7 November 2014 │ 17 pages  Machinery

Western Europe │ Finland

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| Citi Research  Equities |

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| CorpLogo_None |

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| **Metso Oyj (EUR)** | | | | | |
|  |  |  |  |  |  |
| **Year to 31 Dec** | **2012A** | **2013A** | **2014E** | **2015E** | **2016E** |
| Sales (€M) | 7,504.0 | 3,858.0 | 3,597.6 | 3,564.2 | 3,723.2 |
| Net Income (€M) | 335.0 | 272.8 | 243.5 | 263.2 | 303.6 |
| Diluted EPS (€) | 2.24 | 1.82 | 1.62 | 1.75 | 2.02 |
| Diluted EPS (Old) (€) | 2.24 | 1.82 | 1.87 | 2.09 | 2.32 |
| PE (x) | 11.4 | 14.0 | 15.7 | 14.5 | 12.6 |
| EV/EBITDA (x) | 6.3 | 9.0 | 10.1 | 8.7 | 7.7 |
| DPS (€) | 1.85 | 1.00 | 1.00 | 1.15 | 1.20 |
| Net Div Yield (%) | 7.3 | 3.9 | 3.9 | 4.5 | 4.7 |

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| **Neutral** | **2** |
| Price (05 Nov 14) | €25.48 |
| Target price | €27.40 |
| *from €32.00* |  |
| Expected share price return | 7.5% |
| Expected dividend yield | 3.9% |
| **Expected total return** | 11.5% |
| Market Cap | €3,831M |
|  | US$4,783M |

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| Price Performance (RIC: MEO1V.HE, BB: MEO1V FH) |
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| --- |
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| * Estimate Change * Target Price Change |

Metso Oyj (MEO1V.HE)

A Further Big EPS Cut Around the Corner?

* **Two Investor Concerns: Falling Iron Ore & Oil Price** — FY15 cons EBITA down 6% since 3Q, market seems to price in a further earnings cut; now bigger, by some 10%, in our view. Investor concerns seem centered around the sharp fall in the iron ore and oil price, where: 1) Metso has the biggest exposure to iron ore among its Mining equipment peers, and 2) where orders in O&G have grown at a very fast clip on the back of mainly downstream investments (unconventional/shale). In this note, we stress test Metso’s earnings against current investor concerns. Conclusion: A 'doomsday' scenario in iron ore OE & services (rebuilds & capex related spares) would “only” drive a 6% downgrade to consensus FY15 EPS and Metso’s pure Flow Control exposure makes the business defensive against any oil price falls (increased intensity of shale well completions + strategic gas investments in China + downstream investments in ME to support continued order growth). Why not Buy Metso? Even though we believe the market is too pessimistic on Metso’s earnings outlook, we can’t yet be sure that earnings have troughed. Continued downside risk in Minerals and no top-line momentum seen in 2015 caps any outperformance. Reiterate Neutral; TP to EUR 27.40 (32) on lower vols/margins in Minerals.
* **Stress Testing Minerals; Our Assumptions** — A collapse in OE iron ore (from already low levels) and a Lehman-type scenario for services. 75% of Minerals services consist of spares/wares that are production led, the downside risk is in 10% spares/wares linked to OE contracts and 15% of vols exposed to rebuilds. Around 30% is iron ore (8% of total service). These two businesses fell 30% in 2009, we assume similar volume declines in our stress test. Decrementals high due to high portion of staff and inhouse production; we assume a 50% drop-through.
* **From a 7% Premium to a 8% Discount in Three Months** — Shares down 21% from the high in Aug., 6% driven by downgrades and a 15% de-rating; Metso now at a FY15 EV/EBITA rel of 92 vs 107 in Aug. A sector multiple is warranted (~11x FY15 EBITA); any premium rating requires better vols to drive margin/ROCE towards 2017 targets. At 9.7x EBITA, implying ~10% EPS cut, the market is too pessimistic.

