*

Yes. So Claus, thank you. Currently, we're testing our goodwill every quarter, right, and we have not changed our midterm guidance. So for now, there's no impairment for anything.

Claus Almer Nielsen *Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT*

Can you maybe then share some sensitivity in your assumptions that what should -- if you put in, I don't know, 10% lower margins or lower growth, that's the threshold for impairment charges. How close are you to (inaudible) some charges?

Roland M. Andersen *NKT A/S - CFO*

So those sensitivities will be shared in the annual report.

Claus Almer Nielsen *Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT*

So no flavor at this point?

Roland M. Andersen *NKT A/S - CFO*

No, no, no. I mean, I think it's important to understand that we have a process internally, right, where we adjust this goodwill and the risk for impairment every quarter. That's not special in this quarter. And with our midterm guidance, and you know that the midterm guidance is the prime driver of this, there's no indications of impairment.



Claus Almer Nielsen *Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT*

Okay. So maybe if I can answer in another way, let's just assume you have to do an impairment charge of a material magnitude. Would that have any impact on covenants in your performance bond, so when you're selling projects, et cetera, et cetera?

Roland M. Andersen *NKT A/S - CFO*

I wouldn't expect that. I wouldn't expect that all.

Claus Almer Nielsen *Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT*

Okay. Then my second question goes to Photonics. Has your view on NKT being the right owner of Photonics changed given the current weak performance and the weak balance sheet?

Jens Peter Due Olsen *NKT A/S - Chairman of the Board*

Claus, I don't know whether that's a question for me or Basil, but I can...

Claus Almer Nielsen *Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT*

Probably it's for the quarter, I guess.

Jens Peter Due Olsen *NKT A/S - Chairman of the Board*

Okay. So we are very proud owners of Photonics. I think the new leadership team under Basil has taken it from being, I would say, a company developing strong IP rights to becoming a company who is a legitimate player in the commercial part of the space they compete in. And you can see the result now on revenue growth. You can see the result now on EBITDA growth. You can also see the expectations that Photonics has for the midterm, and we are well on track to delivering that. So I mean, no change in strategy whatsoever from my perspective.

Claus Almer Nielsen *Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT*

Sorry, Jens, the question was not about the strategy. It was more about NKT being the right owner. I mean, given the positive performance of Photonics and given NKT's issues, then maybe NKT is not more -- is not the right owner of Photonics anymore.

Jens Peter Due Olsen *NKT A/S - Chairman of the Board*

No. I think -- you know, I mean, you have seen our model we have changed a while ago the governance model of NKT. That also applies to Photonics. And you've seen the results of that when we IPO-ed Nilfisk as a separate listed entity. So I mean, it's fair to assume that, that will also eventually happen for Photonics, but that has not really have anything to do with the performance of NKT Cables whatsoever. I think we're on a trajectory to creating a great stand-alone company here. And Photonics will, and pardon my language, eventually will be released and liberated.

Claus Almer Nielsen *Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT*

Okay. So then just my final question and it goes to the wording about a high activity in 2020. And obviously, I know you didn't provide any guidance for that year, but you have your midterm target at least. Should we expect activity in 2020 from a revenue point of view in the level of 2018? Or how should we really understand this high activity level?

Jens Peter Due Olsen *NKT A/S - Chairman of the Board*

I think you should understand it from the backlog, Claus. So it looks like now that the backlog is allocated evenly between '19 and '20. So -- with not so much more improvements, 2020 will be better than '19, indicating here that '19 is hopefully the bottom.

Claus Almer Nielsen *Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT*

But I guess, the quality of the backlog -- now we're talking of revenue. But if you talk about the quality of the backlog, you have a higher share of low-margin projects to be delivered in 2020 than 2019 and I guess, we're not paying bills by the revenue, by profit.



Jens Peter Due Olsen NKT A/S - Chairman of the Board

Exactly, Claus. Thank you for that one. So when we say it this way, it also has to do with what projects is it and how are we able to plan them in the production flows. So that's why we say it the way we do.

Claus Almer Nielsen Nordea Markets, Research Division - Senior Analyst of Capital Goods and IT

Okay. Maybe I can then just do a follow-up. So yes, we have same activity level planned for '20 year-on-year. But I guess, what you're saying is that the profit level is less in '20 as it is today than in '19. Is that rightly understood?

