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VALMT.HE - Q4 2017 Valmet Oyj Earnings Call

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Good afternoon. My name is Calle Loikkanen, and I'm head of Investor Relations at Valmet. And it is my pleasure to welcome you all to Valmet's Q4 and Full Year 2017 Results Presentation. Valmet's President and CEO, Pasi Laine, and Valmet's CFO, Kari Saarinen, will today walk us through the highlights and results of the year and the quarter. And as always, we will end the session with questions and answers.

But without any further introductions, Pasi, please. You may begin.

Okay. Thank you, Calle. Welcome also on my behalf. So our orders received amounted to EUR 3.3 billion and comparable EBITA rose to EUR 226 million in 2017. So what we will discuss today first in 2017 in brief, then some words about the business lines. Then Kari will go through financial development, and I will come back to dividend proposal, guidance and short-term market outlook.

So first 2017 in brief. So the orders received in the stable business grew to EUR 1,609 million which is the record. And orders received in capital business remained at last year's level and it was about EUR 1.7 billion. Our net sales increased to EUR 3,159 million. And backlog remained at previous year's level at about EUR 2.3 billion. And our comparable EBITA increased to EUR 226 million and margin was 7.2%. And gearing ended up at minus 11%. So those are the highlights, financial highlights.

Then if we look the numbers little bit more in detail, so like I said the orders received almost EUR 3.3 billion. Net sales EUR 3.16 billion. Comparable EBITA EUR 226 million and comparable EBITA margin 7.2%. And we employed in the end of the year about 12,300 people. Then if you look the orders received by geography, very important thing was that China grew quite nicely, so 17% of our orders came from China.

North America was also active especially in capital markets, so 21% of our orders came from North America. Europe 46%, little bit smaller than last year. Asia Pacific, good, 10%, and in South America, we had only 6%. And that's -- we had good services, good small to medium size project market, but big pulp mills were missing, so that's the reason for South America being smaller than normally. But all in all, good development in many areas.

Then if we look how Valmet has been developing over last years. First you see the graph of orders received from 2013 to 2017. And we have now come from the bad year, about EUR 2.2 billion, to a level close to EUR 3.3 billion level. Of course, we made acquisition of Automation there, which has changed the structure little bit, but clearly now our track record is that in normal year orders received is over EUR 3 billion.

Then if we look how Valmet has been developing over last years. First you see the graph of orders received from 2013 to 2017. And we have now come from the bad year, about EUR 2.2 billion, to a level close to EUR 3.3 billion level. Of course, we made acquisition of Automation there, which has changed the structure little bit, but clearly now our track record is that in normal year orders received is over EUR 3 billion.

Net sales has been growing nicely as well. And last year, we ended up at EUR 3.159 billion. And there is - there is growth of almost EUR 600 million from the lowest point. So good development there as well. Our comparable EBITA was in the beginning when we started before non-recurring
items EUR 54 million, and then it has gone up year by year. First EUR 106 million, EUR 192 million, EUR 196 million and now EUR 226 million. So nice and steady development on that one.

And then if we look at the margin development, we started with 2%, then 4.3%, 6.2%, 6.7%, now 7.2%. So constant development also in EBITA margin. So if you look at the company's development from this level, then of course we all can be satisfied with the development.

Then graph how orders received has developed. At the highest during this year, 12 months curve was almost at EUR 3.5 billion level, and it ended now at EUR 3,272 million, small decline in the end of the year. But all in all, we can be happy with the order intake level, so there was, if I remember correctly 4% growth compared to last year, and we can be happy with that.

Then if you look the stable business development, so when we started as Valmet our order intake was roughly EUR 1 billion for stable business, which then included services only. And now after several years of organic growth and Automation acquisition, Automation's organic growth, now we can proudly say that our stable business including the Services and Automation total had orders received EUR 1,609 million and that's the record also in that stable business.

And I think this whole change, about EUR 600 million, has changed Valmet quite much and made Valmet a more solid company to go forward. And I think we can also be pleased with the growth rate, organic growth rate what we have been able to generate both in Services and in Automation.

Our backlog ended at last year's level, almost exactly the same. So EUR 2,292 million. And we say here that a 75% of it is in capital business, 25% in stable business and that about 80% of the backlog is currently expected to be realized as net sales during this year. So from net sale -- from backlog position, we are quite close to the same situation than year ago.

