

THOMSON REUTERS

FINAL TRANSCRIPT

Q3 2017 Outokumpu Oyj Earnings Call

EVENT DATE/TIME: 10/26/2017 03:00 PM GMT



CORPORATE PARTICIPANTS

Christoph de la Camp *Outokumpu Oyj - CFO*

Roeland I. J. Baan *Outokumpu Oyj - CEO, President and President of Europe Business Area*

Tommi Jarvenpaa *Outokumpu Oyj - Head of Investor Relations*

CONFERENCE CALL PARTICIPANTS

Bastian Synagowitz *Deutsche Bank AG, Research Division - Research Analyst*

Carsten Riek *UBS Investment Bank, Research Division - Executive Director, Head of European Steel Research, and Equity Analyst, European Steel Research*

Cedar Ekblom *BofA Merrill Lynch, Research Division - Analyst*

Johannes Grunselius *Handelsbanken Capital Markets AB, Research Division - Research Analyst*

Luc Pez *Exane BNP Paribas, Research Division - Stock Analyst*

Michael Shillaker *Crédit Suisse AG, Research Division - MD and Head of Global Steel and European Miners*

Ola Soedermark *Kepler Cheuvreux, Research Division - Equity Research Analyst*

Philip Ngotho *ABN AMRO Bank N.V., Research Division - Analyst*

Seth Rosenfeld *Jefferies LLC, Research Division - Equity Analyst*

PRESENTATION

Operator

Good day, and welcome to the Outokumpu Third Quarter Earnings Conference Call. (Operator Instructions) At this time, I would like to turn the conference over to Tommi Jarvenpaa, head of Investor Relations, please go ahead.

Tommi Jarvenpaa *Outokumpu Oyj - Head of Investor Relations*

Thank you. Good afternoon and welcome to Outokumpu's Third Quarter 2017 Earnings Webcast. My name is Tommi Jarvenpaa, I'm the Head of Outokumpu's Investor Relations. With me here today are also our CEO, Roeland Baan, and our CFO, Chris de la Camp.

We will be referring to the presentation that can be found on our website. As always, please pay attention to the disclaimer on page 3 in the presentation, as we will be making forward-looking statements.

With these remarks, I am pleased to hand over to our CEO, Roeland. Please go ahead.

Roeland I. J. Baan *Outokumpu Oyj - CEO, President and President of Europe Business Area*

Thanks, Tommi, and good morning, good afternoon, thanks for joining us for this webcast.

I would like to comment on our Q3 results, and starting with as always, repeating our vision. And our vision, just to bring it back in mind, is to be the best value creator in stainless steel by 2020 through customer orientation and efficiency.

I have taken you through the elements often enough, I won't do it this time. The only thing that I would like to just point out, is one of our constituents that we look at as we say best value creator, is the group of our employees. And as you know, we have joined this OHI initiative, Organizational Health Index, to see where we are. We have just concluded the second time of the OHI survey, and in the CMD in a couple weeks' time, we will be able to feedback the initial results out of that survey so you get an idea on how we are progressing on the part of our organizational health.

With that, going to the numbers, the third quarter came out at EUR 56 million adjusted EBITDA, which was heavily influenced by the lower raw material prices. And let me start with the negative effects that impacted the numbers, and then get to the positive ones.

On the negative side, we had a very large influence from the timing of how our metal costs flow through the system, plus hedging loss, amounting to together, EUR 41 million. Again, this is all due to the timing of things. The hedging, for instance, as nickel went up, on our hedges we had to take the negative value of those, whereas the positive influence on our inventories and sales will flow only through once that material is being sold. So, it's just a shift in time, and nothing else, and the same goes for the metal timing lag that we talked about.



Another point which you were aware of, is that we had low ferrochrome production as planned, due to the maintenance that we did in the beginning of the quarter. The good thing is that we were on time in starting back up on the Ferrochrome 3 furnace, and we are running it ever since at full capacity, back to even higher levels as before let's say the initial maintenance that we did in 2016. Very stable, very satisfying.

And then, the Americas have been impacted strongly by a number of one-offs, ranging from the influence of the three hurricanes that had a big impact on availability and cost of scrap and other raw materials, as well as issues that we had from our biggest supplier of rerolled services, and we will go into more depth later on.

On the positive side, first of all, safety. We are reducing still further our total recordable rate. As you might recall, we had a recordable rate of 16 in 2015, got it down to 9 in '16, and now down to 4.8, so significant improvement and we can see that as well in how we are operating our plants.

The cost initiatives that we have started continue very successfully, are on track and in most cases, even ahead of schedule. And again, we will open it up further at the CMD, but there again we are hitting on all cylinders.

As a result, the European profitability, if you clean it for one-offs, significantly improved over 2016. The underlying market is still healthy. We see no let-up there, especially automotive in Europe and appliances in the U.S. are very strong segments. So, again, we don't see any negatives, neither now or on the horizon as far as market demand is concerned.

The one thing that I think are most pleased with is our performance on cash flow. As you know, we've come from a period of very poor balance sheets and the number one priority that we had in our vision was to bring back our net debt and strengthen our balance sheet. And, with the EUR 126 million of cash flow we had in the third quarter, we brought down our net debt further to EUR 1.13 billion, which is below our original end-of-year target of EUR 1.2 billion. We adjusted that, as you know, earlier this year and we are now within spitting distance of making that target. So, extremely pleased with the very strong financial position that the company is in.