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| **MEO1V.HE: Fiscal year end 31-Dec** | | | **Price: €25.48; TP: €27.40; Market Cap: €3,831m; Recomm: Neutral** | | | | | | | | | | |
| **Profit & Loss (€m)** | **2012** | **2013** | | **2014E** | **2015E** | **2016E** |  | **Valuation ratios** | **2012** | **2013** | **2014E** | **2015E** | **2016E** |
| Sales revenue | 7,504 | 3,858 | | 3,598 | 3,564 | 3,723 |  | PE (x) | 11.4 | 14.0 | 15.7 | 14.5 | 12.6 |
| Cost of sales | -5,703 | -2,707 | | -2,519 | -2,442 | -2,522 |  | PB (x) | 1.7 | 3.3 | 3.1 | 2.8 | 2.6 |
| Gross profit | 1,801 | 1,151 | | 1,079 | 1,123 | 1,201 |  | EV/EBITDA (x) | 6.3 | 9.0 | 10.1 | 8.7 | 7.7 |
| Gross Margin (%) | 24.0 | 29.8 | | 30.0 | 31.5 | 32.3 |  | FCF yield (%) | 4.3 | 5.8 | 3.0 | 5.1 | 6.6 |
| **EBITDA (Adj)** | **728** | **494** | | **438** | **506** | **561** |  | Dividend yield (%) | 7.3 | 3.9 | 3.9 | 4.5 | 4.7 |
| EBITDA Margin (Adj) (%) | 9.7 | 12.8 | | 12.2 | 14.2 | 15.1 |  | Payout ratio (%) | 83 | 55 | 62 | 66 | 59 |
| Depreciation | -148 | -52 | | -53 | -53 | -52 |  | ROE (%) | 15.5 | 16.4 | 17.0 | 20.5 | 21.6 |
| Amortisation | -18 | -19 | | -18 | -18 | -19 |  | **Cashflow (€m)** | **2012** | **2013** | **2014E** | **2015E** | **2016E** |
| **EBIT (Adj)** | **562** | **477** | | **425** | **435** | **490** |  | EBITDA | 728 | 494 | 438 | 506 | 561 |
| EBIT Margin (Adj) (%) | 7.5 | 12.4 | | 11.8 | 12.2 | 13.2 |  | Working capital | -176 | 52 | -90 | -70 | -50 |
| Net interest | -49 | -54 | | -64 | -45 | -40 |  | Other | -230 | -230 | -162 | -172 | -186 |
| Associates | 1 | 0 | | 0 | 0 | 0 |  | **Operating cashflow** | **322** | **316** | **185** | **264** | **325** |
| Non-op/Except | 0 | 0 | | 0 | 0 | 0 |  | Capex | -156 | -95 | -72 | -71 | -74 |
| **Pre-tax profit** | **514** | **369** | | **303** | **390** | **450** |  | Net acq/disposals | -57 | 161 | 0 | 0 | 0 |
| Tax | -178 | -131 | | -98 | -127 | -146 |  | Other | 0 | 0 | 0 | 0 | 0 |
| Extraord./Min.Int./Pref.div. | -1 | 40 | | 0 | 0 | 0 |  | **Investing cashflow** | **-213** | **66** | **-72** | **-71** | **-74** |
| **Reported net profit** | **335** | **278** | | **204** | **263** | **304** |  | Dividends paid | -254 | -277 | -150 | -150 | -172 |
| Net Margin (%) | 4.5 | 7.2 | | 5.7 | 7.4 | 8.2 |  | **Financing cashflow** | **-5** | **-287** | **-150** | **-150** | **-172** |
| Core NPAT | 335 | 273 | | 244 | 263 | 304 |  | **Net change in cash** | **104** | **95** | **-37** | **43** | **78** |
| **Per share data** | **2012** | **2013** | | **2014E** | **2015E** | **2016E** |  | **Free cashflow to s/holders** | **166** | **221** | **113** | **193** | **250** |
| Reported EPS (€) | 2.24 | 1.85 | | 1.36 | 1.75 | 2.02 |  |  |  |  |  |  |  |
| Core EPS (€) | 2.24 | 1.82 | | 1.62 | 1.75 | 2.02 |  |  |  |  |  |  |  |
| DPS (€) | 1.85 | 1.00 | | 1.00 | 1.15 | 1.20 |  |  |  |  |  |  |  |
| CFPS (€) | 2.15 | 2.11 | | 1.24 | 1.76 | 2.17 |  |  |  |  |  |  |  |
| FCFPS (€) | 1.11 | 1.47 | | 0.76 | 1.29 | 1.67 |  |  |  |  |  |  |  |
| BVPS (€) | 14.74 | 7.83 | | 8.19 | 8.94 | 9.82 |  |  |  |  |  |  |  |
| Wtd avg ord shares (m) | 150 | 150 | | 150 | 150 | 150 |  |  |  |  |  |  |  |
| Wtd avg diluted shares (m) | 150 | 150 | | 150 | 150 | 150 |  |  |  |  |  |  |  |
| **Growth rates** | **2012** | **2013** | | **2014E** | **2015E** | **2016E** |  |  |  |  |  |  |  |
| Sales revenue (%) | 12.9 | -48.6 | | -6.7 | -0.9 | 4.5 |  |  |  |  |  |  |  |
| EBIT (Adj) (%) | -1.7 | -15.1 | | -10.9 | 2.4 | 12.6 |  |  |  |  |  |  |  |
| Core NPAT (%) | -5.9 | -18.6 | | -10.7 | 8.1 | 15.3 |  |  |  |  |  |  |  |
| Core EPS (%) | -5.9 | -18.6 | | -10.7 | 8.1 | 15.3 |  |  |  |  |  |  |  |
| **Balance Sheet (€m)** | **2012** | **2013** | | **2014E** | **2015E** | **2016E** |  |  |  |  |  |  |  |
| Cash & cash equiv. | 741 | 539 | | 502 | 546 | 624 |  |  |  |  |  |  |  |
| Accounts receivables | 2,158 | 1,116 | | 1,116 | 1,116 | 1,116 |  |  |  |  |  |  |  |
| Inventory | 1,529 | 921 | | 1,011 | 1,081 | 1,131 |  |  |  |  |  |  |  |
| Net fixed & other tangibles | 833 | 376 | | 395 | 413 | 435 |  |  |  |  |  |  |  |
| Goodwill & intangibles | 1,140 | 569 | | 551 | 533 | 514 |  |  |  |  |  |  |  |
| Financial & other assets | 241 | 157 | | 157 | 157 | 157 |  |  |  |  |  |  |  |
| **Total assets** | **6,642** | **3,678** | | **3,732** | **3,846** | **3,977** |  |  |  |  |  |  |  |
| Accounts payable | 1,635 | 824 | | 824 | 824 | 824 |  |  |  |  |  |  |  |
| Short-term debt | 204 | 278 | | 278 | 278 | 278 |  |  |  |  |  |  |  |
| Long-term debt | 1,110 | 779 | | 779 | 779 | 779 |  |  |  |  |  |  |  |
| Provisions & other liab | 1,466 | 616 | | 616 | 616 | 616 |  |  |  |  |  |  |  |
| **Total liabilities** | **4,415** | **2,497** | | **2,497** | **2,497** | **2,497** |  |  |  |  |  |  |  |
| Shareholders' equity | 2,207 | 1,173 | | 1,227 | 1,341 | 1,472 |  |  |  |  |  |  |  |
| Minority interests | 20 | 8 | | 8 | 8 | 8 |  |  |  |  |  |  |  |
| **Total equity** | **2,227** | **1,181** | | **1,235** | **1,349** | **1,480** |  |  |  |  |  |  |  |
| **Net debt (Adj)** | **573** | **518** | | **555** | **511** | **433** |  |  |  |  |  |  |  |
| Net debt to equity (Adj) (%) | 25.7 | 43.9 | | 44.9 | 37.9 | 29.3 |  |  |  |  |  |  |  |
|  | | | | | | |  |  |  |  |  |  |  |
|  | | | | | | | | | | | | | |
| dataCentralLogoFor definitions of the items in this table, please click [here](https://ir.citi.com/SgzzHGOXE8Em3XjCrGYUtHiNJT%2fpWRjDvBvroL6AADHcJYorD%2bBe8xkM49prSZy9yISZF%2fdrR9ENuWQ4b7HuJQ%3d%3d). | | | | | | | | | | | | | |

