

REFINITIV STREETEVENTS

PRELIMINARY TRANSCRIPT

SAND.ST - Sandvik AB to Acquire Market Leading Underground Safety Solutions Company DSI Underground Call

EVENT DATE/TIME: DECEMBER 28, 2020 / 12:30PM GMT

DECEMBER 28, 2020 / 12:30PM, SAND.ST - Sandvik AB to Acquire Market Leading Underground Safety Solutions Company DSI Underground Call

CONFERENCE CALL PARTICIPANTS

Henrik Ager - Senior Key Executive

Stefan Widing - CEO

Andreas Koski - Nordea Markets, Research Division

Tomas Eliasson - CFO

Max Yates - Crédit Suisse AG, Research Division

Magnus Kruber - UBS Investment Bank, Research Division

Madhvendra Singh - BofA Merrill Lynch, Research Division

Gael de-Bray - Deutsche Bank AG, Research Division

PRESENTATION

Operator

(technical difficulty)

We've made some assumptions on it. And our estimation right now is that the impact on earnings per share will be slightly positive as we consummate the transaction.

The EBIT margin of course, we can't give any forecast, but if we do a pro forma, say, for the new group as we stand at the end of September, we will have a dilution on the EBIT margin for the group of around [50] basis points. And around 200 basis points to SMR. But as Henrik has described to you, this is a good business case. There are strong synergies as well going forward. So this will create a lot of value for us.

And with that, I will like to hand over to (inaudible) for conclusion, please.

Unidentified Company Representative

Thank you, Tomas. Yes. So I will just quickly wrap up with the key message points here. Obviously, an important step in our shift to growth. This company has a strong strategic fit with our core business, but still a very complementary offering taking us from a niche player to a global leader in ground support.

It is 100% aftermarket business. And in that way, not only helps SMRT aftermarket business but also making Sandvik (inaudible) cyclical. And it is the site with an acquisition that strengthen our world-leading position in underground mining. So overall, checking some really good boxes with this acquisition. So thanks for that and for listening, and I'll jump over to some Q&A. So hand back to Luis.

Operator

Yes. Thank you, Stefan, Tomas and Henrik. Indeed, we will open up the Q&A session, and

We will start with a question from Gael de-Bray, Deutsche Bank to Henrik. You have a little about the competitive environment, could you elaborate on the pricing environment and the ability to differentiate? I think the market has been characterized by fairly intense focus on price. We have seen that the more productivity driven solutions in ground support are growing and that we see as an exciting trend, and that is also what came out of our customer interviews is that opportunity. The little presence that we have in ground support also points in the direction of more shifting the focus to productivity and away from price, but the history in this business has been a fairly strong focus on competition on price. Thank you, Eric. And a question from Johan Veteran Kanagi, can you tell us details on how much EBIT contribution are coming from the 4 I believe that you have

DECEMBER 28, 2020 / 12:30PM, SAND.ST - Sandvik AB to Acquire Market Leading Underground Safety Solutions Company DSI Underground Call

already -- we have already included that in our presentation. A question from you, Aha, what is a -- what is capital intensity in the company, Henrik? Yes. With the regional and local setup, they actually tie up a lot less net working capital than I would have expected. So that is helpful, and it's a low CapEx manufacturing process actually for the steel products. They have almost brand-new facility for chemicals and a big 1 in Poland, the chemicals travel better. So no big CapEx investment required or a bigger investment in net working capital, we don't see that in the near term. Okay. Another question for you, Henrik Ge from Olof Silom, ABG. What are the potential synergies? Can you elaborate a little bit further in terms of sales synergies, but also on the cost side, production and admin? Yes. Well, as we mentioned, this is a complementary offering that they provide. So no major production synergies. Big opportunity here for us is in -- both in sales synergies with TEI having presence with customers where we don't as Andi and the other way around. Notably, in DSI has low share in most of Africa in the U.S. and in the CIS. So those are big opportunities for sales synergies. A little longer term, there's a big opportunity in R&D for us to then develop more advanced solutions and combined solutions between equipment and ground support consumables. There are, of course, cost synergies. They're not that big. Well we will go after them step-by-step, but the initial focus will be on driving sales and the sales synergies. Also from rule of Cederholm, ABG to use Defam, how is the Romania acquisition pipeline, more relatively large deals such as DSI or smaller? We have always said that our main strategy is smaller acquisition, both on acquisitions, but that we would like to add also a few medium-sized ones over time. And this I would characterize as a medium-sized one. So acquisitions that could form a new division and are significantly above SEK 1 billion in revenue. Our mind focus, again, is on the smaller ones. So that's what our pipeline mainly constitutes, but there are also other deals of this size. But in that sense, we are in no hurry. We look at this from a long-term without sort of 5 year perspective. And then now that we have been able to do this one. Very early in that process. We are in no rush to find similar size deals from that perspective. But of course, if they are available or if they they are open to dialogue. We will not shy away from that either. Thank you, Stefan. Another question for you from Olof Laaman. How was the acquisition process? Was there an auction with other interested parties and how many? It's not for us to comment on the process, I think. There are always other interested parties, but the process, I have no further comment on. Okay. We have also a few questions on the same subject too much for you. If we can give some more color on the expected [PPA] following the deal. And if the synergies will compensate for the PPA charges looking 2 years ahead. Well, we -- as I mentioned, we haven't even started the purchase price allocation, although we -- of course, we have some ideas. And as Henrik mentioned here, these [is] very asset light, we have paid -- or the enterprise value is EUR 943 million. The tangible assets are round numbers like 200. So that leaves us with intangibles of EUR 700 million.