If you look at some of the underlying things, base prices in Europe were on a down trend and it is important to understand as well that -- as well as a consecutive three months of dropping base prices and dropping alloy surcharge. And here, we talk only base price. The base price went down from August, about 1,100, to September, to about a minimum, a low of 1,060. So, throughout the quarter, the price kept dropping, hitting a low in September.

At the same time, imports went up slightly. The overall trend, however, if you look over the last few quarters, is trending up. We are now very close to the same import penetration as we had in 2014 when the Chinese were a big part of the imports.

We are still okay with this level of imports. We see that generally speaking the imports come in at a fair price and form in that sense as well, a fair competitive environment. The flip side is however that of course, it does put you to a cap on pricing, and you cannot just move ahead and move prices at will, because you're being checked by what happens on the import front.

Turn to the U.S., pricing there has increased during the third quarter, and more price increases have been announced going forward. The imports there as well have slightly ticked up, specifically in this case from the rest of the world, and if you look where it comes from then Europe and South Africa have been two main sources for this increase in imports. But, all together as said, a healthy underlying market in the U.S. as well. If you look at inventories, inventories in the U.S. are at the stockholders are still below historical averages, so a healthy market overall.

And with that, I would like to hand over to Chris to talk about the details in the financials.

Christoph de la Camp *Outokumpu Oyj* - CFO

Thank you, Roeland, and good morning, good afternoon, ladies and gentlemen. We'll start by looking at slide number 8 of the deck that you have in front of you, some of the key financials.

Deliveries in the third quarter of 2017 were up versus the comparable period last year, and this was driven predominantly by record-high

deliveries that we achieved in the Americas, yet another new record. That also drove sales higher, but as you can see here, our adjusted EBITDA was down significantly versus the prior year period. The EBITDA, as Roeland has already mentioned, was significantly impacted by negative timing and hedging impacts of EUR 41 million, and just for recollection, which we mentioned last year in 2016 in the same period, we also have a one-off positive impact from the reversal of a credit loss of EUR 22 million, which clearly did not recur this year. So, year-on-year if you take out those two impacts, it was actually a little better.

Going down to the operating cash flows, Roeland has already said that was very solid for the second quarter in a row this year, and much more solid than last year, more than double that reducing net debt down to EUR 1.13 billion, and against last year that's over EUR 260 million down on the same time last year. Our capital expenditure was reasonably consistent at EUR 40 million for the quarter, and we're solidly on target to deliver around EUR 180 million of CapEx this year in line with our plans.

Personnel continues to decline quarter-on-quarter, and was lower than at the end of last year, and also certainly than in the third quarter of 2016.

Let's now move to Europe, slide number 9, and dig a little deeper into each of the business area results. You can see here on the chart on the left, that deliveries were reasonably flat, even one kilotonne up against the same period last year, and this is despite the seasonal slowdown so even versus Q2, we did not see any decline there in terms of delivery volumes. However, as you can see here, the adjusted EBITDA declined quarter-on-quarter and was a little bit down against the prior-year period, but again, what we had this time around in the third quarter versus 2016 was a relative negative impact of EUR 23 million coming from timing and hedging, and also of course the credit accrual reversal which we saw last year of EUR 22 million. So, if you consider those your underlying performance actually improved.

What we see is underlying demand in Europe remaining pretty strong. Base prices were however under pressure due to distributor destocking in Europe, and while we saw Q3 '17 average base prices increase by EUR 35 per tonne against Q3 '16, that was also a good outcome.

Distributor inventories were slightly above historical average levels, and on the ferrochrome operations, we did however see lower production volumes due mainly to the planned outage that we had in July to finally definitively repair that smelter, which has been working right on schedule since then.

Ferrochrome prices during the third quarter of this year improved versus last year, but they were offset by a much weaker Dollar and of course, ferrochrome is traded in U.S. dollars.

Let's now move on to slide number 10, to the Americas, and here the key story is that the Americas BA in the third quarter was heavily burdened by one-off impacts. Deliveries, as you can see on the left-hand side, were strongly up. They achieved a new record with 203,000 tonnes delivered during the quarter, which was 9.2% up compared to the same period last year. However, the EBITDA dropped strongly both against the prior-year period and against previous periods, and this is where the impact of a significant amount of net of timing and hedging, weaker mix and more additional costs that I'll detail a little later, comes into play.

We do, however, see continuing healthy underlying demand, saw that in Q3, and distributor demand was -- although the distributor demand was negatively impacted by lower raw material prices.

Distributor inventories remained at long-term average levels here, and the Q3 '17 average base price decreased by \$30 a tonne compared to the prior year period.

I would like to dig into the Americas' one-offs a little bit further, as it is an important part of the Q3 results explanation. Let us go back to the second quarter of this year, where we reported a EBITDA of EUR 27 million for the Americas, and as part of that reporting we also reported a release of accruals, so a one-off which positively impacted that result by EUR 6 million. So, the underlying result we have to start with is EUR 21 million.

There was an improvement in volumes that had a positive effect, and while we don't put precise numbers against these bars, they show

approximately the relative value. And then, we had a very significant part of our total net of timing and hedging impact globally hit the Americas, and it hits here generally much quicker and much more steeply than in Europe because the U.S. responds almost immediately to changes in metal prices whereas in Europe that comes through the delay. So, significant impact but we also have a significant positive impact on the Americas in the first two quarters of this year, as we reported earlier.