A Further Big EPS Cut Around the Corner?

Metso shares are down 21% from the high in August, 6% driven by downgrades and a 15% de-rating; Metso now at a FY15 EV/EBITA rel of 92 vs 107 at the share price peak. Investor concerns seem centered around the sharp fall in the iron ore and oil price, where: 1) Metso has the biggest exposure to iron ore among its Mining equipment peers, and 2) where orders in O&G have grown at a very fast clip on the back of mainly downstream investments (unconventional/shale). In this note, we stress test Metso’s earnings against current investor concerns. Conclusion: A 'doomsday' scenario in iron ore OE & services (rebuilds & capex related spares) would “only” drive a ~6% downgrade to consensus FY15 EPS and Metso’s pure Flow Control exposure makes the business defensive against any oil price falls. Increased intensity of shale well completions (backed by Weir comments this week), strategic gas investments in China and downstream investments in Middle East should support continued order growth for Metso’s Flow Control business. We also believe that Metso’s new cross selling initiative of valves and pumps, will support volumes into 2015. The main end-market for Metso’s valves business is Oil and Gas and the pumps are sold to Miners (slurry pumps, similar to Weir). Starting in 2015, Metso will now sell valves to Miners (wet mining) and pumps into the Oil and Gas market, similar to peers such as Pentair.