But we have assumed that maybe something around SEK 300 million is depreciable. And then course, it's, of course, a question of how many years it is. And it's so early. So I think I'll stop there.

And then on the question on synergies, yes, of course, eventually. The synergies will, of course, compensate for the PPA depreciations going forward. But 2 years ahead, no. We don't have any guidance on that.

Operator

Thank you. Tomas, a question from Gustaf Schwerin, Handelsbanken. You touched upon that, Henrik, but the growth rate for DSI during 2020 and have corona affected these sales negatively?

Henrik Ager - Senior Key Executive

It has, similar to what we've seen in our own consumables business. So sales have been -- it's down a little bit from 2019. Not much, but it has been impacted as operations have either stopped or slowed down in different parts of the world at different stages as we've gone through this challenging year.

Operator

We can take another question on that subject too, Stefan. Growth prospects for DSI? Is the target higher or lower than the growth target for the business area?

DECEMBER 28, 2020 / 12:30PM, SAND.ST - Sandvik AB to Acquire Market Leading Underground Safety Solutions Company DSI Underground Call

Stefan Widing - CEO

I mean, DSI is obviously a sizable addition in Henrik's growth ambition overall in the BA. From an organic point of view, as we have shown here, they have a relatively similar profile at SMR overall in terms of exposure to hard rock and tunneling. So we would expect that the ability to grow them organically is no different than the rest of SMR.

Operator

Okay. Thank you, Stefan. Question to you, Henrik from Gustaf Schwerin, Handelsbanken. Could you please elaborate on the advantages in go-to-market strategy for aftermarket?

Henrik Ager - Senior Key Executive

Yes. I think -- well, if we start with being present at our customers with the aftermarket, with aftermarket sales is hugely important for for -- also for selling equipment. Adding DSI allows us to do more robust. Either we get some scale benefits with certain customers where we are -- it also enables us to be present at more customers. It's a very similar model to our Rock Tools business, where we often have people on-site managing the Rock Tools, And that allows us to have a very good dialogue with the customers, know what their challenges are and help them with those challenges.

Also creates a great platform for driving productivity in as it does with Rock Tools and Drilling, and it does all with ground support when when we are there in present.

Operator

Okay. We have a question from (inaudible) the. The other exposure on Slide 4 is that all oil and gas. Looking back at previous M&A at DSI, it seems like the increased exposure to oil and gas in 2018, i.e. (inaudible).

Henrik Ager - Senior Key Executive

Right. You may know a little bit more about ferro than I do, but we have visited the 2 ferro sites, and we've looked under that there is a significant business. In ferrous galvanizing, which is for other products than underground and ground support, which is fairly profitable business. It's very fragmented, and it's not just oil and gas. It's not dominated by oil and gas. It's scattered or fragmented engineering companies that come to ferrous for help with the galvanizing process.

Operator

Okay. Thank you. We will now try to open up for questions from you online. I think that will be the easier. Many questions are coming in as we speak and similar in nature. So please raise your voice. Can I ask a question?

Operator

Yes, absolutely.