We then come to three impacts that were very much one-offs. The first was that we had significant production issues from a third party, a key third party supplier, which led to incurring much higher production costs than we would normally have, but also led us to having to sell an overall weaker mix of products into the market at the lower sales prices. So, that's the first big box that was a one-off during Q3. We then had two other relatively smaller items that impacted, you're well aware that there were three major hurricanes that hit the southern U.S. during the third quarter, and that led to raw material in one of the major scrap hubs not being available, therefore, having to replace scrap with higher-priced and higher-cost prime material, which added significantly to the raw material costs in the melting operations there.

And then finally, we had a late delivery of a ferrochrome shipment, which we had to backfill at short notice with locally-sourced ferrochrome, and as a result of that had a small outage in the melt shop which led to additional costs, and then also had to pay a premium for that material to ensure that we could continue the operation. So, these are three significant pieces that together added up to a EUR 30 million impact in the third quarter that were not forecast at all, and very much one-off events.

There were then a number of smaller items in terms of base price falls and a range of smaller things that finally led to the overall loss of EUR 34 million in the Americas.

So then, moving on to Long Products, we can see that these were impacted by typical seasonality. On the left, you can see the delivery volumes here were down. They decreased also year-on-year, and here the key story is that Long Products, of course, makes slabs in our Sheffield operations and they used also, not only, but also by European operations, and with there being less demand in Europe during the quarter, there were less slabs produced and sold in there for the volumes which are counted here, went down. And that also then led to an overall lower EBITDA for the quarter, driven obviously by the low deliveries, but there was also to offset that to some extent, a better product mix to make the overall loss resulting from that smaller.

You see underlying demand remained good in the third quarter for Long Products. Base prices remained fairly stable in Europe and the U.S. compared to the same period last year, and this business obviously, because of its size, also suffered from that timing and hedging negative impact, but it was smaller than the other two businesses at only EUR 2 million.

Let's move on to slide number 13, the cash flow. Overall, cash flow as we've already pointed out was very solid in the third quarter '17, with EUR 126 million of operating cash. We had a net cash from investing activities of minus EUR 13 million. This is the regular quarterly CapEx going out offset by the proceeds from the disposal of our pipe mill in Florida that we sold in July. This is the net impact of those, and then we had refinancing repayment, or financing repayments, of EUR 107 million during the course of the quarter and finished the quarter with EUR 295 million of cash in the bank. So, somewhat better than the same period last year, and also at the beginning of this year.

The strong cash flow was driven predominantly by a strong release of working capital during the quarter, and some of this was caused by nickel prices moving up and therefore increasing our payables.

In terms of financing costs, we incurred EUR 32 million of those during the quarter, and of those interest expenses were EUR 23 million. That is a number which is several million lower than the comparable period last year, and we are beginning to get those interest costs down as part of our effort to overall reduce the cost of financing over time, as we reduce the net debt. Our overall liquidity reserves were at approximately EUR 1.1 billion, so very adequate, and as Roeland already mentioned, our net debt is now down at EUR 1.13 billion, so within grasping distance of the target we set ourselves for the end of the year of EUR 1.1 billion max.

Let's now turn to slide number 14, and our other balance sheet and financing metrics. So, as I said, EUR 1.1 billion firmly in reach for the end of the year on net debt. You can see here that if you take the longer term view, we continue to make good progress in repairing the balance sheet of the company, both in terms of absolute debt levels but also in terms of the leverage that we're achieving, and now another

0.1 down to 1.7 net debt leverage, and our gearing continues to decline and now stands at 44%. Again, we are targeting here of course in the longer term, 35%, so that target is also now firmly moving into sight.

On the right-hand side, you can see the maturity profile of our debt. We're now over the hump of 2017-2018, the dark blue bars that you see here are short-term current debt, mainly commercial paper, and the next big maturity now that you can see is actually in 2019, and that's a bond that is outstanding. We also have there a big maturity in 2019, our revolving credit facility, which comes up in early 2019 and clearly we have both of those firmly in sight and we'll be addressing those in good time before we come too close to those maturities.

And with that, I am going to hand back to Roeland to speak a little bit about the business and financial outlook for the fourth quarter.

Roeland I. J. Baan *Outokumpu Oyj - CEO, President and President of Europe Business Area*

Thank you, Chris. So, taking a look forward, what we see is the following. Looking at the, as said before, the underlying stainless steel demand is expected to remain healthy in both Europe and the U.S., and by the way Asia as well, into Q4 and onwards.

There are always a few things towards the end of the year that play a role. One of them is the typical slowdown in the U.S. market, as towards the end of the year, especially the distributor segment, is paring their stocks, their inventories, in order to get the tax credits that go with it towards the end of the year. So, that will have a negative impact on the volumes for the quarter.

Europe doesn't have that so strongly, so we actually expect the volumes to remain relatively flat quarter-on-quarter.

We do expect as well that the significant third-party supply issues we had will not recur in the fourth quarter, and as a result, we take them as expecting to be resolved. The big story for the Q3, which was the net of time and hedging, is actually expected to be slightly positive, so you can say it's negligible. However, we have again typical for the end of the year, we have about a EUR 30 million extra maintenance tab in Europe because this is one most of the facilities close down for maintenance. If you put all those things together, then we expect for Q4 an adjusted EBITDA that is higher compared to the third quarter.

Tommi Jarvenpaa *Outokumpu Oyj - Head of Investor Relations*

All right, thank you, everyone. Operator, we are now ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will now take our first question from Michael Shillaker from Credit Suisse.

