Nokia Corporation Financial Report for Q2 and Half Year 2020

Nokia Corporation
Half year report
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Continued improved execution drives strong margin and cash performance

- Strong margin expansion, primarily driven by Mobile Access
- Clear roadmap progress, particularly related to our 5G mid-band portfolio
- Confidence in resilient customer base and strong liquidity position
- 11% decrease in net sales, largely driven by COVID-19 and China
- Strong growth in Nokia Enterprise
- Positive operating profit, on a reported basis, in both Q2 and half year 2020
- Within previously provided Outlook ranges for full year 2020, adjusted the non-IFRS mid-points for EPS to EUR 0.25 and operating margin to 9.5%
- Delivered strong free cash flow year-to-date and raised 2020 recurring free cash flow guidance to be clearly positive

This is a summary of the Nokia Corporation financial report for Q2 and half year 2020 published today. The complete financial report for Q2 and half year 2020 with tables is available at www.nokia.com/financials. Investors should not rely on summaries of our financial reports only, but should review the complete financial reports with tables.

RAJEEV SURI, PRESIDENT AND CEO, ON Q2 2020 RESULTS

Nokia delivered a strong improvement in Q2, with better-than-expected profitability, significant improvement in cash generation, clear indications of a return to strength in mobile radio, and a year-on-year increase in earnings-per-share, despite the challenges of COVID-19. These results show that our execution has improved as planned and that we are well positioned to end the year with a significantly stronger financial position. As a result, we are adjusting upward both the midpoint of our full-year 2020 non-IFRS EPS and operating margin guidance within our previously disclosed outlook ranges.

Profitability gains in the quarter were supported by a 4.5 percentage point year-on-year improvement in Networks gross margin, building on a 3.5 percentage point gain in the first quarter, and driving Nokia non-IFRS gross margin to 39.6%. Nokia Enterprise also grew year-on-year constant currency sales by 18% compared to one year ago and expanded margins.

Nokia-level revenue was down in the quarter, with the majority of that the result of COVID-19 as well as a sharp decline in China based on the prudent approach we have taken in that market. We also saw a reduction driven by our proactive steps to reduce the volume of low margin services business. We expect that the majority of sales missed in the quarter due to COVID-19 will shift to future periods.

At the start of the year, we said we would have a sharp focus on our Mobile Access business and improving cash generation. In both areas we continue to make good progress. Free cash flow in the quarter was positive €265 million, versus negative €1.0 billion one year ago, and Nokia ended Q2 with €1.6 billion of net cash, and €7.5 billion in total cash. Given our strong first-half improvement, we now expect free cash flow for full-year 2020 to be “clearly positive” compared to our earlier guidance of “positive”.

In Mobile Access, we saw healthy improvements in our radio portfolio, where roadmaps are strengthening, costs are coming down, and product performance is rising. We have a particularly powerful portfolio in mid-band mobile radio, with proven products deployed with 55 customers, and the first live C-Band network demonstrated in the U.S. during the quarter. Pleasingly, our “5G Powered by ReefShark” shipments continue to increase and we believe we remain on track to reach 35% or better by year end. And, we now have 83 5G deals.

Our continued momentum was demonstrated by the progress we announced after the quarter ended. These included the availability of a software upgrade that allows millions of Nokia 4G/LTE radios deployed to more than 350 customers to be migrated seamlessly to 5G; and plans to accelerate leadership in Open RAN. Nokia is the only global supplier fully committed to O-RAN with commercial 5G Cloud-RAN networks. We also announced an expansion of our IP routing business into the data center market and highlighted that Apple was deploying our technology at its data centers.

This is my last quarterly announcement as CEO of Nokia and I want to close with a note of thanks: thanks to our shareholders, thanks to our customers, thanks to our many other stakeholders, and a particular thanks to the great employees of Nokia. You have constantly made me proud and I expect that you will continue to do so in the many years to come. Thank you all. It has been a pleasure and an honor.