Jens Peter Due Olsen NKT A/S - Chairman of the Board

No, no. Just saying if you have the right combination of projects in your factory flow, you can actually have a better output with a -- even with a lower-margin portfolio. That's why we articulate 2020 in broad strokes.

Operator

We will now take our next question from Dennis Dinkelmeyer of Goldman Sachs.

Dennis Klaus Dinkelmeyer Goldman Sachs Group Inc., Research Division - Research Analyst

The first question I'd like to clarify up, the content on Slide 28 regarding the covenants. It states that the key covenants are not applied when the ratio of loan to value of collateralized assets meet certain thresholds. Just to clarify, the statement here refers to bank loans worth EUR 317 million on the one hand. On the other hand, to the collateralized assets of NKT Victoria and Photonics. Could you help us to, first of all, confirm that this assumption is correct? And secondly, could you help us to understand where approximately this threshold is standing? Is it 1:1, 2, 0.5, 0.1? And what sort of range are we talking that these covenant thresholds of your other debt will not be applied?

Jens Peter Due Olsen NKT A/S - Chairman of the Board

I think that -- so first of all, we're talking about the revolving credit facility, and the asset has been collateralized against them. That's the structure. On the volume circumstances -- Dennis, because -- I understand the question, but we thought a bit about this. So we're going to say it this way. And on those certain circumstances and certain valuations of those 2 assets, the key covenants will not apply.

Dennis Klaus Dinkelmeyer Goldman Sachs Group Inc., Research Division - Research Analyst

If there's covenants, is that condition applied at all times? I understand the value of Photonics as of right now and the value of NKT Victoria to anyone, the value in business. Should this materially change over the next year? Or has it changed from the assessment when you had the conversations with your banks, i.e. do you even have covenants that, at any point in time of the operation, would be forced to kick in?

Roland M. Andersen NKT A/S - CFO

So you have a valuation of the ship, and you have a valuation of Photonics, right, and your guess is as good as ours on what Photonics is worth. And that has then been collateralized up against the RCF. So that's the security that the bank group has, can say. That's how it works.

Dennis Klaus Dinkelmeyer Goldman Sachs Group Inc., Research Division - Research Analyst

Understand. And there's a certain threshold, and the threshold you will not disclose what the ratio is?

Roland M. Andersen NKT A/S - CFO

No, no. We're not going to disclose it.

Dennis Klaus Dinkelmeyer Goldman Sachs Group Inc., Research Division - Research Analyst

And just to clarify one more, apologies. For the revolving credit facility, EUR 317 million, some of that is the bank loan. What is the exact number of the bank loan? Is it EUR 317 million? Or is it a subcomponent of this?

Roland M. Andersen NKT A/S - CFO

So the RCF is EUR 300 million, clean. And then there's mortgage component.

Dennis Klaus Dinkelmeyer Goldman Sachs Group Inc., Research Division - Research Analyst

And then a follow-up question. Does that mean, given that you have collateralized your loans against this, that if you collateralized Photonics against these loans that, at the moment, an IPO or sale of this asset would not be possible given that it's collateralized?

Roland M. Andersen NKT A/S - CFO

No, that's fully possible. We have full freedom to dispose the assets. And then most likely, depending on what the value is, you'll plow back some of your proceeds on the RCF.

Dennis Klaus Dinkelmeyer Goldman Sachs Group Inc., Research Division - Research Analyst

That makes sense. Then one final follow-up question. Just coming back to the order outlook and the market outlook. We've seen some -- as you've pointed out, we've seen a pickup in several of your -- and in the industry (inaudible) and even offshore and the interconnector space. You've previously talked about potentially winning some interconnectors and also some offshore projects, and it's not quite clear how market shares are evolving at the moment. But could you please comment on your -- on the market shares that you're gaining and potentially why you have seen a subdued order outlook and if this is something that you see maybe with the financial profile of the company. Maybe companies feel that your leverage is too high. What is sort of holding you back winning more orders at the moment? What do you feel?

Jens Peter Due Olsen NKT A/S - Chairman of the Board

No, I think actually we're taking our fair share of the market and the markets that we operate in. There's clearly some markets where we are not pitching in, but in our (inaudible) the markets where they're relevant to us, we're taking our fair share. I think that's also what the last 3 or 4 months has shown. The only unfortunate thing is there's a long lead time on this. So some of this will hit '19 and then will only start really to kick in, in '20 and '21 as we move forward.

Operator

We will now take our next question from Akash Gupta of JPMorgan.