Andreas Koski - Nordea Markets, Research Division

So it's Andrea Koski from Nordea. I just have a question on the margin dilution of [50] basis points for the group. Is that based on the 12% to 13% EBIT margins for DSI underground? Or do you take PPA amortization into account, as it comes down to around 7%, 8%, is that...

DECEMBER 28, 2020 / 12:30PM, SAND.ST - Sandvik AB to Acquire Market Leading Underground Safety Solutions Company DSI Underground Call

Tomas Eliasson - CFO

That is -- Tomas here. That is absolutely correct. Short answer.

Operator

Yes. So happy with that answer, Andreas? And anyone else, please?

Yes. It's a great opportunity to ask your questions

Could I ask a question? It's Max from Crédit Suisse.

Operator

Yes, please.

Max Yates - Crédit Suisse AG, Research Division

Could you give us, Henrik, some color on how the margins have trended over the cycles? So what the peak and trough margins of this business has been to better help us understand how it's performed in previous downturns?

Henrik Ager - Senior Key Executive

Yes. The the history isn't that long in terms of the numbers that we've had access to. So we've seen in the one previous cross around 2015, they were at about half the margin they are at now.

Max Yates - Crédit Suisse AG, Research Division

Okay. And just if could you give a little bit of color around who the largest competitors are in the industry currently for (inaudible).

Henrik Ager - Senior Key Executive

Sure. The 2 biggest ones are Genmar and Minova, I'm now focusing on underground Hard Rock. Half the ground support market in the world is underground soft rock, and most of that is in China. And there, you have lots of local competitors.

But for underground hard rock, Genmar, which is U.S.-based and Minova, which is owned by [America] and Australia. They are similar size, somewhere around half the size of DSI in underground hard rock.

And then you have Normed, which is finish based and also new concept mining, which is based out of South Africa and was acquired by [Epiroc] a year or 2 ago. And they are -- and maybe fifth or sixth of the market share of DSI. Yes. It's Rossland here. How about acquisitions in this new area? Is that already completed? Or do you have other options here in this market segment?

DECEMBER 28, 2020 / 12:30PM, SAND.ST - Sandvik AB to Acquire Market Leading Underground Safety Solutions Company DSI Underground Call

Henrik Ager - Senior Key Executive

The -- there are lots of smaller players, and there is opportunity. I think, our focus will be on primarily on adding technology, it may be. When sometimes you would consider an acquisition also to gain presence with a customer or in a market if it's an attractive production facility and market presence would consider that. So there are lots of opportunities. We're -- been quite focused on DSI and -- in the recent period. So we don't expect one next week.

Operator

Anyone else with question?

Magnus Kruber - UBS Investment Bank, Research Division

Magnus here with UBS.

Unidentified Analyst

Can I -- sorry.

Magnus Kruber - UBS Investment Bank, Research Division

Can I...

Operator

Sorry, Magnus. Can we just step (inaudible) to that -- on the prior question.

Henrik Ager - Senior Key Executive

No, I just wanted to add to make a clarification. When we talk about trough margin, you have to add, I think Henrik's statement that they have improved margins quite a lot recently. So I wouldn't read into that that they would drop to half in the next downturn necessarily. I think it's difficult to say for us at this point. That's where they were in the last trough, but then they have more structurally improved.

Yes. So to clarify a little bit on that.

Operator

Thank you. So Magnus, please go ahead with your question.

Magnus Kruber - UBS Investment Bank, Research Division

Yes. Actually, I was pretty much on the same topic there. How much did they drop in sales in 2015, I guess, to get those margins decline in context?

Stefan Widing - CEO

We don't have numbers prior to 2015. So we don't know how much they drop in sales to land at that margin or when they landed at that margin.

DECEMBER 28, 2020 / 12:30PM, SAND.ST - Sandvik AB to Acquire Market Leading Underground Safety Solutions Company DSI Underground Call

Henrik Ager - Senior Key Executive

If you want, you could also see, obviously, 2020 as a bit of a down market year. So it also gives some sense.

Stefan Widing - CEO

It is a much more stable business, given that it's so directly linked to production and production tends to stay at quite similar levels also when you have a downturn. So I would expect margins to be a lot more stable. And like Stefan said, they have improved significantly their margins. And it's been clear during the due diligence, the steps that they have taken to improve their margins, both -- some through their acquisitions and quite a bit through internal improvements that they've made since their CEO, Michael Rice, joined them in 2016. A lot of things, and many things have gone better.