And okay, still some words, so I think for us this EUR 2.3 billion level backlog is a good level, so it means that that we have enough work for almost all the units, but then we have also capability to take new orders, so that the lead times for the customers are not getting -- growing too much, so I think this EUR 2.3 billion level is good level for us.

Then couple words about business line development. If we start from Services. Here of course, we are happy that the Services order intake grew about 5% organically. And then a small negative thing is that if you compare quarter 4 against -- from 2016 against 2017, there was no growth, actually EUR 2 million decline. But I would prefer to look the whole year and state that we had 5% growth which is more than what we have promised. We have said that we target to grow in order intake twice the market and we are saying that market is growing 1% to 2% a year.

In net sales, we are little bit more behind from the growth. So then of course this year, there is possibility to continue with the growth in net sales as well.

Geographically, North America was the place where we -- I'll show later the graphs, where we didn't see growth but all the other areas in Services were growing, which is of course good. Then here you see split between the business units and geographical areas. And like you see, 45% of our Services order intake is coming from Europe. We had growth in Europe, in North America 25%, there no growth in euros, decline in euros, and all the other areas were growing in euro terms. So good development from geographical perspective.

Business units, if you calculate from the last year's figures, you can see that Mill improvements and Energy have been growing and spare parts, and then quite flat with the others.

Then Automation. Orders received totaled to EUR 368 million and it's about 10% growth compared to last year. And I think this is good achievement. We were growing both in direct sales where Automation is selling on their own products to our customers, and we were growing also on package sales where we combine our capital business and Automation together. So both type of businesses were growing. And we told -- and the total growth was about 10%.

Net sales was also very good especially in the last quarter where we had EUR 150 million net sales, and that has of course helped us to reach the profitability Kari will talk about later on. So good development in Automation. About 74% of Automation orders are coming from Pulp and Paper
customers and Energy customers. Energy and Process customers are bringing about 26% of the growth. And during the year, we have been saying that market is satisfactory because Energy and Process hasn’t been active and that’s the case, but the activity in Pulp and Paper side has been more than -- has been good, so I’ll come back to guidance later on.

Geographically, you can see here that we -- our operation -- Automation is still very much Europe and North America based. Luckily we started to grow now in China as well and China contributed to 8% of the orders and, of course, one task what we have in front of us is to have bigger growth numbers in South America, China, and Asia-Pacific. But of course, it’s good to be strong also in the markets like Europe and North America where there is quite a lot of activities all the time.

Then Pulp and Energy. Orders received decreased quite a lot to EUR 678 million. So last year, we received EUR 939 million -- orders worth of EUR 939 million and now only EUR 678 million. And the decline came from pulp side and I will describe that more in next slide.

Net sales ended up at EUR 929 million, which of course, was result of the good order intake in previous years. Then if we look that little bit more in detail, so 48% of orders came from Energy. And when you calculate it, then you end up somewhere EUR 330 million in order intake in Energy. And like we have been saying. Energy market has been satisfactory or good during the year and that part of the businesses is going as planned.

Then on Pulp side. The market hasn’t been active and, of course, then that will lead to a situation that in some of the pulp and pulp units, we will have lack of work in coming months. And how we plan to react to that is that we can use, of course, the qualified engineers, qualified personnel also in other business units, so we don’t see any dramatic situation in front of us. But Energy, all in all, was reasonably good last year and then pulp market is not active.

If you look at it from geographic point of view, Europe was, due to Energy, quite good. Then we started to get orders in Energy also in Asia-Pacific, so Asia-Pacific grew to 18% and that’s of course good. And then here you see that the capital market activity in South America was quite low, so only 9% of the orders came from South America.

Then in Paper, opposite development. So our orders received totaled to EUR 1,035 million, which is, of course -- we have only categorization up to good, but it’s more than good. And growth was over EUR 300 million compared to last year and we are very happy with the development. Net sales increased to EUR 755 million and we are happy with that one as well.

Then if you look the split of the orders, then you see that all the parts of the business were actually growing. So if I start from this 21%, which is Paper, so Paper was then, if you calculate on rough terms, it was about EUR 200 million, and these are new paper machines or rebuilds to paper machines. And at the lowest point, it was EUR 60 million a year, so last year was good also for our paper machine business.