Akash Gupta JP Morgan Chase & Co, Research Division - Research Analyst

My first question is for Chairman of the Board. The question I have is that given the financial condition of the company, are you open to consider all available option, including a potential sale of the company and entire company, not just the Photonics, to maximize shareholder value? And in that regard, can you confirm if you had any preliminary discussions or approach from anybody?

Jens Peter Due Olsen NKT A/S - Chairman of the Board

Well, I think we are a listed company so, of course, all options are listed in the table. Having said that, we never comment on any rumors or context whatsoever, and I will not do that this time either. And I would say we have a strategy that we are in the process of executing, and we do believe that will generate sufficient value for our shareholders and disregarding these other issues.

Akash Gupta JP Morgan Chase & Co, Research Division - Research Analyst

So if I understood it correctly, you are not actively looking for a sale. But if somebody -- some offers come on the table, then you will consider it and in the meantime, you're working on your 2020 strategy. Is that the right interpretation?

Jens Peter Due Olsen NKT A/S - Chairman of the Board

Not entirely. We never comment on whether we are looking for a sale or an acquisition. We never comment on M&A until it actually happens. But we are a listed company. We are always open to all ways of creating value. We have demonstrated that in the past, and we will continue to do that in the future. Meanwhile, we have a great strategy. We have a great team. We're going to execute against this strategy. And when we do that, as we do that, we will generate value to our shareholders.

Akash Gupta JP Morgan Chase & Co, Research Division - Research Analyst

And my second question is on submarine business, where basically some of your peers which have reported results early this week and last week spoke about maintaining price discipline in the market. Given the improved backlog at your end, can you talk about how will you strike a balance between pricing and growth?

Jens Peter Due Olsen NKT A/S - Chairman of the Board

No. We clearly agree with -- to the extent that the market is picking upward and we start to look into '20 and '21. I think the industry as such is looking at a better balance. But we've been open on that. We have given concessions on 1 or 2 projects, right? But as we look into '20 and '21, I think things may change a little bit. That I agree with my competitors on.

Akash Gupta JP Morgan Chase & Co, Research Division - Research Analyst

It was very reassuring. And finally, on the bonding side. Given the shape of balance sheet and current financing situation, is it fair to assume that your interest on bonding facilities might increase somewhat compared to current levels? Or that has nothing to do with your current financial position?

Jens Peter Due Olsen NKT A/S - Chairman of the Board

No, the bond is a fixed coupon, if that's the question.

Akash Gupta JP Morgan Chase & Co, Research Division - Research Analyst

Project bonds. So like when you participate in a tender, you offer various bonds and -- yes.

Jens Peter Due Olsen NKT A/S - Chairman of the Board

The bonds? Yes, no, I don't expect that to happen.

Akash Gupta JP Morgan Chase & Co, Research Division - Research Analyst

So you don't expect the cost of those project bonds to increase or change versus what you have currently?

Jens Peter Due Olsen NKT A/S - Chairman of the Board

No, no, no.

Operator

We will now take our next question from Kristian Nihtilä of Mandatum Life.

Kristian Nihtilä

I'd like to ask about your visibility and the shorter-term visibility as the issues you're experiencing now. And you mentioned the low water levels and damage cables and so on. None of these was communicated in connection with the hybrid bond issue in September just a few weeks before end of Q3. So what is your visibility? And when did these issues occur?

Roland M. Andersen NKT A/S - CFO

So the Rhine River specifically, I think, started in September, right, and they were weak. There was indications that it would start to rain and so on. So basically, by the end of October, we were starting to sort of making our mind about how this is going to work out. And on the other specific incident, that happened, I think, very late in October. If that gives you a little bit of flavor. Understand it looks like it comes a little late in the year, but these are very specific external circumstances that was happening suddenly type of thing.

Kristian Nihtilä

Okay. And what are your thoughts about basically when will these issues be solved? Or are they already?



Roland M. Andersen NKT A/S - CFO

No. I think with the provisions we have done, that will solve it, right? But me guessing on when it starts raining in the half again is a little I think out of line for me, right? But the estimate is now based on projections we get, that will be our out of the woods beginning in January. That's the basis for this.

Operator

(Operator Instructions) We will now take our next question from Artem Tokarenko of Crédit Suisse.