NOKIA FINANCIAL RESULTS

EUR million (except for EPS in EUR)	Net sales	Networks	Nokia Software	Nokia Technologies
Q2'20	**5 092**	**3 955**	**597**	**341**
Q2'19	5 694	4 393	678	383
YoY change	(11)%	(10)%	(12)%	(11)%
Constant currency YoY change	*(11)%*	*(10)%*	*(12)%*	*(11)%*

Q1-Q2'20	**10 005**	**7 713**	**1 210**	**689**
Q1-Q2'19	10 726	8 336	1 221	753
YoY change	(7)%	(7)%	(1)%	(8)%
Constant currency YoY change	*(7)%*	*(8)%*	*(1)%*	*(9)%*

- Both non-IFRS and reported net sales in Q2 2020 were EUR 5.1bn, compared to EUR 5.7bn in Q2 2019. On a constant currency basis, both non-IFRS and reported net sales decreased 11%. Excluding one-time licensing net sales in Q2 2020 and Q2 2019, net sales decreased 10% on both a non-IFRS and reported basis.
- Q2 2020 net sales were impacted by COVID-19 and unique dynamics in China. In Q2 2020, we estimate that COVID-19 had an approximately EUR 300 million negative net impact on our net sales; with the majority of these net sales expected to be shifted to future periods, rather than being lost.
- In Q2 2020, Nokia's gross and operating margin both expanded year-on-year, primarily driven by broad based strength in Networks, particularly in Mobile Access, with IP Routing and Fixed Access also contributing positively. In addition, reported operating margin benefitted significantly from lower amortization of acquired intangible assets, as well as lower restructuring and associated charges. Non-IFRS gross margin was 39.6% (reported 39.4%) and non-IFRS operating margin was 8.3% (reported 3.3%).
- Non-IFRS diluted EPS in Q2 2020 was EUR 0.06, compared to EUR 0.05 in Q2 2019, primarily driven by higher gross profit in Mobile Access within Networks, continued progress related to our cost savings program and a net positive fluctuation in financial income and expenses. This was partially offset by higher investments in 5G R&D to accelerate our product roadmaps and cost competitiveness in Mobile Access and a net negative fluctuation in Nokia's venture fund investments.
- Reported diluted EPS in the first six months of 2020 was EUR 0.00, compared to negative EUR 0.11 in the first six months of 2019. The change was primarily driven by lower amortization of acquired intangible assets, lower restructuring and associated charges, continued progress related to our cost savings program, a net positive fluctuation in financial income and expenses and higher gross profit, partially offset by higher investments in 5G R&D to accelerate our product roadmaps and cost competitiveness in Mobile Access and a net negative fluctuation in Nokia's venture fund investments.
- Q2 2020 was the fourth quarter in a row of solid cash performance. Since establishing a program in 2019 to focus on free cash flow, we have made great progress driving sustainable operational improvements, particularly in net working capital management. During Q2 2020, net cash increased by approximately EUR 0.2 billion, resulting in an end-of-quarter net cash balance of approximately EUR 1.6 billion. During Q2 2020, total cash increased by approximately EUR 1.2 billion, primarily driven by the successful issuance of EUR 1.0 billion of debt, resulting in an end-of-quarter total cash balance of approximately EUR 7.5 billion.

COVID-19

The COVID-19 crisis has made vividly clear the critical importance of connectivity to keep society functioning. We believe we have a resilient customer base, and we feel a sense of duty to our customers and the communities they serve.

We believe the impact of COVID-19 on Nokia's financial performance and financial position was primarily related to a net sales impact of approximately EUR 500 million in the first half of 2020, with the majority of these net sales expected to be shifted to future periods, rather than being lost. In Q1 2020, the estimated COVID-19 impact was approximately EUR 200 million, and related primarily to supply chain disruptions. In Q2 2020, the estimated COVID-19 net impact was approximately EUR 300 million, composed of a negative impact of approximately EUR 400 million related to delivery and implementation challenges, partially offset by a positive impact of approximately EUR 100 million related to capturing a part of the negative net sales impact from Q1 2020. To a much lesser extent, COVID-19 also affected our operational costs (for example, lower travel), capital expenditures (temporary delays), cash outflows related to taxes (tax relief), and net working capital (for example, lower inventories due to temporary disruptions).

In addition, and in accordance with our prudent management of our capital structure, we took further proactive steps to strengthen our liquidity position by raising EUR 1.0 billion of debt in Q2 2020, on a net basis. As a result, we ended Q2 2020 with approximately EUR 7.5 billion of total cash.