Michael Shillaker *Crédit Suisse AG, Research Division - MD and Head of Global Steel and European Miners*

A couple of questions, if I may. Firstly, on the third-party supplier issues, can you give us a little bit more detail in terms of what actually happened, and was it just a mix issue? Because it doesn't really link up exactly with the record volumes you've shipped in the U.S., so can you give us a little bit more detail on exactly what happened there? And also, with those one-offs that you say are non-recurring, the supplier issues, forget the hurricane, there's nothing you can do about that, but also the ferrochrome deliveries -- how sure are you that whatever went wrong is now fixed, and therefore this isn't going to be recurring in maybe not the fourth quarter, but could happen again next year? And the third follow-up to that question is, do you also have any recourse over the third party on what went wrong in terms of claims or similar, and is that something you're pursuing? And then, my other question, just on electrodes, didn't come up today but you've been very proactive in terms of coming out and putting a surcharge on graphite electrodes given what's happened to pricing. Can you give us a little sense of what you're seeing in terms of both pricing and availability of electrodes for next year? How secure are your supplies? How locked are you into next year on contract pricing? Because obviously you've been pretty vocal about it, but when I listen to what the U.S. mini mills in carbon steel are saying, they sort of shrug it off as though it's a non-issue, and clearly that doesn't come through as the same with the surcharge you've implemented. Thanks a lot.

Roeland I. J. Baan *Outokumpu Oyj - CEO, President and President of Europe Business Area*

All right, so as you probably know, we don't own our own hot mill in the U.S. We have a contract with a third party that rolls our slabs for us and delivers back to the black hot band. The supplier had a few issues on the quality side, specifically with stainless but as well on the carbon side, which they roll as well, and they decided to take a shutdown, which was planned, and that we actually catered for. We had sufficient inventory in-house to take care of that. However, the shutdown went 50% over its planned time, and as a result within our own plant we had to idle some of our facilities, which is a very costly as you probably will appreciate. And secondly, when the supplier got back on-stream, there were quality issues, specifically issues on the surface quality and as a result, we had to do a lot of rework on it, and even with the rework some of the product that came out was not suitable for let's say the higher end of the material use. So, the polished cold rolled raw materials, etc. So, as a result, we had to downgrade those products and actually sell them as hot band into the market, which of course is a far lower margin than cold rolled. Do we have any recourse? We do have some, but ultimately that is not really the issue. The issue is that we have to solve the issues together. We are in very, very close cooperation with our supplier. We have our own team inside. We have daily meetings, and we are absolutely convinced that our supplier is doing everything in their possibilities to solve this issue. One of the things they're doing, is they're taking out a stop now, or actually from next week, to put in a few pieces of equipment that will significantly improve the quality of the deliveries, and in that sense, we're expecting that not only will the issue of Q3 not recur, we actually expect that the quality in general will be better after this stop than it has been before Q3. On the electrode surcharge, and the electrode situation, it's obvious that there is a shortage of electrode material. The specific coke that goes in that, needle coke, is in short supply. Demand is, specifically in Asia, high and spot prices have been driven up to levels of \$25,000, \$26,000 a tonne, from a previous level of about \$3,000 a tonne. The last auction I have seen into Q1 was above \$15,000 a tonne, and it is unclear of course, where it is going forward. The tightness in the market will continue, there's no doubt about it. Our own cost impact is not the full -- currently not yet, the full impact of the higher pricing you see in the market. Term deals, as well, are below the spot price, but significantly higher, three to four times higher than the previous price. So, I believe that there will be for 2018, for the total industry, there will be a clear cost increase. As far as supply is concerned, we have partially inventory, partially-existing long-term contracts that cover us, and we have the rest covered through new contracts that we have put in place recently. So, in terms of our operations, we do not feel on the threat. If you look at the income side, we introduced the electrode surcharge EUR 30, generally speaking the surcharge has been accepted by the market. Not without any grumbling, because the other European competitors have not done a similar move. However, we do believe that it is necessary to claim the increased cost of production back from our customers. We cannot just take it on the chin and we will stick to our strategy in that sense.

Michael Shillaker *Crédit Suisse AG, Research Division - MD and Head of Global Steel and European Miners*

Okay, that's great. So just on the ferrochrome issue as well, is that something that you're convinced that the delivery issue, that you're convinced is one-off and won't be repeated?

Roeland I. J. Baan *Outokumpu Oyj - CEO, President and President of Europe Business Area*

That was a one-off that was not, that was a logistical issue whereby a ship couldn't move because of weather, and we had to supply from somewhere else. So, that is -- again -- is a one-off

Operator

We will now take our next question from Seth Rosenfeld from Jefferies.

Seth Rosenfeld *Jefferies LLC, Research Division - Equity Analyst*

A couple questions with regards to outlooks for realized pricing please, both for what you saw in Q3 and what should we expect going into the fourth quarter. In the release and in your comments earlier, you talked about the year-over-year realized price shifts in Europe and in the U.S., but can you give us a better sense of how realized prices in your P&L fared on a quarter-over-quarter basis? Second, looking forward into the fourth quarter, can you just give us a better sense of when the current volatility in spot prices, or the recent volatility in spot prices, is expected to hit your P&L? Given your known contract structure and extended lead times, what should we expect for sequential base price performance, both in the U.S. and in Europe, please?