Artem Tokarenko Crédit Suisse AG, Research Division - Research Analyst

Thank you very much for taking my follow-up questions. If I may, to come back to the covenants. My understanding is that the -- your covenants don't apply to revolving credit facility. But my understanding also is that out of the EUR 300 million credit facility, you've drawn just EUR 100 million. The majority -- the rest of your debt is coming from mortgages and the hybrid bond. Could you firstly confirm this? And secondly, if it is the case, could you please talk a little bit about how the covenants look for that part of the debt and again, whether they are cleared or not for the next year?

Roland M. Andersen NKT A/S - CFO

Thank you for that. I think there's been little bit of a misunderstanding. So it is so that we have done a revolving credit facility. And on the revolving credit facility, there are covenants. Those are the covenants that we're talking about. And on those key -- on that facility, those key covenants will not apply when a certain ratio on that loan to value of collateralized assets are at agreed thresholds. That's how it works.

Artem Tokarenko Crédit Suisse AG, Research Division - Research Analyst

Yes, understood. But I mean the majority of your debt is coming not from the revolving facility. It's coming from mortgages and the hybrid bonds. So my question is, what are the covenants on that -- on the remaining part of the debt ex that revolving credit facility?

Roland M. Andersen NKT A/S - CFO

Yes. So on mortgage debt, there's no real covenants, meaning you have to pay your interest. And on the hybrid that is deeply subordinated, there's no covenants.

Artem Tokarenko Crédit Suisse AG, Research Division - Research Analyst

Right, okay. And then touching on those one-off costs because of the low tide in River Rhine. Is it fair to assume that those run at about EUR 10 million per quarter? And if you see another quarter of issues with this next year, this will be -- this should impact your next year's guidance.

Roland M. Andersen NKT A/S - CFO

It depends on how we can remediate, right, in Cologne, because some of these costs has to do with other projects. We need to release the factory. But it would be fair to say that every third month, it'll be between, I don't know, I'm just saying a number, EUR 5 million to EUR 10 million, yes.

Artem Tokarenko Crédit Suisse AG, Research Division - Research Analyst

Okay, right. And my last question is around other projects which you need to win to hit the upper end of your guidance for next year. Could you please confirm when you expect them to come? And maybe talk a little bit about where these opportunities are for you.

Roland M. Andersen NKT A/S - CFO

No. What we're saying is that in order to reach the upper end, we need to win more projects with production in Karlskrona during 2019. That's the only thing we're saying. That could be a large project by the end of the year. It could be smaller project that goes to second half. It depends on how it hits the flow and how we sort of recognize the earnings.



Artem Tokarenko *Crédit Suisse AG, Research Division - Research Analyst*

Okay, sure. And sorry, last question on Photonics actually. I think Photonics has 25% exposure to semiconductors. Do you see this as a potential risk for ordering in Q4 and maybe next year?

Basil Garabet *NKT A/S - CEO & President of NKT Photonics*

No, we're not. These -- the main business we have in semiconductor are projects that have multi-years of development projects. So we're not actually supplying anything in the semiconductor aside from these projects, and they tend to be large projects.

Operator

We will now take our next question from Dennis Dinkelmeyer of Goldman Sachs.

Dennis Klaus Dinkelmeyer *Goldman Sachs Group Inc., Research Division - Research Analyst*

Roland, just one quick follow-up regarding the high-voltage project that has experienced a little delay. I just wanted to clarify which project this has been delayed and whether the NKT Victoria was involved in the repair. And if you could provide us a little bit more color on this.

Roland M. Andersen *NKT A/S - CFO*

Yes. So we're not going to disclose the name of the project. But one of the problems was that NKT was not -- Victoria was not involved. And we may decide to do that in the second round now.

Dennis Klaus Dinkelmeyer *Goldman Sachs Group Inc., Research Division - Research Analyst*

No problem. And then with regards to the -- just clarifying the follow-up question earlier. The Rhine River impact is, you said, was for every third month EUR 9 million to EUR 10 million. Or what -- I didn't quite catch this.

Roland M. Andersen *NKT A/S - CFO*

That you can't see because it's a series of events, right? First of all, we have a project that are ready to ship out. And secondly, we have new production coming to the factory that also has to ship out. So currently, we are -- it's a bottleneck. That's why we need to create operational -- we need to create turntable space, and that's a little expensive to do that way. So it's on a different assumption. So if we come to Q1 and we don't need that, it'll be a lot less costly, whereas if we still need that, it'll be through the -- it'll still be EUR 5 million to EUR 10 million.