Then if you take Board, Board was then in rough terms about EUR 430 million and that was very good year for Board business as well. So we have been selling many board machines. And Tissue had last year record an order intake and it was EUR 250 million, and in rough terms, if you calculate from here, it's EUR 350 million. So also Tissue had a good year, so actually all these business parts had good year in 2017.

Then if you look it from geographical perspective, China became big market again. So it's about EUR 380 million from EUR 1 billion, so about EUR 400 million in China and that's a lot more than it used to be. So China is again at a very high level in activity. North America was active and Europe was active. Less activity in Asia-Pacific, and in South America, we still have quite a lot of work to be done to increase our market share, but good development in China, in North America and Europe.

So that was quick overview of our businesses, and now Kari will go through more the financials.
was flat. Capital business orders EUR 354 million, so those were clearly below last year’s quarter 4. So both Pulp and Energy as well as Paper business line reduced, so they were below. So capital business has fluctuations, negative and positive over the quarters.

Net sales EUR 936 million. So this is the record high quarter ever for Valmet, so we increased 19% compared to year ago. All areas and also all business lines exceeded the last year’s figures. Order backlog that was EUR 2.3 billion, so that’s the same level as a year ago. But we are actually quite happy with the quality of the order backlog what we have in our hands now. Comparable EBITA for the quarter 8.1%, so this is also now record high. And we are now first time at our target range between 8% to 10% that we set around 1.5 years ago. And balance sheet also continues strong, gearing was minus 11% end of last year.

And then also some comments on the full year. So Pasi was also already saying that orders received they were 4% higher than last year. For the full year, stable business increased 6%. Paper business line increased by 44%, whereas the Pulp and Energy business line reduced by 28%. China and North America were the growth areas for the year. Net sales 8% growth primarily actually coming from capital business which increased 14%, stable business growth was less than 2%.

The share of capital business of the sales that was 53% for the year, so stable was 47% compared to 50-50 year 2016. Full year comparable EBITA EUR 226 million or 7.2%. This is also the highest ever year for Valmet both in euros as well as in percentage. Earnings per share EUR 0.84 per share, up from last year’s EUR 0.55, so we increased more than 50% here. And last year’s cash flow EUR 291 million compared to EUR 246 million the year before.

Gross profit for the quarter. So actually the quarter’s gross profit percentage, so that decreased from last year’s, and this is because of the share of capital business, so that was 53% also for Q4. And last year capital business was 48%, so there’s 5% difference here. But also worth to notice here that our absolute gross profit, so gross profit euros, they were the highest ever at Q4.

SG&As. So we have worked quite hard with the SG&As now over the years and there was no increase now during year 2017 even though the volumes were quite high. So we control costs quite strictly. And then also because of the high workload, we also had an opportunity to utilize some of the sales teams at the customer projects.

So this is a nice picture now showing that -- that, once more, that our quarter 4 was the highest ever EBITA both as percentage, 8.1%, and also in euros, 76 million. So we have actually come a long way from the beginning of 2014 when we had 0 level. And we are also quite happy here with the dark green bar that the stable business sales, that was a bit lowish for the first 3 quarters of the year, so that picked up now so that the growth in quarter 4 was 8%. And then also one thing here is that this year 2017 proved again the seasonality of Valmet’s EBITA, so that we start the year with low and then we pick up towards the end of the year.

Our cash flow. So quarter’s cash flow EUR 89 million. So that was good driven by the reduction of networking capital, also good cash collection as well as the profitability of the business. And full year cash flow once more EUR 291 million, so there was good increase from last year’s EUR 246 million. So we have now had over past 6 quarters, we have now had reasonably good 5 quarters out of those. Quarter’s CapEx is EUR 20 million, that’s a bit higher than usually. And the reason is that we are in the middle of ERP project, first call was quarter 4 last year.

Our net working capital, that reduced to minus EUR 366 million. This is minus 11% of rolling 12 months orders received, so networking capital is EUR 70 million less than a year ago. We have had positive development with the inventories as well as also accounts receivables. Gearing. So gearing reduced to minus 11%. So we had net cash worth of EUR 100 million in the end of the year, so year ago we were at 6% gearing and net debt was EUR 52 million.