Roeland I. J. Baan *Outokumpu Oyj - CEO, President and President of Europe Business Area*

So, if you take the third quarter, in Europe from the Q2, which was the peak of pricing in Europe at about 1140, 1150, to September, there was a drop of approximately EUR 60, EUR 60-65. So, significant impact, and we all understand why this happens. And if not, I'll just take a

little bit of time to explain. In Q2, towards the end of Q2, it was clear that ferrochrome was dropping significantly and at the same time, nickel prices were dropping. So, it's becoming clear that the alloy surcharge with a time delay is going down, and it happens as well the alloy surcharge went down two consecutive months, August and September, with over EUR 100. Everyone can see that coming, especially of course the distribution segment, and rather than waiting for the lower pricing to hit, they will liquidate as much of their inventory as possible and in doing that, they'd rather take a hit on the base price than actually take the big hit on the alloy surcharge that would result from waiting two months. So, that has been the big driver down on the prices in Europe. In the U.S., the price, if you take CRU went up slightly quarter-on-quarter by about \$8. However, if you look at our pricing, because of our mix issues, we were actually below Q2. And if you now, from there, go on to Q4, and again to take into account the fact that there was a dynamic move down in Q3. So, your average doesn't reflect what happened in September. September was rock bottom at about EUR 1,060 base price, and in spite of the fact that we see some tick-up again coming in Q3, the average base price in Q4 in our opinion will not be very far off from what it was in Q3. So, there is no help from pricing in Europe going forward. In U.S., it's a little bit more positive. There, we have seen some price improvement in Q4, and we expect on the spot side to have an effect although as you say, there is probably about two-thirds that is on contract that will not be impacted by that. The good news is that all this will come together in Q1.

Seth Rosenfeld Jefferies LLC, Research Division - Equity Analyst

Thank you, and just one follow-up question, please. In the U.S., where you've flagged lower realized prices because of the mix, I'm just trying to better understand. Are you saying that you had lower base prices just net of the move from cold-rolled to hot-rolled, or that you actually realized lower base prices on a like-for-like basis for individual grades? There were widespread reports of very aggressive discounting during the course of Q3, so even though CRU price might not have moved, or actually it went up, there were transactions being reported far below that. Does that have anything to do with the weakness that you saw, that you commented on, or is that totally separate?

Roeland I. J. Baan Outokumpu Oyj - CEO, President and President of Europe Business Area

No, I think you see, although to a lesser extent than in Europe, the same principle of moving alloy surcharge in the U.S. leads to a will to reduce inventories at the distribution segment. However, the alloy surcharge moves much faster, is much more direct. So, the window is shorter. So yes, you will have had some of that, but in our case for our specific mix, and I'm talking now not about the hot-band but the cold-rolled, in our specific cold-rolled mix as well, we have had to sell stuff as simple 304 whereas ideally we would have used that for polishing into a higher application than as was intended, but we couldn't because of the quality. So, it's a little bit of all.

Operator

We will now take our next question from Carsten Riek from UBS.

Carsten Riek UBS Investment Bank, Research Division - Executive Director, Head of European Steel Research, and Equity Analyst, European Steel Research

Two questions from my side. The first one, on the inventory effects/hedging, could you actually just separate the inventory effect from the hedging? How much did the hedging actually amplify the usual moves in the -- so these losses or gains in the inventory? And the second question I have is, on the U.S. business, of course it was heavily negative but then I follow your arguments here, one of inventory hedging losses, etc., etc., that adds up to more than EUR 50 million, which means do you expect ex-U. S. to return to positive EBITDA in the fourth quarter despite lower volumes? Could you actually comment on this? Thank you very much.

Christoph de la Camp Outokumpu Oyj - CFO

Yes, I'll take that one. So, without giving specific numbers, what I will say is that the hedging impacts in Q3 were very large, so they amplified the inventory effects very significantly. In terms of the U.S. business, as you know we don't guide specifically by business, but certainly the U.S. business should do much better in the fourth quarter than it did in the third quarter because these effects should not recur. So, whether what exactly that final number is going to be, we shall see, when we announce the Q4 results, but they should certainly be better in the U.S. or in the Americas, I should say.

Carsten Riek UBS Investment Bank, Research Division - Executive Director, Head of European Steel Research, and Equity Analyst, European Steel Research

Okay, but you sound much more at least convinced, that we actually see a significant step upwards rather than a small step upwards in the earnings in Americas?

Christoph de la Camp *Outokumpu Oyj - CFO*

Yes, because we see the timing effects not recurring anywhere across the business, not just in the U.S., and we expect that the supply issues are resolved. So, and as we said, the ferrochrome delivery issue will not recur.

Carsten Riek *UBS Investment Bank, Research Division - Executive Director, Head of European Steel Research, and Equity Analyst, European Steel Research*

Maybe a quick follow-up on the cash flow, because you mentioned, you had a very good free cash flow but a large part of it came actually out of the net working capital, especially out of the payables. You still stick to your below EUR 1.1 billion target, which means we will see some kind of further net debt reduction. Could we expect that the free cash flow will be positive but it's very likely that it doesn't actually be in the same kind of magnitude as we have seen it in the third quarter, simply because of some reversal effects in the working capital?

Christoph de la Camp *Outokumpu Oyj - CFO*

I don't want to be too specific on the cash flow forecast for the fourth quarter, but we are very confident that we'll be below EUR 1.1 billion by the end of the year.

Operator

We will now take our next question from Luc Pez from BNP Paribas.

Luc Pez *Exane BNP Paribas, Research Division - Stock Analyst*

Gentlemen, a follow-up quick question on the Americas if I may, because even if I restate your EBITDA per tonne from the one-offs related to the supplier and the hurricane issue, we are talking EBITDA of EUR 60 per tonne which looks extremely low, and I cannot reconcile that with the very high utilization rate you enjoyed over the quarter. Could you therefore be maybe a bit more specific as to how you see this improving? And I'm not talking specifically into Q4, but more looking at '18 and maybe a pass up to 2020, that would help maybe form a better understanding as to how you see the turnaround on this business. Thank you.