Dennis Klaus Dinkelmeyer *Goldman Sachs Group Inc., Research Division - Research Analyst*

What is currently baked in for your 2019 guidance?

Roland M. Andersen *NKT A/S - CFO*

Yes. Because I think -- so first thing is that I think it's important if we talk about a round number of EUR 10 million, and then EUR 5 million of them or half of them, a little less than 1/3 is revenue that we postpone and the rest is real cost, right? So there's an element of stalling the project revenue recognition, right, and there's an element of actual cash costs. Now the basis for what we said about '19 is that this is solved beginning of January.

Dennis Klaus Dinkelmeyer *Goldman Sachs Group Inc., Research Division - Research Analyst*

And does this factor high logistics costs given that a lot of companies are affected by this and the cost of transportation on the Rhine will be elevated?

Roland M. Andersen *NKT A/S - CFO*

No, that's included in this number. So that's included in the -- yes.

Operator

We will now take our next question from Pontus Wachtmeister of Penser Bank.

Pontus Wachtmeister

Disregarding the specific issues in the quarter for you as a company, some of your peers have also kind of suffered in the last year. Can you describe something in the bigger picture of this market so that we understand if there is a cycle, if there is a dynamic across Europe at the moment which we should be aware of and which you are part of? Or do you consider operational areas very different? Also, I'd just like to double check, you do not provide any guidance on revenue for next year, right, yes? Or you just mentioned the order book. But can you say anything about level if we could be around this year or referencing to that -- because the revenue should be easier to -- new guidance rather than margins.

Roland M. Andersen NKT A/S - CFO

Yes, okay. Let me start with number two. I recognize that it would be nice with a lot more flavor. I think we gave preliminary guidance to 2019 basically to get estimates straight, to get consensus view out there straight with our own view. And it's a preliminary number and we'll come back as soon as we have more latest by the annual reporting in February. So for now, I think the preliminary guidance is hopefully, if not preliminary, at least helpful. On your question on the market, I'm not quite sure what you're talking about. But if you're talking about the high-voltage market, I think our view is still that we are in the middle of the mega trends in this market. Like offshore wind is -- if not booming, then at least healthy. I think also the larger projects on interconnect DC are still out there, admittedly considerably delayed, but delayed for a number of reasons. Some have not had legal rights in place, some had Brexit concerns. Some had, for financial reasons, postponements and so on. So that's how we see the market. We -- the market -- or our view on the market is still positive. But we acknowledge that, especially the interconnect DC projects are subject to uncertainty with regards to award dates.

Pontus Wachtmeister

Okay. I mean, from looking at the peers your list yourself, that's a very, very top-down view of the share prices. It seems like some -- it's not a mega trend or the mega trend is going not up. So I'm just curious to what is the discrepancy between how you describe the market and what is actually happening and then the ability to make a good business out of it.

Roland M. Andersen NKT A/S - CFO

No, but I think it's clearly an issue for us that we can't fill our capacity next year in Karlskrona. That's a large factory. It's an expensive factory to have sitting there with not full capacity.

Operator

We will now take our next question from Jakob Magnussen of Danske Bank.

Jakob Magnussen Danske Bank Markets, Research Division - Senior Credit Analyst

A question to your medium-term leverage guidance of 1.5x. Clearly, you're not going to live up to that guidance next year and presumably also not in 2020. When do you expect to come back to this 1.5x? And what are you actively going to do to speed up the deleveraging process, i.e. rights issue, asset sales or CapEx reductions, stuff like this?

Roland M. Andersen NKT A/S - CFO

I think that this guidance here was given in connection with our midterm guidance, right? So when we start hitting our midterm guidance, also, the leverage target will come down to this level. That's how we see it.

Jakob Magnussen Danske Bank Markets, Research Division - Senior Credit Analyst

But are you going to do something actively to speed up this process given that you're going to stray somewhat away from this midterm guidance in the next 2 years?

Roland M. Andersen NKT A/S - CFO

The midyear plans and the guidance we've given today on both '19 and '20 assumes that we start delivering on our strategy and thereby, bring the company hopefully faster and closer to the midterm targets.

Operator

It appears there are no further questions at this time. I would like to turn the conference back to the hosts for any additional or closing remarks.

Jens Peter Due Olsen NKT A/S - Chairman of the Board

Okay, thank you very much to all of you. Thank you here from the NKT team. There's no more remarks from us.

Operator

This concludes today's call. Thank you for your participation. You may now disconnect.

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