Potential risks and uncertainties continue to exist related to the scope and duration of the COVID-19 impact and the pace and shape of the economic recovery following the pandemic.

During the COVID-19 pandemic, we have continued to advance our 5G roadmap and product evolution, as planned, and our COVID-19 mitigation actions in R&D have been very successful. We believe we remain on track with our plans to drive progressive improvement over the course of 2020.

Health and safety

Naturally, Nokia's first focus during the COVID-19 crisis is to our employees. We have in place strict protocols for Nokia facilities and provided clear advice to our employees about how they can mitigate the risks of COVID-19 in situations where they have to go about critical work.

We took already early on a range of steps, including banning international travel for Nokia employees, except for strictly-defined 'critical' reasons; closing all our facilities to all visitors, with the exception of people engaged in essential maintenance and services, and asking our staff to work from home wherever possible. We started implementing these measures in some regions in January already and have updated guidance as the situation has developed.

As the overwhelming majority of Nokia employees continue working remotely, we are providing guidance on how staff can maintain a healthy work-life balance and look after their physical and mental well-being.

Supporting the essential services our customers provide

The products and services that we provide have never been more critical in enabling the world to continue to function in an orderly way. We continue to work closely with all our customers, to ensure that the changing needs and requirements at this time are well understood and that we respond appropriately to them.

In Q2 2020, connectivity continued to bring together people isolated from each other by the COVID-19 pandemic. Remote working and schooling, robust delivery of basic services and smart deliveries are just some examples that have been enabled by connectivity solutions. We announced new deals that bring connectivity to the most rural areas of, for example, California and Ireland, making sure small businesses, farms and schools are connected.

Nokia has a global manufacturing footprint designed for optimized global supply, and to mitigate against risks such as local disruptive events, transportation capacity problems, and political risks. Our supply network consists of 25 factories around the globe and six hubs for customer fulfillment. As a result, we are not dependent on one location or entity. We have also established a global command center to manage the supply chain challenges arising from the outbreak; and we are ready to activate relevant business continuity plans should the situation in any part of our organization require this.

Impact on asset valuations

COVID-19 has affected the valuations of certain assets, including investments in non-publicly quoted assets through Nokia's venture fund investments and pension plans, the valuation of which is inherently challenging in fast-moving market conditions (for details, please refer to note 5, "Pensions and other post-employment benefits" and note 8, "Fair value of financial instruments" in the "Financial statement information" section included in Nokia Corporation interim report for Q2 and Half Year 2020).

In relation to its financial statements as of June 30, 2020, Nokia has considered also the indicators of impairment of goodwill and other intangible assets, recoverability of deferred tax assets, valuation of inventories, and collectability of trade receivables and contract assets. Based on these assessments, COVID-19 is currently not expected to have such long-term effects on Nokia's financial performance that it would require adjustments to the carrying amounts of goodwill and other intangible assets or deferred tax assets. Also, Nokia has not identified any significant increase in the amount of bad debt or need to adjust the valuation of inventories.

Doing our part to fight the pandemic

We also feel another sense of duty – to the societies where Nokia operates. As a global company, we have a duty to be part of the global fight against this pandemic. Therefore, Nokia has launched a Coronavirus Global Donation Fund.

In Q2 2020, we engaged with local organizations such as hospitals, community groups and NGOs in nearly 50 countries, helping them fight the pandemic and mitigate its impacts.

These actions demonstrate our strong commitment to supporting global efforts to end the pandemic and overcoming the disruption and challenges we currently face.

OUTLOOK

Full Year 2020

Non-IFRS diluted earnings per share	Non-IFRS operating margin
EUR 0.25 (adjusted from EUR 0.23) plus or minus 5 cents	9.5% (adjusted from 9.0%) plus or minus

Long term (3 to 5 years)

Non-IFRS operating margin	Annual distribution to shareholders
12 – 14%	An earnings-based growing dividend of approximately 40% to 70% of n

[1] Free cash flow = net cash from/(used in) operating activities - capital expenditures + proceeds from sale of property, plant and equipment and intangible assets – purchase of non-current financial investments + proceeds from sale of non-current financial investments.