Christoph de la Camp *Outokumpu Oyj - CFO*

Yes, I'll take that one as well. So, we have an action plan, clearly to improve an underlying -- we recognize -- let's take a step back maybe, and just look at this business three or four years ago where it was making triple-digit EBITDA losses. Last year it was still making a double-digit EBITDA loss, and even year-to-date after these issues in the third quarter, we are so far positive EBITDA and we can see a very healthy trend over the years. So, that's just the big picture, but we recognize that we're not where we need to be yet, and that we have a long way to go. The key building blocks are on the cost side, that there is now going to be put in place a cost restructuring plan for Mexico that we will tackle by applying efficiency and productivity improvement measures to significantly reduce and further reduce the cost there. That's one key measure. We continue to work on multiple, very many different fronts in Calvert to reduce the costs around freight and logistics. We have further opportunities on procurement, we have further opportunities in terms of our procurement of scrap and raw material pricing there, and obviously in the operations of the mill. So, this is part of the cost reduction program that the team there will continue to implement, and Mike, our head of Americas, will talk about that in more detail in three weeks' time at the Capital Markets Day. In terms of the other big piece where we still see potential, is that we can push yet more volumes through. We're showing regularly that we can push the volume boundary further, and that improves obviously the performance. So, this is the second big lever for the business. But of course, the biggest lever probably is around improving the margin that we achieve per tonne, and we're still today not selling everything, cold-rolling everything and selling it as prime material. So, we have further work to do to push our intermediate products into the premium segment to achieve higher margins with premium customers. So, this is the biggest area where the team there is working intensively on improving the service to customers. There are a lot of process improvements that have been done just in terms of back office sales, there. There are a lot of service improvements that are being put in place that the customers there can see the work intensively improving, the overall quality, quite aside from the Q3 issues, to make the material more attractive. Clearly with a more interesting cost structure would also be more competitive in some areas, and in terms of being able to compete with some others. So, these are all the sort of areas that we're working on intensively. It's improving the margins for the mix, it's improving the volumes, and it's further work on the cost side.

Roeland I. J. Baan *Outokumpu Oyj - CEO, President and President of Europe Business Area*

It was in 2015 that the business in the Americas recorded over EUR 160 million negative EBIT, and we set out for a significant restructuring and turnaround program. We were, as Chris was saying, still negative in 2016, but already a little better, and we are now solidly positive in

the year-to-date for 2017. So, the trend is extremely positive, and if I look at the amount of initiatives we still have on the drawing board and that we are still undertaking, then there's actually no doubt in my mind that we will fulfill the full potential of that plan.

Luc Pez Exane BNP Paribas, Research Division - Stock Analyst

So, if I may add a follow-up, what I understood and I think it was also discussed when we did the site visit back in March, a lot of the problem comes from the final point you were coming up with which is the fact that you're relying a lot on the distributors, and not selling maybe the optimum mix of the Calvert [setup], I would say? And part of my understanding, and especially if I look at companies like ArcelorMittal or Nippon Steel or JFE, is that this certification process takes a long time. So, my question is the following: are the recurring quality issues that you face, you've been facing another one in Q3, things that impair the certification process and makes it maybe a bit longer than what you had planned when you took the helm of the group?

Roeland I. J. Baan Outokumpu Oyj - CEO, President and President of Europe Business Area

No, not at all. So, we are certified for our products with all the OEMs that count, and this is specifically in our case for our segment focus, is in appliances and oil and gas. We have no certification issues. We don't even have, I think at the moment, certifications running, because we have all that we need. So, no issue there.

Operator

We will now take our next question from Philip Ngotho from ABN AMRO.

Philip Ngotho ABN AMRO Bank N.V., Research Division - Analyst

I have one question left, that's actually on the Q4 guidance from the European volumes. I believe that normally Q4 should be seasonally a bit better than Q3, so I was wondering why you're guiding for flat volumes given the still-healthy demand. Is this solely due to the maintenance stop, or are there other things at play? And, as a follow-up on that, I was also wondering what the volume impact is from the maintenance stop in Europe?

Roeland I. J. Baan Outokumpu Oyj - CEO, President and President of Europe Business Area

If you look through our patterns, we are normally in Q4 similar to Q3. This might be as well because we are probably more than our three main competitors, we have a far larger participation in the Nordic and Central European market. So, we outpunch our market share in those areas. And, those are the areas as well that during the summer holiday period, basically moves through without too much interruption. The part of Europe that has the biggest interruption of course, is the Southern part of Europe, where our relative participation is smaller. So, I think that's why you see maybe less of a seasonal impact in Q3 than you see with the others, and as a result we are flatter towards Q4.

Philip Ngotho ABN AMRO Bank N.V., Research Division - Analyst

Okay, and I don't know if you want to disclose it, but what is approximately the volume impact that you would have from the maintenance stop? Or there isn't any?

Roeland I. J. Baan Outokumpu Oyj - CEO, President and President of Europe Business Area

It is very difficult to say, because our maintenance stop coincides of course with the whole of Europe closing down for Christmas. It's difficult to say what volume is not there.

Operator

We will now take our next question from Bastian Synagowitz from Deutsche Bank.