During quarter 4, we paid out EUR 43 million loans ahead of schedule. The maturity of our long-term debt is 4 years and the average interest rate is 1.3%. Equity to asset ratio solid 39%, last year 37%. And then return on capital employed. So we also reached our target range here, so target range 15% to 20%. In comparable return on capital employed, we were at 16%, so this was driven by the positive profitability what we had.

So back to you, Pasi.
Thank you. So, first the dividend proposal and then the guidance and short-term market outlook. So the board of directors is proposing EUR 0.55 per share as a dividend for annual general meeting to be approved. And then if that happens, then we have a quite nice trend in our dividend. We started with EUR 0.15, then it was EUR 0.25, then EUR 0.35, EUR 0.42 and now board of directors is proposing EUR 0.55. So nice development also in dividend from Valmet if shareholders so approve. And like we have said, dividend payout policy is that dividend payout should be at least 50% of the net sales and this one is about that policy.

Then guidance and short-term market outlook. Guidance, we are not giving now and the reason is that there are so much, not big changes, but there are changes in the accounting principles with this new standard IFRS 15. And we, as well as many other companies are now restating the numbers from 2017. And once we will have the restated numbers also approved by our auditors, then we will release them latest in March. And then, once we come out with the numbers, we will give also you the guidance for 2018.

Otherwise we would have ended in a situation that we guide with the numbers what we are not later on reporting and that would have been confusing. So I'm sorry for the situation but unfortunately due to the changes in the accounting standards we are in this situation. And then once you have more questions about this, I'm sure that Kari is happy to answer to those. Thank you. You're welcome, Kari.

Then short-term market outlook. So in Services, we keep good outlook. In Automation, we change that to good. And then, I think our guidance was not -- market outlook was not maybe exactly correct last year because we had growth of 10% in order intake, and we were saying that the market is satisfactory. So we -- our reason like I have been saying was that that Pulp and Paper were active and Process and Energy not, but Pulp and Paper was so much active that actually the total year when you grow 10% then it is maybe not good to say that the market outlook is only satisfactory. So we change now that to good.

Then in pulp, we continue to say that market is weak. And we don't see that they are very big projects to be decided soon. And like we have been saying earlier, it is usually so that once our big customers will announce a project, then it will take several months before there is a decision for the suppliers of the technology, and currently there is no official announcement from exact start of a pulp mill project. So that's why we continue to have the outlook as weak.

Then energy, we keep outlook as satisfactory. Like I said about -- if I remember correctly, about EUR 330 million order intake for the year and that gives us reasonable workload, so we continue to keep the outlook as satisfactory. Board and paper, good. Then I think last year order intake was overall rating good, so it was very good at least. So don't expect that the year will be the same than 2017, but still the market activity continues to be good and of course, our workload is good in paper. And the same applies to tissue that we have very good workload and there is still market activity, so we continue to keep our short-term market outlook at good level also for tissue.

So this about the market outlook and guidance. And then as a summary, we can say that 2017 in brief that our stable business grew to EUR 1.6 billion level. Our capital business was at previous year's level about EUR 1.7 billion. Net sales increased to EUR 3.159 billion. Backlog, like I said and Kari said is reasonable at EUR 2.3 billion euro level. EBITA increased to EUR 226 million, and EBITA margin was 7.2% and gearing was minus 11%. So Valmet had good year in 2017.

QUESTIONS AND ANSWERS

Calle Loikkanen - Valmet Oyj - Director of IR

Very good. Thank you, Pasi. Thank you also Kari. And now let’s continue with Q&A. So let’s first start with questions here in Keilasatama and then move on to questions on the phone lines. So while you gentlemen get ready, do we have any questions here in Keilasatama? It seems that we don’t have any question here right now. So let’s continue with questions on the line. So operator, do we have any questions on the phone lines?
Operator

Yes, we do. We have 3 at the moment. The first question comes from the line of Manu Rimpelä.