KEY DRIVERS OF NOKIA'S OUTLOOK

Networks and Nokia Software are expected to be influenced by factors including:

- Our expectation that we will slightly underperform our primary addressable market, which is expected to be flattish on a constant currency basis in full year 2020, excluding China (This is an update to our earlier commentary to perform in-line with our primary addressable market, which is expected to decline on a constant currency basis in full year 2020, excluding China). Our updated expectation is primarily due to lower network deployment services within Mobile Access and a slightly improved market outlook, given the lower than expected market impact from COVID-19 in Q2 2020;
- Our expectation for operating profit seasonality in 2020 to be similar to 2019, with the majority of operating profit to be generated in the fourth quarter. Due to our strong free cash flow performance in the first six months of 2020, we no longer expect our free cash flow seasonality in 2020 to be similar to 2019. (This is an update to earlier commentary for both operating profit and free cash flow seasonality in 2020 to be similar to 2019);
- Potential risks and uncertainties related to the scope and duration of the COVID-19 impact and the pace and shape of the economic recovery following the pandemic;
- Competitive intensity, which is particularly impacting Mobile Access and is expected to continue at a high level in full year 2020, as some competitors seek to take share in the early stage of 5G;
- Our expectation that we will accelerate our product roadmaps and cost competitiveness through additional 5G investments in 2020, thereby enabling us to drive product cost reductions and maintain the necessary scale to be competitive;

- Our expectation that we will drive improvements in automation and productivity through additional digitalization investments in 2020;
- Customer demand could weaken and risk could increase further in India, after the country's Supreme Court upheld a ruling that telecoms companies must pay retroactive license and spectrum fees;
- Opportunities and risks in North America following the completion of a merger, and, more broadly, the potential for temporary capital expenditure constraints due to potential mergers or acquisitions by our customers;
- The timing of completions and acceptances of certain projects;
- Some customers are reassessing their vendors in light of security concerns, creating near-term pressure to invest in order to secure long-term benefits;
- Our expectation that we will improve our R&D productivity and reduce support function costs through the successful execution of our cost savings program, which is explained in more detail in the Cost savings program section of Nokia Corporation interim report for Q2 and half year 2020;
- Our product and regional mix, including the impact of the high cost level associated with our first generation 5G products; and
- Macroeconomic, industry and competitive dynamics.

Nokia Technologies is expected to be influenced by factors including:

- The timing and value of new and existing patent licensing agreements with smartphone vendors, automotive companies and consumer electronics companies;
- Results in brand and technology licensing;
- Costs to protect and enforce our intellectual property rights; and
- The regulatory landscape.

Additionally, our outlook is based on the following assumptions:

- Nokia's outlook for recurring free cash flow is expected to be supported by an improvement in net working capital performance and improved operational results, partially offset by a more substantial difference in 2020 between profit and free cash flow in Nokia Technologies;
- Non-IFRS financial income and expenses are expected to be an expense of approximately EUR 300 million in full year 2020 and over the longer-term. (This is an update to earlier commentary for an expense of EUR 350 million in full year 2020 and per annum over the longer-term). Our updated commentary is primarily due to our expectation for lower costs related to the sale of receivables and improved FX results;
- Non-IFRS income taxes are expected at a rate of approximately 26% in full year 2020 and approximately 25% over the longer-term, subject to the absolute level of profits, regional profit mix and changes to our operating model;
- Cash outflows related to income taxes are expected to be approximately EUR 400 million in full year 2020 and approximately EUR 450 million per annum over the longer term until our US or Finnish deferred tax assets are fully utilized (This is an update to earlier commentary for EUR 450 million in full year 2020.) C

updated commentary is primarily due to our expectation for lower cash taxes in 2020, driven by COVID-19-related tax relief; and

- Capital expenditures are expected to be approximately EUR 550 million in full year 2020 and approximately EUR 600 million per annum over the longer-term. (This is an update to earlier commentary for EUR 600 million in full year 2020.) Our updated commentary is primarily due to temporary delays related to COVID-19.

ANALYST CONFERENCE CALL

Nokia's analyst conference call will begin on July 31, 2020 at 3 p.m. Finnish time. A link to the webcast of the conference call will be available at www.nokia.com/financials. Media representatives can listen in via the link, or call +1-412-717-9224.

