“Sulzer proved resilient in a challenging market environment”

Interview with Peter Löscher, Chairman of the Board of Directors, and Greg Poux-Guillaume, Chief Executive Officer

Sulzer looks back on a rich history of more than 180 years. What, in your opinion, does the Sulzer brand stand for today?

PETER LÖSCHER | Sulzer has a distinguished industrial history. Throughout its 183 years of existence, the company has experienced significant changes. And what I find particularly impressive: whenever Sulzer has faced a market challenge, the company has been able to reinvent itself and emerge from that phase stronger than before.

GREG POUX-GUILLAUME | Our brand is very strong. It is a symbol for engineering expertise, high-quality products and solutions, and it stands for innovation. Our people are true experts in their fields and are passionate about what they do. We set ourselves the highest standards in terms of quality. Being a reliable, fast, and trusted partner for our customers is our top priority.

Mr. Poux-Guillaume, you have been CEO for more than a year. Can you draw a conclusion? What was your highlight in 2016?

GPG | 2016 was certainly a year of transformation for us. Sulzer is a great company with high-quality products and services and talented people. I am very proud to be a part of this company and of this management team. Our primary goal is to make Sulzer a sustainable leader in its segments, and we have made good progress towards that.

However, it has also been a tough year. The market environment remains very challenging in oil and gas, which is half of our business. We had to take some difficult but necessary measures to downsize and reposition the company. Looking back at 2016, it was great for me to see that Sulzer remained resilient in a complex market environment with a lot of headwinds. I believe in the future of Sulzer, and I am excited to lead the team shaping it.

Sulzer’s service offering is growing. How important is the service business for you?

GPG | Our service share has steadily increased over the last few years. We currently generate roughly 50% of our sales in the aftermarket. The service and spare parts business is more resilient in the current market environment, and it tends to have higher margins than the new equipment business. So, yes, service is very important to us and takes a significant position in our strategic thoughts.

PL | The service business is becoming increasingly competitive as new equipment volumes wane. Traditional manufacturing companies are realizing the immense value of aftermarket services such as maintenance and repairs or long-term service agreements, for instance. And customers are looking for the full package—service partners who are fast, reliable, offer competitive prices, and have the ability to innovate. Sulzer has all that and more.

How was Sulzer’s performance in 2016? Did you reach your targets?

GPG | We did well in a very challenging year. Our order intake decreased to CHF 2.8 billion—a 2% drop due to headwinds from the oil and gas market. Still, Sulzer maintained or even gained market share. Our sales were also down by 2% to CHF 2.9 billion but the comprehensive Sulzer Full Potential (SFP) measures allowed us to save another CHF 88 million. Thus, we were able to mitigate most of the pricing and volume erosion, which lead to an operational profitability that is down by only 30 basis points. We delivered a strong free cash flow above last year’s level in a market where customers had less money and stretched out their payment terms. Overall, we beat our guidance on all of the key performance indicators: we fulfilled our promises. There is still a lot to do, but we are heading in the right direction.

“Our aftermarket business is more resilient and tends to have higher margins than new equipment. Sulzer has significant development potential in the service business which is exciting.”

Greg Poux-Guillaume, CEO

PL I Despite these difficult circumstances, we were able to generate value for our shareholders. While our core net income per share was down, we demonstrated our strong cash generation ability despite considerable market headwinds. The Board of Directors is therefore pleased to propose an ordinary dividend that is on last year’s level of CHF 3.50 per share at the Annual General Meeting on April 6, 2017.

The oil and gas market continues to be very demanding for all market players. How do you see the development in this market in 2016?

GPG I Headwinds in the oil and gas market have persisted. The pricing environment continued to deteriorate in 2016 in this market and we do not expect this pressure to abate in 2017. Customers have cut their capital expenditures and operating costs, leading to significant overcapacity in the industry. This tends to make companies more aggressive in terms of pricing as they await the rebound in the cycle.

Towards the end of the year, OPEC decided to cut its oil output and triggered a number of non-OPEC nations to follow this decision. This prospect strengthened the rebound of oil prices to over USD 50, a good development for our industry. But we remain cautious and have not changed the course of our SFP plan. So far, oil production is still surpassing demand and we have not seen an impact on our commercial pipeline. The commercial rebound we are expecting is not just a question of absolute oil prices; it also hinges on the confidence of oil companies in a sustainable recovery of the market.

When do you expect a commercial recovery in the oil and gas market?

PL I As a supplier to the oil and gas industry, we are close to the end of the value chain. When international or national oil companies start investing again, this trend usually transforms into orders for Sulzer six to eight months later. Like many market participants, we expect that supply and demand will rebalance sometime in the second half of 2017. This means that the commercial rebound for Sulzer’s products and services is more likely to occur in 2018.

How did Sulzer perform in the other markets in 2016?

GPG I In terms of order intake in 2016, we grew in most of our other markets, including power and water. General industry, which encompasses everything else, was also healthy and boosted in part by the acquisitions we closed. Sulzer’s current struggles are oil-and-gas related and we should not lose sight of the fact that the other half of our business is performing well.

What is the status of the Sulzer Full Potential (SFP) program? What did you achieve in 2016?