Magnus Kruber - UBS Investment Bank, Research Division

And (inaudible) here again, one follow-up. Maybe I missed, do you have any cost synergies?

Stefan Widing - CEO

Yes, there are cost synergies. The obvious one in central admin functions and also in the sales organization to realize them, we'll take some work. We'll have to bring them then over to Sandvik Legal entities and Sandvik ERP systems and so on.

So we won't realize them very quickly. It will take some time, but there are cost synergies to realize over the next few years. You have no size of that part of the business?

Stefan Widing - CEO

This is Stefan. No, we are not quantifying that other than saying that if you look at their current EBIT margin, obviously, our goal is to bring that up to at least 50% or higher going forward, and that will come partly through the cost synergies, but primarily, as Henrik said, to save some...

Operator

Thank you. (Operator Instructions)

Madhvendra Singh - BofA Merrill Lynch, Research Division

Maddy from Bank of America. So just one quick question. In the overall value chain, now you have presence in drilling, ground support and material loading and hauling. So -- and as the slide says, you don't have presence in [Charles], blast and ventilate segment. So is there a plan to expand presence in that segment as well?

Henrik Ager - Senior Key Executive

Yes, of course, it looks like an obvious than gap to fill. But obviously, that's also a quite different type of business. So I was treat an obvious conclusion. I mean, the focus now will be to digest and do the best with this. And then we will continue to explore strategically what further options we have.

DECEMBER 28, 2020 / 12:30PM, SAND.ST - Sandvik AB to Acquire Market Leading Underground Safety Solutions Company DSI Underground Call

Madhvendra Singh - BofA Merrill Lynch, Research Division

Okay. So you don't rule it out, but that's not the focus in the short run?

Stefan Widing - CEO

I would not rule it out, but I would also say that it's -- there's a reason why that is maybe left to do, so to say. It's a different competency and so on. So it would have to be looked at very carefully.

Andreas Koski - Nordea Markets, Research Division

So Andreas Koski from Nordea again. Can I ask one more on the EBIT margin? Because as I understand, if we will have [BPA] diluting the margin for DSI or maybe 400 basis points or so. And then you were saying now that you target 15% EBIT margin for TSI. Is that including the PPA amortization. So on an underlying basis, that would be closer to 20% for DSI

No. Good clarifying question. No. As a first step, it would be excluding PPA, so the underlying margin.

Henrik Ager - Senior Key Executive

Yes. It's more like an EBITA margin. And the dilution is -- I wouldn't say 400 bps, more close to 300 bps valuation from the amortization?

Gael de-Bray - Deutsche Bank AG, Research Division

This is Gail Debre from Deutsche Bank. Can you hear me?

Operator

Yes. Very clear.

Gael de-Bray - Deutsche Bank AG, Research Division

Okay. Cool. Cool. Look, I think you just -- you recently provided an update on cost measures and savings at the group level, but also for the various divisions. So my question is, of course, not directly related to DSI. But since you've increased the final cost for the program quite substantially, but you haven't done it for the mining business. I was wondering what was the message behind this. Does that mean that the market conditions in the past few months have improved much faster than previously assumed?

Stefan Widing - CEO

I think what you can read -- this is Stefan, what you can read is, when we announced this back in -- well, first, last week of March, initially, it was a more even split between the BAs and more in -- also in SMRT. And I don't think it's sort of a surprise that since then we have seen mining not going down as much as we could have feared back in March.

So yes, the weighting has shifted more towards SMS, for sure.

DECEMBER 28, 2020 / 12:30PM, SAND.ST - Sandvik AB to Acquire Market Leading Underground Safety Solutions Company DSI Underground Call

Operator

Gael, do you have any other question? Or was this clear to you?

Gael de-Bray - Deutsche Bank AG, Research Division

No, sorry, I was on mute. No, that's clear. Thanks very much.

Operator

So do we have any more questions? Okay. So we will close now the call, and we thank you all for listening in and for very good questions. And we have a very nice day. Bye from us.

Stefan Widing - CEO

Thank you.

Henrik Ager - Senior Key Executive

Thank you.

DISCLAIMER

Refinitiv reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES REFINITIV OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2020, Refinitiv. All Rights Reserved. 16871 12-29/12-31/20 27