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| Figure 1. Underperformance last 3 months in line with intensified falls in iron ore & crude oil |
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| Source: Citi Research; Datastream |

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| Figure 2. Metso has the biggest exposure to iron ore among its mining equipment peers |
| CIRACHART |
| Source: Citi Research; Company Reports |

## Minerals Sensitivity

As written in our note post the recent Sell side dinner with the CEO ([Metso Oyj - Feedback – Sell-side Dinner with the CEO](https://ir.citi.com/WFEOIBWf3YQN1UVkhlqaBuHO3IgmWTwyul5iK8LaphDytnV7b29lrIZLP1Q7iV8BPBBai5yMdlU%3d)), Mining OE orders exposed to iron ore is some €70-100m annualized; some ~2% of group orders. In our sensitivity we bring these to zero, in addition to our bearish call on Mining services. Note: the 75% of Minerals services that is production led (spares and wares) is left “as is” given a continued strong production outlook for iron ore as per our recent Mining survey. The downside risk in our view is in capex related service volumes (spare/wares) and rebuilds. These two activities make up 10% and 15% of Minerals services sales, respectively. Volumes for spares and wares linked to OE contracts and rebuilds fell 30% in 2009. We assume the same decline in our sensitivity and apply high 50% decrementals (double Metso’s gross margin) given a high share of staff (rebuilds) and in-house production (spares bought in, most of the wares produced in-house). Our FY15-16 EPS would be 3% and 5% lower should this scenario play out. The lower OE orders would drive a 2% downgrade, dropping through €100m at 30% decrementals. Thus total downgrade would be 5-7%.

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| Figure 3. Sensitivity Analysis – Minerals Services (Sharp Fall in Spend Exposed to Iron Ore) |
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| Source: Citi Research; Company Reports |

## Valuation and target price

The events for investors involved in Metso this year has been rather significant with the bids from Weir, the big 2Q beat (28% vs cons) and then the renewed earnings volatility with the relatively big 3Q miss (10% vs cons). The latter miss however explained by timing of Metso’s revenue recognition in our view, with Metso a much more stable business following the demerger from Valmet (share of projects have halved to 20% of sales). The new strategy is also focusing on continued cost pruning and increased scalability (SGA/GM/utilizing global footprint/product renewal) and increased cross selling (in Flow Control), to make Metso a higher returning business. The stock was up 45% from the lows in January to the peak in August and is down 21% since or 19% vs SXNP. Metso now sits at a FY15 9.7x EV/EBITA multiple vs the sector at 10.7x, a 92 relative vs 107 at the share price peak. We retain Neutral given continued downside risk to earnings and no top-line momentum seen in 2015, but believe the market is too pessimistic on Metso’s earnings outlook. FY14-15 EPS falls 13% and 15%, on lower volumes and margins in Minerals. Our TP falls to EUR27.40 from EUR32 and is based on a blend of four valuation methods: EV/Sales, EV/EBITA, normalized EPS and DCF (see Figure 8 for more detail). We have changed from a DCF and PE relative approach to fit the valuation methodology in line with the rest of our Machinery coverage.

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| Figure 4. Metso Shares Have Outperformed SXNP by 12% YTD… |  | Figure 5. …. Sharp Underperformance Last Three Months |
|  |  |  |
| Source: Citi Research; Datastream |  | Source: Citi Research; Datastream |

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| Figure 6. Metso Valuation History |
| |  |  |  |  |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | |  | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014E | 2015E | 2016E | | EV/Sales | 1.44 | 1.66 | 1.12 | 0.83 | 1.33 | 1.25 | 1.03 | 1.07 | 1.23 | 1.23 | 1.16 | | EV/EBITA clean | 10.9 | 12.1 | 7.8 | 8.2 | 12.3 | 11.6 | 9.1 | 8.4 | 10.0 | 9.7 | 8.5 | | EV/EBITA | 10.9 | 12.1 | 7.8 | 10.5 | 11.9 | 11.7 | 9.3 | 9.4 | 11.5 | 9.7 | 8.5 | | EV/EBIT | 11.6 | 13.8 | 8.4 | 12.6 | 9.0 | 13.5 | 9.7 | 9.8 | 12.1 | 10.1 | 8.8 | | EV/CE | 1.9 | 2.3 | 1.5 | 0.9 | 1.6 | 1.6 | 1.6 | 2.3 | 2.4 | 2.3 | 2.2 | | PE clean | 15.3 | 15.1 | 8.6 | 9.6 | 11.2 | 15.8 | 13.5 | 13.0 | 15.7 | 14.5 | 12.6 | | PE reported | 11.4 | 24.4 | 12.0 | 35.0 | 13.7 | 32.3 | 13.8 | 12.8 | 18.7 | 14.5 | 12.6 | | FCF yield | 13.9% | 10.5% | 12.5% | 61.1% | 20.5% | 13.0% | 14.5% | 15.7% | 11.5% | 14.1% | 16.3% | | Dividend yield | 6.3% | 9.1% | 3.6% | 6.1% | 6.6% | 6.5% | 7.8% | 4.2% | 3.9% | 4.5% | 4.7% | | P/B | 2.3 | 2.9 | 1.9 | 0.9 | 1.7 | 1.9 | 1.6 | 3.0 | 3.1 | 2.8 | 2.6 | |
| Source: Citi Research; Company Reports, Datastream |