Manu M. Rimpelä - Nordea Markets, Research Division - Head of Equity Research of Finland & Senior Analyst

Good afternoon. My first question would be on the pulp utilization you mentioned for 2018. How do you see that impacting the profitability of the group? And are you able to fully compensate the lost workload in the Energy division or will we see a negative margin contribution from the lack of workload at the moment? And if you win orders during for instance Q2 this year, how long will it take before they start contributing to your pulp sales?

Pasi Kalevi Laine - Valmet Oyj - President & CEO

So pulp utilization, it’s even more -- there are 2 business units which have good workload and -- no, 1.5 and 1.5 don’t have good, so actually we try to utilize the engineers and all capable persons there in other business units. We have good workload situation in Board and paper and also in Energy. So we try to minimize the absorption issues. And of course, I can’t say any numbers, but we work on that issue and we try to compensate that in some other units then.

Manu M. Rimpelä - Nordea Markets, Research Division - Head of Equity Research of Finland & Senior Analyst

Okay. But as a kind of net impact, so will that be a drag on your profits in 2018, can you comment on that?

Pasi Kalevi Laine - Valmet Oyj - President & CEO

I think in our size of the company, you quite often have a situation that not all the units have full workload. So of course, we are concerned about it and we will focus on it, but that’s normal life in our cyclical business that you have units which are not fully utilized. So difficult to say any more clear answer. Can you Kari help?

Kari Juhani Saarinen - Valmet Oyj - CFO

No, I think that was it pretty much, so that...

Pasi Kalevi Laine - Valmet Oyj - President & CEO

Yes.

Manu M. Rimpelä - Nordea Markets, Research Division - Head of Equity Research of Finland & Senior Analyst

Okay. And then can you just give us some understanding, if we look at the margin development you had during 2017, did we see all the core divisions report improvement in their margins, or was this specifically driven by some business units? And now I’m assuming that we exclude the cost overruns on the Q4 result?

Kari Juhani Saarinen - Valmet Oyj - CFO

So you were asking more like profitability of our businesses and what was the development there, is that right, Manu?
Manu M. Rimpelä - Nordea Markets, Research Division - Head of Equity Research of Finland & Senior Analyst

Yes, if you compare to 2016?

Kari Juhani Saarinen - Valmet Oyj - CFO

Well, overall we did the record quarter now and also record year. So overall, we are very happy with the profitability. Of course, if we then look at the mix of the business, so last year quarter 4, we had 48% capital sales, 52% was stable and now it was the other way around, capital was 53% and stable was 47%. So even though we were actually able to make reasonably good and the best result ever for Valmet now. So I think that everybody picked up in the profitability.

Manu M. Rimpelä - Nordea Markets, Research Division - Head of Equity Research of Finland & Senior Analyst

Okay. So it’s fair to assume that all the 4 business units improved their profitability during ’17?

Kari Juhani Saarinen - Valmet Oyj - CFO

Correct.

Manu M. Rimpelä - Nordea Markets, Research Division - Head of Equity Research of Finland & Senior Analyst

Okay. And then the final question would be on the difference between the order intake and the order backlog. So the order backlog is flat compared to previous year, but you had a still pretty almost EUR 150 million increase in the order intake, so can you just explain did you -- why is that order backlog not up by the end of this year 2017?

Kari Juhani Saarinen - Valmet Oyj - CFO

Well, to be honest, I haven’t done that math now, Manu, but I would just say that overall we are quite happy with the quality of our order backlog at the moment.

Manu M. Rimpelä - Nordea Markets, Research Division - Head of Equity Research of Finland & Senior Analyst

Okay. Can you comment anything about the margins in the backlog, are they higher or lower than previous year when you started the year?

Kari Juhani Saarinen - Valmet Oyj - CFO

Well, that -- if you now look at what happened with our orders and then also with our net sales, so that our stable business increased 6% in orders, but the sales growth was less than 2%. So you can do the math that the stable business portion of the order backlog is higher now.

Operator

We have a question from the line of Johan Eliason.
Johan Eliason - Kepler Cheuvreux, Research Division - Analyst

This is Johan Eliason, Kepler Cheuvreux. I am coming back to the topic of pulp. You restate the weak outlook and referred that there is no sort of an official statement there from the potential customers. But if we look at your sort of quotation activity or your interaction with the customers, would you say it’s at a higher level today than a year ago? Or are there no changes for this pulp segment specifically?