Bastian Synagowitz Deutsche Bank AG, Research Division - Research Analyst

I've got two questions left. Firstly, could you please give us any color on how much of the negative impact you had from the lower productivity in the ferrochrome smelter in the third quarter? I would have thought that this is a 10 million to 20 million item. And then secondly, you quantified a small positive from metal hedges in Q4, but then I understand there would also be a negative for emission credits, etc., which runs against this. So, is it fair to assume that the total effect of those two items will be largely neutral, and is there any other impact which is non-operational which you have not been quantifying or mentioning in the outlook statement? Those would be my last questions, thank you.

Roeland I. J. Baan *Outokumpu Oyj - CEO, President and President of Europe Business Area*

Sorry Bastian, what was your second question? I have the first one.

Bastian Synagowitz *Deutsche Bank AG, Research Division - Research Analyst*

How is this impact from metal hedges? But then I understand that there is also a negative impact from for example emission credits, and maybe other items which is running against this. And so, I just wanted to get some clarification. Can we expect the net of those two items to be largely neutral, i.e., all in, largely going to be zero impact from hedges and whatever the impact from emission credits could be? And then also, are there any other items which are non-operational, i.e., which are not related to falling volumes or prices, which you haven't been mentioning in the outlook statement which we should have on the radar?

Roeland I. J. Baan *Outokumpu Oyj - CEO, President and President of Europe Business Area*

Okay, so I'll start with the negative impact of lower-volume ferrochrome. We do not disclose that, but you can see in the report what our production was, so you can easily see what the shortfall was versus the theoretical quarterly capacity. And Chris?

Christoph de la Camp *Outokumpu Oyj - CFO*

On the others, as we say, they are anticipated -- and it's always a bit difficult to forecast these, because it depends very much on the development of a number of different commodities that cannot forecast. Apart from metals, we also have derivatives around carbon emissions, FX, and also to a lesser extent, interest rates. But, it's difficult to say whether they will all cancel each other out, but the net effect should not be that big. Certainly not as big as we saw in the third quarter. In terms of other accounting items, we can't see much. The one caution I would say is, that some of the ferrochrome benefits that we'll see from higher pricing will take time to work their way through the stainless steel business and will not hit immediately. So, again, this is a deferred impact because as you -- the material you sell directly into the third market, third-party market, has an immediate P&L impact while the material that works its way through your stainless steel takes longer to become P&L-positive, because clearly we can't take a profit on internally-generated sales. So, this comes through with a delay, but it's not a negative. It's just a delayed positive.

Bastian Synagowitz *Deutsche Bank AG, Research Division - Research Analyst*

That's very helpful information. Roeland, to follow up on your first one, so from your comments I basically conclude that there hasn't been any additional cost item for just the repair work and so on, which was related to this, if you adjusted for or refer us to the pure production loss?

Roeland I. J. Baan *Outokumpu Oyj - CEO, President and President of Europe Business Area*

It was about a million, it was minimal.

Operator

We will now take our next question from Cedar Ekblom from Bank of America Merrill Lynch.

Cedar Ekblom *BofA Merrill Lynch, Research Division - Analyst*

I've got a bit of a longer-term question about your raw materials sourcing. There's been a lot written on electric vehicles and the demand for nickel from electric vehicles in the future, and the fact that electric vehicles may have to use nickel from sulfide ore bodies. As an European stainless steel producer, my understanding is that your primary nickel is sourced from sulfide sources, and that you wouldn't be a user of ferronickel. So, first of all, the question is, is that correct? Secondly, if you do see on a very medium-to-longer-term view, a new source of demand for primary nickel from EVs, how do you think the stainless steel industry deals with that? Is there potential for you to start using more ferronickel in your process, or is there potential to see scrap utilization rates rise? My understanding is that the European stainless steel producers are the most efficient in the world in terms of scrap utilization, so how much higher can that go? And then secondly, if we look at a high nickel price, when do you start to think high nickel prices result in demand destruction for stainless steel? Are we a way away from that, or is this something that we need to be concerned about should we start to see nickel quotations rise because of the EV demand? Thank you.

Roeland I. J. Baan *Outokumpu Oyj - CEO, President and President of Europe Business Area*

That's probably one of the most deeply-philosophical questions I've had for a long time. There's no simple answer. First of all, what I can say, we do use ferronickel and we do buy ferronickel. Our primary source, however, for nickel is scrap. 87% of our output is covered by scrap.

So, the real prime use is not that big. Now, no one knows what the electrical vehicle market will do. We don't even know whether this will be nickel-based batteries, or there's some breakthrough that was found in MIT where they're now working on aluminum-based batteries that have higher efficiency, are lighter, etc., etc. So, we have to see what happens. The one thing I think that you will see that will happen, is that the disconnect -- if the prime nickel demand would shoot up due to electrical vehicles, and prices would shoot up, you'll see a further decoupling of pricing of scrap versus the prime nickel pricing. So, I think you will find the two speed world, where prime nickel leads its own life and is separated from what ferronickel and scrap prices are doing. So, I don't see a danger to the long-term stainless steel demand because I don't see that there will be a significant increase in stainless steel cost due to nickel. Again, the scrap is there, it has to be sold, so the market itself will push it, thanks to NPI and ferronickel, to a large discount versus LME if LME would shoot up to levels that are untenable.

Operator

We will now take our next question from Ola Sodermark from Kepler.

Ola Soedermark Kepler Cheuvreux, Research Division - Equity Research Analyst

A follow-up question on the ferrochrome costs, can you specify how much ferrochrome you are using per tonne produced, or given a sort of sensitivity compared to the price levels before the prices started to rock?