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| Figure 7. Metso - Citi Valuation Framework |
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| Source: Citi Research; Company Reports, Bloomberg |

## Financials

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| Figure 8. Metso – Income Statement (Figures in EURm, except for EPS) |
| |  |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | --- | |  | 2009 | 2010 | 2011 | 2012 | 2013 | 2014E | 2015E | 2016E | | **Sales** | **5,016** | **5,552** | **6,646** | **7,504** | **3,858** | **3,598** | **3,564** | **3,723** | | Cost of goods sold | -3,808 | -4,130 | -4,978 | -5,703 | -2,707 | -2,519 | -2,442 | -2,522 | | **Gross profit** | **1,208** | **1,422** | **1,668** | **1,801** | **1,151** | **1,079** | **1,123** | **1,201** | | SG&A | -938 | -1,028 | -1,107 | -1,187 | -703 | -666 | -642 | -652 | | Other operating expenses | 24 | 51 | 11 | -156 | -25 | -46 | -46 | -60 | | **EBIT** | **294** | **445** | **383** | **458** | **423** | **367** | **435** | **490** | | Net financials | -72 | -75 | -65 | -49 | -54 | -64 | -45 | -40 | | **PTP** | **222** | **370** | **318** | **410** | **369** | **303** | **390** | **450** | | Tax | -71 | -112 | -149 | -178 | -131 | -98 | -127 | -146 | | *tax rate %* | *32.0%* | *30.3%* | *46.9%* | *43.4%* | *35.5%* | *32.5%* | *32.5%* | *32.5%* | | **Net income** | **150** | **257** | **167** | **231** | **278** | **204** | **263** | **304** | |  |  |  |  |  |  |  |  |  | | **% sales** |  |  |  |  |  |  |  |  | | Gross margin | 24.1% | 25.6% | 25.1% | 24.0% | 29.8% | 30.0% | 31.5% | 32.3% | | EBIT margin | 5.9% | 8.0% | 5.8% | 6.1% | 11.0% | 10.2% | 12.2% | 13.2% | | PTP margin | 4.4% | 6.7% | 4.8% | 5.5% | 9.6% | 8.4% | 10.9% | 12.1% | | Net margin | 3.0% | 4.6% | 2.5% | 3.1% | 7.2% | 5.7% | 7.4% | 8.2% | | SG&A | 18.7% | 18.5% | 16.7% | 15.8% | 18.2% | 18.5% | 18.0% | 17.5% | |  |  |  |  |  |  |  |  |  | | **Clean values:** |  |  |  |  |  |  |  |  | | Clean EBITA | 293 | 328 | 398 | 486 | 496 | 443 | 453 | 509 | | Clean EBIT | 255 | 270 | 346 | 468 | 477 | 425 | 435 | 490 | | Clean EPS | 1.19 | 2.09 | 1.66 | 1.75 | 1.82 | 1.62 | 1.76 | 2.02 | |
| Source: Citi Research; Company Reports |