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About Nokia

We create the technology to connect the world. Only Nokia offers a comprehensive portfolio of network equipment, software, services and licensing opportunities across the globe. With our commitment to innovation, driven by the award-winning Nokia Bell Labs, we are a leader in the development and deployment of 5G networks.

Our communications service provider customers support more than 6.4 billion subscriptions with our radio networks, and our enterprise customers have deployed over 1,300 industrial networks worldwide. Adhering to the highest ethical standards, we transform how people live, work and communicate. For our latest updates, please visit us online www.nokia.com and follow us on Twitter @nokia.

RISKS AND FORWARD-LOOKING STATEMENTS

It should be noted that Nokia and its businesses are exposed to various risks and uncertainties and certain statements herein that are not historical facts are forward-looking statements. These forward-looking statements reflect Nokia's current expectations and views of future developments and include statements regarding: A) expectations, plans or benefits related to our strategies, growth management and operational key performance indicators; B) expectations, plans or benefits related to future performance of our businesses (including the expected impact and timing of that impact of COVID-19 on our businesses and our customers' businesses) and any expected future dividends including timing and qualitative and quantitative thresholds associated therewith; C) expectations and targets regarding financial performance, cash generation, results, the timing of receivables, operating expenses, taxes, currency exchange rates, hedging, cost savings, product cost reductions and competitiveness, as well as results of operations including target synergies, better commercial management and those results related to market share, prices, net sales, income and margins; D) expectations, plans or benefits related to changes in organizational and operational structure; E) expectations regarding competition within our market, market developments, general economic conditions and structural and legal change globally and in national and regional markets, such as China; F) our ability to integrate acquired businesses into our operations and achieve the targeted business plans and benefits, including targeted benefits, synergies, cost savings and efficiencies; G) expectations, plans or benefits related to any future collaboration or to business collaboration agreements or patent license agreements or arbitration awards, including income to be received under any collaboration or partnership, agreement or award; H) timing of the deliveries of our products and services, including our short term and longer term expectations around the rollout of 5G, investment requirements with such rollout, and our ability to capitalize on such rollout; as well as the overall readiness of the 5G ecosystem; I) expectations and targets regarding collaboration and partnering arrangements, joint ventures or the creation of joint ventures, and the related administrative, legal, regulatory and other conditions, as well as our expected customer reach; J) outcome of pending and threatened litigation, arbitration, disputes, regulatory proceedings or investigations by authorities; K) expectations regarding restructurings, investments, capital structure optimization efforts, uses of proceeds from transactions, acquisitions and divestments and our ability to achieve the financial and operational targets set in connection with any such restructurings, investments, capital structure optimization efforts, divestments and acquisitions, including our current cost savings program; L) expectations, plans or benefits related to future capital expenditures, reduction of support function costs, temporary incremental expenditures or other R&D expenditures to develop or rollout software and other new products, including 5G and increased digitalization; M) expectations regarding our customers' future actions, including our customers' capital expenditure constraints and our ability to satisfy customer's needs and retain their business; and N) statements preceded by or including "believe", "expect", "expectations", "consistent", "deliver", "maintain", "strengthen", "target", "estimate", "plan", "intend", "assumption", "focus", "continue", "should", "will" or similar expressions. These forward-looking statements are subject to a number of risks and uncertainties, many of which are beyond our control, which could cause our actual results to differ materially from such statements. These statements are based on management's best assumptions and beliefs in light of the information currently available to them. These forward-looking statements are only predictions based upon our current expectations and views of future events and developments and are subject to risks and uncertainties that are difficult to predict because they relate to events and depend on circumstances that will occur in the future. Factors, including risks and uncertainties that could cause these differences include, but are not limited to: 1) our strategy is subject to various risks and uncertainties and we may be unable to successfully implement our strategic plans, sustain or improve the operational and financial performance of our business groups, correctly identify or successfully pursue business opportunities or otherwise grow our business; 2) general economic and market conditions, general public health conditions (including its impact on our supply chains) and other developments in the economies where we operate, including the timeline for the deployment of 5G and our ability to