Roeland I. J. Baan Outokumpu Oyj - CEO, President and President of Europe Business Area

I couldn't. I don't, because of course, we have ferrochrome in austenitics, we have ferrochrome specifically in ferritics as well where it is the only alloying element. So, what I can say is, we use about three-quarters of our own production, our own production is about 500,000 tonnes, so we use three-quarters of that.

Ola Soedermark Kepler Cheuvreux, Research Division - Equity Research Analyst

And yes, to follow up also on consumption of graphite electrodes and surcharges and the sensitivity there and your consumption per tonne of graphite electrodes?

Roeland I. J. Baan Outokumpu Oyj - CEO, President and President of Europe Business Area

Yes, that's something that we don't do. We have our own processes we are very proud of, which gives us our competitive advantage and we don't want to disclose that.

Ola Soedermark Kepler Cheuvreux, Research Division - Equity Research Analyst

And the sensitivity to graphite electrode price?

Roeland I. J. Baan Outokumpu Oyj - CEO, President and President of Europe Business Area

We count on the fact that we can roll any increase onto the market.

Operator

We will now take our next question from Johannes Grunselius from Handelsbanken.

Johannes Grunselius Handelsbanken Capital Markets AB, Research Division - Research Analyst

Most of my questions have been answered, but maybe I can ask you a question about how you foresee the start of 2018 to play out? I understand that's quite a difficult question. But, if I understand you correctly, you're guiding us that the underlying demand in Europe is currently better than a year ago. But, on the other hand, there is more imports coming into Europe. How do you foresee the pricing power now when you're discussing with clients compared to a year ago? I'm thinking about how we should expect the year to start next year, in Europe.

Roeland I. J. Baan Outokumpu Oyj - CEO, President and President of Europe Business Area

You know that from competitive authority reasons, we cannot discuss forward pricing. We would immediately go to jail if we do that.

Johannes Grunselius Handelsbanken Capital Markets AB, Research Division - Research Analyst

Yes, okay.

Roeland I. J. Baan *Outokumpu Oyj - CEO, President and President of Europe Business Area*

What I can tell you is that we do not see any reason why the underlying demand for stainless steel would change from the healthy level it is today, as well if you look at -- and you know it as well as I do -- if you look at GDP estimates, etc., etc., all very positive, and the positive thing for stainless steel is it's driven all by consumer spending. So, it has moved from investment spending, qualitative easing, etc., into now an economy that's driven by consumer spending. And lo and behold, that is exactly where stainless steel is being used. So, we actually are very upbeat in that sense. The only thing I can say on pricing without going to jail immediately, is as I said, average pricing will be flat Q-on-Q but where you had a diminishing dynamic in Q3 on pricing, you have an increase in dynamic in Q4 on pricing which will work its way through into the new year.

Johannes Grunselius *Handelsbanken Capital Markets AB, Research Division - Research Analyst*

Okay, so I'm curious about it obviously, but you can't really indicate any sort of step up in the base price given what we know now at the moment, then, for Q1? I need to make my own guessing?

Roeland I. J. Baan *Outokumpu Oyj - CEO, President and President of Europe Business Area*

Literally, I would be breaking the law.

Johannes Grunselius *Handelsbanken Capital Markets AB, Research Division - Research Analyst*

Sure, fair enough. Then I suppose a more easy question for you to answer, but the maintenance you're guiding for here will involve maintenance costs of 30 million. Is this the usual annual maintenance, sort of repair, or is it more ambitious than in previous years?

Roeland I. J. Baan *Outokumpu Oyj - CEO, President and President of Europe Business Area*

It is slightly more ambitious than last year. We found that there are a few things that we can improve, so it's not pure maintenance, it is as well a small investment in debottlenecking and improving efficiency. So, it's a slightly bigger program than we had last year.

Johannes Grunselius *Handelsbanken Capital Markets AB, Research Division - Research Analyst*

Okay, maybe the final question also I can see that you paid no taxes as you haven't done for a while. How should we view that for the next few years, when in time will you start paying tax again?

Christoph de la Camp *Outokumpu Oyj - CFO*

Well, we do pay some taxes, but it's at a low level obviously, because we operate in some jurisdictions where we have no tax loss carry forward. Mexico is a good example. But generally, you're right. Our tax level is very low, so we have tax loss carry-forwards in a number of major jurisdictions where we do not have to pay anything beyond minimum taxes, and we expect that to continue for a number of years. Last year as you recall, we took some deferred tax assets back onto the balance sheet for Sweden and for Finland. If you look at it on an entity level, Finland is developing very well. That's also where we take most of the ferrochrome profit. So, at some stage, we expect to move back to a taxpaying position in Finland, but it'll be a number of years yet. It'll take a little longer in Sweden and much longer in countries like Germany, and then ultimately, the U.S.

Operator

As there are no further questions in the queue, I would like to hand the call back for any additional or closing remarks.

Tommi Jarvenpaa *Outokumpu Oyj - Head of Investor Relations*

Thank you, and thank you very much everyone for your active participation. Outokumpu's fourth quarter and full year 2017 results will be published on January 31. Until then, thank you, and goodbye.

Operator

Thank you, that will conclude today's conference call. Thank you for your participation. Ladies and gentlemen, you may now disconnect.

DISCLAIMER

Thomson Reuters 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 Briefs 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 BRIEFS REFLECTS THOMSON REUTERS'S SUBJECTIVE CONDENSED PARAPHRASE OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS 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 BRIEF. 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.

©2017 Thomson Reuters. All Rights Reserved.