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| Figure 9. Metso – Divisional Summary (Figures in EURm) |
| |  |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | --- | |  | 2009 | 2010 | 2011 | 2012 | 2013 | 2014E | 2015E | 2016E | | **Orders** |  |  |  |  |  |  |  |  | | Minerals | 1,690 | 2,538 | 3,595 | 3,303 | 2,745 | 2,385 | 2,466 | 2,561 | | Flow Control | 662 | 799 | 941 | 979 | 1,012 | 1,030 | 1,063 | 1,111 | | Others | -44 | -56 | -70 | -67 | -48 | -6 | -6 | -6 | | **Group** | **2,308** | **3,281** | **4,466** | **4,215** | **3,709** | **3,408** | **3,523** | **3,666** | |  |  |  |  |  |  |  |  |  | | **Sales** |  |  |  |  |  |  |  |  | | Minerals | 2,176 | 2,325 | 2,851 | 3,359 | 2,955 | 2,612 | 2,528 | 2,629 | | Flow Control | 766 | 745 | 886 | 993 | 969 | 996 | 1,046 | 1,104 | | Others | -40 | -51 | -65 | -70 | -66 | -10 | -10 | -10 | | **Group** | **2,902** | **3,019** | **3,672** | **4,282** | **3,858** | **3,598** | **3,564** | **3,723** | |  |  |  |  |  |  |  |  |  | | **Clean EBITA** |  |  |  |  |  |  |  |  | | Minerals | 211 | 271 | 324 | 420 | 383 | 319 | 314 | 358 | | Flow Control | 94 | 72 | 104 | 101 | 134 | 149 | 159 | 170 | | Others | -12 | -16 | -30 | -35 | -21 | -25 | -20 | -20 | | **Group** | **293** | **328** | **398** | **486** | **496** | **443** | **453** | **509** | |  |  |  |  |  |  |  |  |  | | **Clean EBITA Margin (%)** |  |  |  |  |  |  |  |  | | Minerals | 9.7% | 11.7% | 11.4% | 12.5% | 13.0% | 12.2% | 12.4% | 13.6% | | Flow Control | 12.2% | 9.7% | 11.7% | 10.2% | 13.8% | 15.0% | 15.2% | 15.4% | | **Group** | **10.1%** | **10.9%** | **10.8%** | **11.3%** | **12.8%** | **12.3%** | **12.7%** | **13.7%** | |
| Source: Citi Research; Company Reports |

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| --- |
| Figure 10. Metso - Cash flow (Figures in EURm) |
| |  |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | --- | |  | **2009** | **2010** | **2011** | **2012** | **2013** | **2014E** | **2015E** | **2016E** | | Net Income | 150 | 257 | 167 | 231 | 238 | 204 | 263 | 304 | | D&A | 143 | 178 | 172 | 166 | 71 | 71 | 71 | 71 | | Change in WC | 518 | 25 | -123 | -176 | 52 | -90 | -70 | -50 | | Other Items | -41 | 46 | 61 | -3 | -45 | 0 | 0 | 0 | | **Operating Cash Flow** | **770** | **506** | **277** | **218** | **316** | **185** | **264** | **325** | | Net capex | -108 | -127 | -154 | -146 | -90 | -72 | -71 | -74 | | **Free Cash Flow** | **662** | **379** | **123** | **72** | **226** | **113** | **193** | **250** | | Acquisitions/disposals | 1 | -13 | -15 | -5 | -56 | 0 | 0 | 0 | | Other investing items | -220 | -177 | 224 | -53 | 64 | 0 | 0 | 0 | | **Investing Activities** | **-327** | **-317** | **55** | **-204** | **-82** | **-72** | **-71** | **-74** | |  |  |  |  |  |  |  |  |  | | Proceeds from share issues | -2 | -7 | 0 | 0 | 0 | 0 | 0 | 0 | | Other financial items | 53 | -227 | -355 | 267 | 25 | 0 | 0 | 0 | | Dividends paid | -99 | -105 | -232 | -254 | -277 | -150 | -150 | -172 | | **Financing Activities** | **-48** | **-339** | **-587** | **13** | **-252** | **-150** | **-150** | **-172** | |  |  |  |  |  |  |  |  |  | | **Inc (+)/dec(-) in cash** | **395** | **-150** | **-255** | **27** | **-18** | **-37** | **43** | **78** | |  |  |  |  |  |  |  |  |  | | **Cash, beg of period** | **314** | **727** | **610** | **590** | **731** | **467** | **430** | **474** | | Exchange-rate differences | 18 | 33 | -1 | -18 | -35 | 0 | 0 | 0 | | Others | 0 | 0 | 0 | 0 | -211 | 0 | 0 | 0 | | **Cash, end of period** | **727** | **610** | **354** | **599** | **467** | **430** | **474** | **552** | |
| Source: Citi Research; Company Reports |