Pasi Kalevi Laine - Valmet Oyj - President & CEO

I think we all the time have quite much activity with our customers to develop different kind of future projects. So I haven’t seen there big change in the market activity. And like we maybe have been saying earlier, we now focus on small to medium-sized projects where there is enough activity in most of the pulp technologies. And then what comes to the big project, we don’t see currently or we haven’t heard of any official decision to go ahead with a big capital investment in pulp side and that’s why we keep our outlook as weak currently.

Johan Eliason - Kepler Cheuvreux, Research Division - Analyst

And on pulp, I think you mentioned that you have basically increased your revenues from the stable businesses by EUR 0.5 billion or so since you became a separately listed company. Does that have any impact on your willingness to take on a full project which I don’t think you have taken on, a full green field, since you become an independent company? Are you more willing to do that now if there’s any of those coming up around the corner or are you still preferring to share the risk with your competitors for each project coming?

Pasi Kalevi Laine - Valmet Oyj - President & CEO

This full mill -- so first of all this stable business, I think I said the stable business in the whole Valmet has been growing and not only in pulp side, so that the stable business of course has business coming from paper side as well and not only pulp. And then this one hasn’t -- is something what we have been all the time developing organically and continue to develop organically. And then of course it will make us more and more stable and I hope more and more profitable as well. Then what comes to the full pulp mills, during Valmet time, we have taken one very big rebuild for the whole mill and that was full mill offering. Then we were not active in one case in South America where customer wanted to buy the full mill. So there is no policy change in regards to that in Valmet. And of course, if the terms are good, then of course we are willing to talk about full mill offering with customer. Then if the terms are not good, then we are not.

Johan Eliason - Kepler Cheuvreux, Research Division - Analyst

Good. And then this accounting. What I have seen so far is either that some revenues or [earnings] are moving around over the quarters but also in some cases where the business is so through [agents] it has basically reduced the revenue inclusion but not really the bottom line, I imply the margin improvement, what is the most likely outcome for you here?

Kari Juhani Saarinen - Valmet Oyj - CFO

Well, Johan, first of all we are still in the process of working on the figures, so work is ongoing and it’s unaudited. We are planning to come out with the restated revenue figures in -- latest in March. But we are actually restating both net sales and once we restate net sales so that we’ll have an impact to the profitability as well out of that net sales that we restate. And it will impact both the beginning of the balance sheet of year 2017 as well as then of the profit and loss statement of each quarter year 2017 as well as the ending balance sheet of year 2017 as well.

Johan Eliason - Kepler Cheuvreux, Research Division - Analyst

Okay, yes. So there is no sort of implication that the accounting might change your margin target setting. It basically follows all the way through in the ways, roughly the same way or?
Kari Juhani Saarinen - Valmet Oyj - CFO
Well, this is exactly what we are working on at the moment.

Operator
Our next question comes from the line of Antti Suttelin.

Antti Suttelin - Danske Bank Markets Equity Research - Head of Research of Finland
On the margin, if you adjust (inaudible) and compare full year '17 to '16, your margin fell, it didn't improve and I have a little bit difficulty understanding how all business lines could improve it on an adjusted basis, the margin didn’t actually improve? That's my first question.

Kari Juhani Saarinen - Valmet Oyj - CFO
So Antti, the line was quite bad. So but it was difficult to hear but I think that your point was that our margins wouldn’t improve and...

Antti Suttelin - Danske Bank Markets Equity Research - Head of Research of Finland
Correct.

Kari Juhani Saarinen - Valmet Oyj - CFO
But I -- I think that they improved, so this is what I can say you. So they did.

Antti Suttelin - Danske Bank Markets Equity Research - Head of Research of Finland
But if I look at the full year or EBITA margin landed at 7.2% if I recall right, it was 7.3% if I adjust with the EUR 17 million in Q4. So it fell slightly on an adjusted basis?

Kari Juhani Saarinen - Valmet Oyj - CFO
Well, first of course like my statement included that EUR 17 million and I guess that you are doing some side calculations here.

Antti Suttelin - Danske Bank Markets Equity Research - Head of Research of Finland
Yes, and I can understand that in the way you defined your margin, the profitability must have been improving a lot because this was a pulp related problem. But how could the other part of the business improve, that's what I keep wondering?