GPG I Our objective with the SFP program is to save CHF 200 million on a 2018 run rate. Today, more than 90% of those savings have been secured through actions that we have already launched. We announced all significant restructuring measures in 2016. We saved CHF 88 million in 2016, and we expect another CHF 40 to 60 million of savings for 2017. So, SFP is progressing very well. We are ahead of schedule, and we will deliver the numbers we promised to deliver.

PL I We were an early mover in terms of taking out costs and optimizing our factory footprint. We have one of the most comprehensive transformation programs in the industry, and it is generating results, making Sulzer more efficient, agile, and competitive. As soon as volumes recover, this effect will become visible in our bottom line.

Sulzer acquired five businesses in 2016.

GPG I Yes, we have said that we are targeting small to midsize acquisitions at the right price, and we managed to execute on that plan.

Peter Löscher, Chairman of the Board of Directors, and Greg Poux-Guillaume, CEO, discussing the past year at Sulzer.

Greg Poux-Guillaume looks back on an exciting yet demanding year at Sulzer.

We more than doubled the size of our applicator business, leading us to carve it out of Chemtech and create a new division. In April, we took over PC Cox, a leading manufacturer of industrial dispensers. We then closed the acquisition of Geka in August. Through this, we diversified our applicator business into the beauty segment and gave it unrivalled industrial scale. Since January 1, 2017, these businesses have been part of our new Applicator Systems division, a leader in proprietary B2B mixing and applicator solutions.

We also grew on the pumps side. In December, we signed an agreement to acquire the pump manufacturer Ensival Moret. With this transaction, we managed to close specific product gaps in our pumps portfolio relating to axial flow pumps and slurry pumps, thereby bringing additional reach to our pumps business in the general industry segments. We also expanded our turbo equipment service footprint by acquiring control of Rotec's gas turbine service business in Russia. This acquisition makes us a leading player in a promising energy market where localization is a must. Finally, we bought a product range from Wärtsilä to strengthen our upstream separation business in Chemtech.

What is your merger and acquisitions strategy?

PL I We target companies that fill gaps in our product portfolio and strengthen our presence in certain regions or segments. We concentrate on small and midsize acquisitions that can be integrated into our company quickly and where one plus one equals more than two.

GPG I Sulzer has an active and ongoing M&A pipeline, but it is all about value. I believe that our recent track record of deal execution will demonstrate that when we can get the right asset at the right price, we get things done. But we also know when to walk away.

How do you see your competitive landscape evolving and what does it mean for Sulzer?

PL I The flow control industry has all the markings of an industry that should consolidate. Being part of that through an industrial combination that creates significant value is always an option. But our main focus is on our transformation plan. The best value creation lever for our shareholders will remain the implementation of the SFP program. We have supportive, long-term shareholders and our focus is on what we can control.

You said that innovation is a key component of Sulzer's brand. How do you make sure it remains a priority during your transformation?

GPG I With the introduction of many new products in 2016, we have proven that innovation is and will remain a key pillar of our strategy and our culture. It is true that during a transformation, priorities need to be set. But we have not compromised on innovation, and we are celebrating that through the Sulzer Innovation Awards we launched recently. Once a year, we will celebrate outstanding Sulzer innovations and their inventors. Our company is bursting with talent and creativity; it is an inspiration to us all.

“We always strive for something more with our products and solutions. Being a reliable, fast, and trusted partner for our customers is our top priority.”

Peter Löscher, Chairman of the Board of Directors

The year 2016 brought many changes in the top management. Why?

GPG | There is certainly a market dimension to this. Four of our top five competitors in the pumps industry announced a CEO change in 2016. Market conditions change and companies adapt their leadership team to reflect that—much like in sports. In our case, we had a Division President retire and another take an extended leave of absence for family reasons. Our top Human Resources position had also been vacant for six months. And we did not have a Chief Commercial and Marketing Officer. That was a weakness in a challenging commercial environment where Sulzer had to learn to work better as a team. All of this came to a head at the same time and gave us the opportunity to not only strengthen the team but also diversify our talent pool. We believe that we now have the stable, dynamic management team that will take Sulzer to the next level.

PL | The Board of Directors was very pleased to welcome two new members: Axel C. Heitmann and Mikhail Lifshitz. Both have rich experience from their activities as board members and leaders of international companies. They had to step into the large shoes of Klaus Sturany, who did not stand for reelection. And the Board is convinced that with Greg and his team, Sulzer has the right leadership.

Looking ahead, what do you expect for 2017 in terms of financial performance?

GPG | It will be a transition year. We will reach the end of our cost-cutting measures in 2017—before the market rebound we expect for 2018. So, we are expecting a challenging year during which we will work hard to maintain volumes and to protect our profitability while we complete our transformation. But it is all about execution, and 2016 gives us solid reasons to believe that Sulzer can and will execute.

Mr. Löscher, what is your vision for Sulzer?

PL | Sulzer will be an employer of choice for the best talent and a preferred partner to our customers. We are creating an agile organization that can adapt quickly to changing market conditions. And we will grow profitably. I am convinced that Sulzer’s strong brand, its passionate employees, and its extraordinary products and solutions are the key ingredients to overcoming these challenging times. We are well on the way to achieving our goals, and we will continue to follow this path with all our energy.

Peter Löscher wants to make Sulzer an employer of choice for the best talent.