|  |
| --- |
| Figure 11. Metso - Balance sheet (Figures in EURm) |
| |  |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | --- | |  |  |  |  |  |  |  |  |  | |  | **2009** | **2010** | **2011** | **2012** | **2013** | **2014E** | **2015E** | **2016E** | | **Fixed assets** | **2,416** | **2,426** | **2,254** | **2,223** | **1,173** | **1,174** | **1,174** | **1,177** | | Intangibles assets | 1,175 | 1,167 | 1,155 | 1,140 | 569 | 551 | 533 | 514 | | Tangible assets | 819 | 849 | 854 | 833 | 376 | 395 | 413 | 435 | | Financial Assets | 422 | 410 | 245 | 250 | 228 | 228 | 228 | 228 | |  |  |  |  |  |  |  |  |  | | **Current assets** | **2,572** | **3,161** | **3,774** | **3,688** | **2,038** | **2,128** | **2,198** | **2,248** | | Inventories | 1,172 | 1,305 | 1,677 | 1,529 | 921 | 1,011 | 1,081 | 1,131 | | Trade debtors | 959 | 1,297 | 1,564 | 1,478 | 877 | 877 | 877 | 877 | | Other current assets | 441 | 559 | 533 | 681 | 240 | 240 | 240 | 240 | |  |  |  |  |  |  |  |  |  | | **Cash & securities** | **727** | **645** | **590** | **731** | **467** | **430** | **474** | **552** | |  |  |  |  |  |  |  |  |  | | **Total assets** | **5,715** | **6,232** | **6,618** | **6,642** | **3,678** | **3,732** | **3,846** | **3,977** | |  |  |  |  |  |  |  |  |  | | Gross debt | 1,455 | 1,044 | 889 | 1,212 | 892 | 892 | 892 | 892 | |  |  |  |  |  |  |  |  |  | | **Current liabilities** | **2,213** | **2,863** | **3,302** | **2,908** | **1,482** | **1,482** | **1,482** | **1,482** | | Trade creditors | 1,347 | 1,673 | 1,837 | 1,635 | 824 | 824 | 824 | 824 | | Current provisions | 330 | 299 | 597 | 567 | 140 | 140 | 140 | 140 | | Other current liabilities (ex-debt) | 536 | 891 | 868 | 706 | 518 | 518 | 518 | 518 | |  |  |  |  |  |  |  |  |  | | **Provisions** | **246** | **245** | **278** | **279** | **110** | **110** | **110** | **110** | | Post-employment benefits | 190 | 195 | 238 | 245 | 96 | 96 | 96 | 96 | | Tax provisions | 56 | 50 | 40 | 34 | 14 | 14 | 14 | 14 | |  |  |  |  |  |  |  |  |  | | Other non-current liabilities | 9 | 9 | 13 | 16 | 13 | 13 | 13 | 13 | |  |  |  |  |  |  |  |  |  | | **Net Equity** | **1,792** | **2,071** | **2,136** | **2,227** | **1,181** | **1,235** | **1,349** | **1,480** | | Ordinary Shareholders Funds | 1,783 | 2,049 | 2,115 | 2,207 | 1,173 | 1,227 | 1,341 | 1,472 | | Minorities | 9 | 22 | 21 | 20 | 8 | 8 | 8 | 8 | |  |  |  |  |  |  |  |  |  | | **Total Equity and Liabilities** | **5,715** | **6,232** | **6,618** | **6,642** | **3,678** | **3,732** | **3,846** | **3,977** | |
| Source: Citi Research; Company Reports |

# Metso Oyj

## Company description

Metso Corporation is a global supplier of machinery, systems and aftermarket services for mining, construction and oil & gas. Divisions include Mining and Construction; Automation.

## Investment strategy

Metso shares are down 21% from the high in August, 6% driven by downgrades and a 15% de-rating; Metso now at a FY15 EV/EBITA rel of 92 vs 107 at the share price peak. Investor concerns seem centered around the sharp fall in the iron ore and oil price, where: 1) Metso has the biggest exposure to iron ore among its Mining equipment peers, and 2) where orders in O&G have grown at a very fast clip on the back of mainly downstream investments (unconventional/shale). Our Stress test on investor concerns reveals that a “doomsday” scenario in iron ore OE & services would “only” drive a 6% downgrade to consensus FY15 EPS and Metso’s pure Flow Control exposure makes the business defensive against any oil price falls (increased intensity of shale well completions + strategic gas investments in China + downstream investments in ME to support continued order growth). We retain Neutral given continued downside risk to earnings and no top-line momentum in 2015, but believe the market is too pessimistic on Metso’s earnings outlook.