Kari Juhani Saarinen - Valmet Oyj - CFO
Well, I think that your point like overall is quite difficult to open up here, but I just like repeat what I'm saying that the profitability of each business actually increased.
Antti Suttelin - Danske Bank Markets Equity Research - Head of Research of Finland
Okay, let me come back to that.

Kari Juhani Saarinen - Valmet Oyj - CFO
Yes.

Antti Suttelin - Danske Bank Markets Equity Research - Head of Research of Finland
I would like to ask about the programs you are running, the quality cost and the procurement programs. What contributions did they generate in 2017 and should we expect continuous improvement in 2018 in these respects?

Pasi Kalevi Laine - Valmet Oyj - President & CEO
So in our procurement savings, we achieved 3.9% savings compared to last year. And like we have of course, earlier been saying that part of that goes to customers when trying to be competitive to win the cases. Then -- so there we were actually as we were planning, a little bit better. Then in quality costs, we ended up at 2.7% in cost of poor quality against the net sales, and the long-term target is 1.3%, so we still have goal to get the -- reduce them by half, and there hasn’t been development since 2015, so 2015 it was 2.6%, and last year we had this one famous project and that why it increased to -- and now we can say it increased to 4%, and now it came back to previous year’s level, so 2.7%, but there is still room for improvement in our cost of poor quality. Procurement developed like planned, but then -- there’s still way to go in quality.

Antti Suttelin - Danske Bank Markets Equity Research - Head of Research of Finland
Okay. And just -- yes, and (inaudible)?

Pasi Kalevi Laine - Valmet Oyj - President & CEO
Now it was difficult to hear. Can you repeat?

Antti Suttelin - Danske Bank Markets Equity Research - Head of Research of Finland
18 targets.

Pasi Kalevi Laine - Valmet Oyj - President & CEO
Maybe you are using Skype, because it’s all the time breaking, but can you still repeat?

Antti Suttelin - Danske Bank Markets Equity Research - Head of Research of Finland
Yes, sorry, I was asking about 2018 in these respects?

Pasi Kalevi Laine - Valmet Oyj - President & CEO
We continue to have the same annual goal for procurement and then long-term goal in quality is the same as earlier, so get it to be under 1.3%.
Our next question comes from the line of Tom Skogman.

Tom Skogman - Carnegie Investment Bank AB, Research Division - Head of Research of Finland

This is Tom from Carnegie. I wonder about the dividend and the balance sheet. I realize you have increased the dividend a lot but on the other hand, you will be net cash even after paying the dividend and typically that doesn’t make sense in companies, and when you were in this situation the last time you acquired PAS. So I have to ask to you, when will you inform us what you will do with the excess cash because you are just continuing to build net cash at the moment? And why have you not informed us so far?

Pasi Kalevi Laine - Valmet Oyj - President & CEO

The dividend proposal is EUR 0.55, and like you have calculated, it’s increasing from last year’s nicely. Then you are totally correct that balance sheet continues to be strong also after the dividend. Then when analyzing our balance sheet you -- like we have discussed with you and with your colleagues many times, that of course, we have to remember that part of the money is advance payments what the customers have been giving to us for us to buy goods for them. So we can’t calculate all of them actually to be our own money. And then in our type of business, it’s good to have strong balance sheet for customers to trust us and give the advance payments to us. So it’s important to run the company with strong balance sheet. Then what for we can use the balance sheet, then we have been saying that we are focusing on improving the company by focusing in internal development. Of course, if there are very good opportunities otherwise to develop the company, then of course, we are looking. If there are good opportunities with good price, but up to now, we haven’t found any good target.

Tom Skogman - Carnegie Investment Bank AB, Research Division - Head of Research of Finland

Okay. And then as you don’t give any guidance for 2018, I have to kind of ask what do you see as the biggest margin drivers, so the market is not taken by surprise when you come out with your guidance in March at the latest? What will be the key drivers? Do you expect quality cost to go down? You said the order book margin is probably up because it tilts more to stable businesses, but what are the other key things that you are looking at when we talk about 2018 margin given the total order backlog is flat, will there be any cost changes somewhere or so?