successfully capitalize on that deployment ; 3) competition and our ability to effectively and profitably invest in existing and new high-quality products, services, upgrades and technologies and bring them to market in a timely manner; 4) our dependence on the development of the industries in which we operate, including the cyclicality and variability of the information technology and telecommunications industries and our own R&D capabilities and investments; 5) our dependence on a limited number of customers and large multi-year agreements, as well as external events impacting our customers including mergers and acquisitions and the possibility of our customers awarding business to our competitors; 6) our ability to maintain our existing sources of intellectual property-related revenue through our intellectual property, including through licensing, establishing new sources of revenue and protecting our intellectual property from infringement; 7) our ability to manage and improve our financial and operating performance, cost savings, competitiveness and synergies generally, expectations and timing around our ability to recognize any net sales and our ability to implement changes to our organizational and operational structure efficiently; 8) our global business and exposure to regulatory, political or other developments in various countries or regions, including emerging markets and the associated risks in relation to tax matters and exchange controls, among others; 9) our ability to achieve the anticipated benefits, synergies, cost savings and efficiencies of acquisitions; 10) exchange rate fluctuations, as well as hedging activities; 11) our ability to successfully realize the expectations, plans or benefits related to any future collaboration or business collaboration agreements and patent license agreements or arbitration awards, including income to be received under any collaboration, partnership, agreement or arbitration award; 12) Nokia Technologies' ability to protect its IPR and to maintain and establish new sources of patent, brand and technology licensing income and IPR-related revenues, particularly in the smartphone market, which may not materialize as planned, 13) our dependence on IPR technologies, including those that we have developed and those that are licensed to us, and the risk of associated IPR-related legal claims, licensing costs and restrictions on use; 14) our exposure to direct and indirect regulation, including economic or trade policies, and the reliability of our governance, internal controls and compliance processes to prevent regulatory penalties in our business or in our joint ventures; 15) our reliance on third-party solutions for data storage and service distribution, which expose us to risks relating to security, regulation and cybersecurity breaches; 16) inefficiencies, breaches, malfunctions or disruptions of information technology systems, or our customers' security concerns; 17) our exposure to various legal frameworks regulating corruption, fraud, trade policies, and other risk areas, and the possibility of proceedings or investigations that result in fines, penalties or sanctions; 18) adverse developments with respect to customer financing or extended payment terms we provide to customers; 19) the potential complex tax issues, tax disputes and tax obligations we may face in various jurisdictions, including the risk of obligations to pay additional taxes; 20) our actual or anticipated performance, among other factors, which could reduce our ability to utilize deferred tax assets; 21) our ability to retain, motivate, develop and recruit appropriately skilled employees; 22) disruptions to our manufacturing, service creation, delivery, logistics and supply chain processes, and the risks related to our geographically-concentrated production sites; 23) the impact of litigation, arbitration, agreement-related disputes or product liability allegations associated with our business; 24) our ability to re-establish investment grade rating or maintain our credit ratings; 25) our ability to achieve targeted benefits from, or successfully implement planned transactions, as well as the liabilities related thereto; 26) our involvement in joint ventures and jointly-managed companies; 27) the carrying amount of our goodwill may not be recoverable; 28) uncertainty related to the amount of dividends and equity return we are able to distribute to shareholders for each financial period; 29) pension costs, employee fund-related costs, and healthcare costs; 30) our ability to successfully complete and capitalize on our order backlogs and continue converting our sales pipeline into net sales; 31) risks related to undersea infrastructure; and 32) the impact of the COVID-19 virus on the global economy and financial markets as well as our customers, supply chain, product development, service delivery, other operations and our financial, tax, pension and other assets, as well as the risk factors specified in our 2019 annual report on Form 20-F published on March 5, 2020 under "Operating and financial review and prospects-Risk factors" as supplemented by the form 6-K published on April 30, 2020 under the header "Risk Factors" and in our other filings or documents furnished with the U.S. Securities and Exchange Commission. Other unknown or unpredictable factors or underlying assumptions subsequently proven to be incorrect could cause actual results to differ materially from those in the forward-looking statements. We do not undertake any obligation to publicly update or revise forward-looking statements, whether as a result of new information, future events or otherwise, except to the extent legally required.

Attachment

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