## Valuation

Our TP falls to EUR 27.40 from EUR 32 and is based on a blend of four valuation methods: EV/Sales, EV/EBITA, normalized EPS and DCF. We have changed from a DCF and PE relative approach to fit the valuation methodology in line with the rest of our Machinery coverage

## Risks

Stock-specific risks to our target price include the fact that the high level of demand cyclicality in supplying capital equipment to the mining and aggregates industries has historically made for volatile sales, earnings and cash flows for Metso. Metso may outperform should orders in Mining division surprise to the upside or margins for the group increase by more than expected on the back of cost savings program. Post completion, the demerger creates the potential for M&A at some point over the next 12 months.

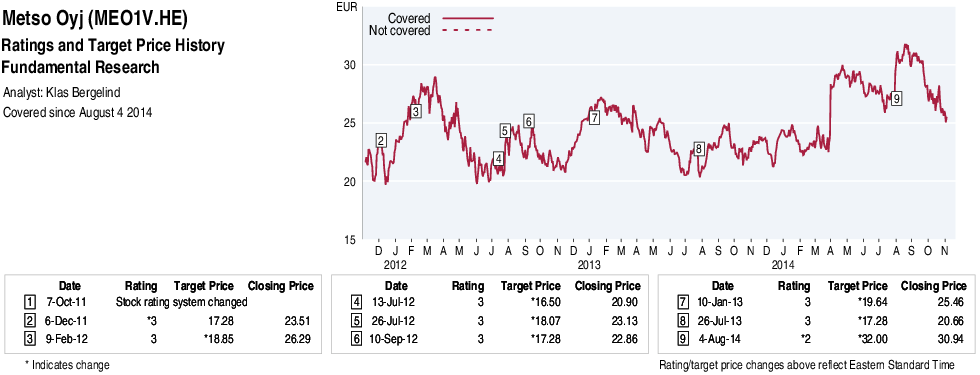
If the impact of these risk factors is more or less negative than we anticipate, then the share price could deviate significantly from our target price.

Appendix A-1

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Metso Oyj (MEO1V.HE)

Ratings and Target Price History - Fundamental Research

Analyst: Klas Bergelind - Covered since August 4 2014

------------------------------------------

Target Closing

Price Price

Date Rating (EUR) (EUR)

------------------------------------------

7 Oct 11 Stock rating system changed

6 Dec 11 \*3 17.28 23.51

9 Feb 12 3 \*18.85 26.29

13 Jul 12 3 \*16.50 20.90

26 Jul 12 3 \*18.07 23.13

10 Sep 12 3 \*17.28 22.86

10 Jan 13 3 \*19.64 25.46

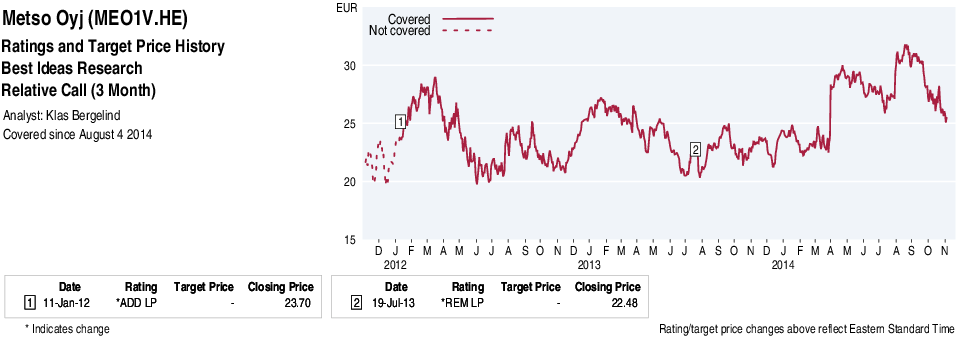
26 Jul 13 3 \*17.28 20.66

4 Aug 14 \*2 \*32.00 30.94

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\* Indicates change

Rating/target price changes above reflect Eastern Standard Time



Metso Oyj (MEO1V.HE)

Ratings and Target Price History - Best Ideas Research

Relative Call (3 Month)

Analyst: Klas Bergelind - Covered since August 4 2014

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Target Closing

Price Price

Date Rating (EUR) (EUR)

------------------------------------------

11 Jan 12 \*ADD LP - 23.70

19 Jul 13 \*REM LP - 22.48

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\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
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|  | 12 Month Rating | | | Relative Rating | | |
| Data current as of 30 Sep 2014 | Buy | Hold | Sell | Buy | Hold | Sell |
| Citi Research Global Fundamental Coverage | 48% | 40% | 12% | 0% | 100% | 0% |
| % of companies in each rating category that are investment banking clients | 66% | 63% | 56% | 0% | 64% | 0% |

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