Pasi Kalevi Laine - Valmet Oyj - President & CEO

So first of all, sorry that we are not giving now the guidance because it would have been a lot of easier, but unluckily, the situation is like it is. And we continue to target to improve the profitability with the same topics as earlier. Of course, one portion is the -- to increase not to share, but to continue to grow the stable business. So that’s very important that we continue to develop the growth of Services and Automation together. Then in all in all, I think we try to be as tough as possible with pricing. So there is still possibility to improve our profitability. We have design-to-cost actions so that we take our existing products and redesign them so that we can reduce the costs. So that’s one target. Then we have targets for procurement savings and like I said, part of the procurement savings goes also to the benefit of the customer. And then we have quality management program and then one program to improve our project management so that we would improve the margin from today’s as sold levels during the project execution phase. So all in all, we have still room for -- internal improvement to continue to develop Valmet favorably.

Tom Skogman - Carnegie Investment Bank AB, Research Division - Head of Research of Finland

Yes. And what about this ERP system? Will that be a positive or a negative margin contributor for 2018?
Kari Juhani Saarinen - Valmet Oyj - CFO

Well, we are in the middle of roll out. So first quite small rollout was done year 2017 and now we are going ahead then actually quite many rollouts during 2018. But we are not able to harvest the benefits year 2018. So those will come late 2019, beginning of 2020.

Tom Skogman - Carnegie Investment Bank AB, Research Division - Head of Research of Finland

Will there be big OpEx costs related to the 2018 rollout somehow?

Kari Juhani Saarinen - Valmet Oyj - CFO

Well, it continues the same way as we have been doing now this year 2017. So we don't see -- foresee any hikes in the costs this year.

Operator

We have another question from the line of Manu Rimpelä.

Manu M. Rimpelä - Nordea Markets, Research Division - Head of Equity Research of Finland & Senior Analyst

Just a follow up question. Can you comment about the services mix that you have in the backlog? I mean if I understand this right, you increased the share or these kind of modernization refurbishment orders which take a longer time to deliver. So what kind of margin impact will that have in the services business? Will we see a negative mix?

Kari Juhani Saarinen - Valmet Oyj - CFO

Well, I think at opening that up -- is quite difficult, but if we look at that overall so Services, Services orders were higher than Services sales last year. So Services order backlog is higher. And then also if we look at the end of the year, so we were quite happy with the sales of Performance parts or the orders of Performance parts in the end of the year.

Operator

And our last question comes from the line of Johan Eliason.

Johan Eliason - Kepler Cheuvreux, Research Division - Analyst

I was just curious about what you said about South America and the paper business. You have 0 orders from that area and you said you need to strengthen your market share. I mean it's a bit surprising considering your very strong position in tissue, that you don't have any tissue business there that must be a growth market in my view. Do you have any specific plans? Are there any local distributors or service shops or whatever you can acquire to get into at least the tissue business down there? Could you shed any lights on that?

Pasi Kalevi Laine - Valmet Oyj - President & CEO

So first of all, South America is surprisingly small market for paper machines and board machines. And then they have typically been using quite small machines where we are not competitive, and there is one company who has local -- strong presence there in Brazil. We have strengthened our team and we are actively working with many customers to strengthen our position in South America and then -- in capital side. And then, of course, in services side, we are servicing Pulp and Paper customers, but in that graph where I was talking about it, it was only about capital business.
and not the services business. So of course, we have services business for paper, board, and tissue in South America. But of course, in long run, we want to be stronger in South America as well and we do it organically. I think last good example was the announcement of us building a new services center in Chile.

Operator
Thank you. We have no further questions.

Pasi Kalevi Laine - Valmet Oyj - President & CEO
Thank you.

Kari Juhani Saarinen - Valmet Oyj - CFO
Thank you.

Calle Loikkanen - Valmet Oyj - Director of IR
All right. Thank you, operator. Thank you for the questions and the answers. And lastly I just want to use this opportunity for some marketing. We will be hosting our next Capital Markets Day on the 18 of September, so please do mark that in your calendars already now. But otherwise, this is it for today. Thank you very much for participating and I wish you a really good rest of the day.

Pasi Kalevi Laine - Valmet Oyj - President & CEO
Thank you.

Kari Juhani Saarinen - Valmet Oyj - CFO
Thank you.