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OUT1V.HE - Q2 2018 Outokumpu Oyj Earnings Call

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PRESENTATION

Operator

Good day, and welcome to the Outokumpu Interim Report Second Quarter 2018 Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Tommi Järvenpää. Please go ahead.

Tommi Järvenpää

Thank you. Good afternoon, and welcome to Outokumpu's Second Quarter 2018 Earnings Webcast. My name is Tommi Järvenpää, I'm the head of Outokumpu's Investor Relations. With me here today are also our CEO, Roeland Baan and our CFO, Christoph 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 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 - President & CEO

Tommi, thank you. Good afternoon. So we will go through the Q2 results. I'll start with some of the general issues, then Chris will take over. First of all, as always, our vision, best value creator in stainless steel by 2020 through customer orientation and efficiency. Although you can all dream it by now, I keep on repeating it. It is what drives us. It is where we are at this stage exactly at the midpoint. And it is as well where we are very confident given the performance of the company, specifically in the last few quarters, and what we see coming forward that we are confident of making our 2020 targets.

Getting through the numbers. Q2 came in at EUR 136 million adjusted EBITDA and as we say here, a good performance in an adverse environment, and it is really what it is. We have seen -- due to the trade disruptions out of Article 232, we have seen tremendous amount of imports landing into Europe at the rate far elevated compared to last year. We've seen pressure on European prices. And in spite of that, we have turned a very solid performance, EUR 136 million is actually our third highest quarter in the last 10, 11 years. So we are extremely pleased with that, driven by higher



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deliveries across the board both in Europe and in Americas as well as in LP. The pricing mix has positive effect not so much because of pricing yet, but definitely because of a richer mix, specifically in the U.S.

And then on the negative side, you see there higher costs due to increase in transportation costs in the U.S. specifically, and of course, the electrode pricing, which is still pretty much elevated and doesn't seem to be abating. And then you see a bridge effect is the emission allowance gain that we have in Q1. So all in all, we are -- we have a very solid performance there.

If you look at pricing, as said before, you can see that there has been a significant pressure on the base pricing in Europe, and I'll come back to that a bit more in the next 2 slides to put some color on it. Conversely, we have seen a rise in U.S., and you might say -- well the \$80 you see here is -- looks not in line with the announcements that have been made, which has to do more with timing than anything else. We have seen as well nickel price strong and, of course, we had a ferrochrome price of \$1.42, which was a good support to our ferrochrome results. On the other hand, mitigated by, of course, effect where we had the furnace down for the planned maintenance for 4 weeks, increased maintenance cost plus a loss of production volume because of that. By the way, that maintenance has gone extremely well, the furnace came back online as was planned and was within a week back into normal production. So extremely good job done.

If you look at, as I said, the base prices, here you have an overview of what happened in Europe and U.S. And I think the thing that is most conspicuous is the enormous drop that you see in the European base prices. These are CRU numbers, and the base price here is the derived base price, because more and more -- with all these imports coming in, more and more of the pricing went to effective pricing, so base price plus alloy surcharge. And as you then deduct the alloy surcharge from that effective pricing, it is the sort of resultant price you can see. It doesn't mean that the whole market is there, but this is the level where deals were being done, especially towards the end of the quarter in specifically the southern part of Europe.

Conversely, if you look at U.S., you have seen -- since Q4 of '17, you have seen a significant uptick. Again, you will not see that completely back into the numbers, because there is a lag effect due to -- in our own numbers, because there is a lag effect due to the contracts that we have running. But the momentum in the U.S. is strong and expected to continue into 2018, whereas -- sorry, into Q3, whereas for European base prices, we see them bottoming out and slowly recovering towards the end of Q3.

Interesting to see as well is the transaction prices, the effective prices in the 3 main areas. And there you see that China actually, especially in the last few weeks, last 4 weeks, has been -- the pricing in China has come up significantly from a pretty low price earlier on in the year, so underpinning some further pricing strength.

Now as I said, this is all due to imports. And if you look at this graph, we see that in the second quarter of this year, imports now in Europe were 31% of consumption, and that is actually both in terms of percentage of consumption as well as absolute volume is the highest point it has ever had in the European stainless steel history. We had actually, in May -- April, May, we had levels of 120,000 -- 110 000, sorry, tonnes that came into the European market versus a normalized 85,000, which we had during 2017. So that clearly had a tremendous impact, which we saw in the pricing in Q2 and which still lingers into Q3.

Most of these imports is not from China, but it is, what we call, rest of Asia and rest of world and then specifically, South Africa was a significant importer into Europe and so was the U.S. actually. Those were 2 large parts of the imports. Rest of Asia, we saw a significant increase from Malaysia into Europe. So as said, all in all, in a pretty unprecedented market with a tremendous import pressure and tremendous price pressure, an extremely good result and going -- looking forward as well, we see that the thing is we turning the other way again.

With that, I hand over to Chris.

Christoph de la Camp - Outokumpu Oyj - CFO

Thank you, Roeland, and good morning, good afternoon, ladies and gentleman. I'd like to turn to Slide #9, take a quick look at the group key financials there. And you can see here, the delivery performance in the second quarter of 2018, which was significantly better than in Q1 and also in the prior year period in 2017. It was a record delivery performance, as Roeland's already said, so very happy with that. And that, of course, also drove substantially the higher revenues that we saw in the second quarter.



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Looking at the EBITDA, came in very much in line with Q1 result as guided, albeit somewhat lower than the Q2 result last year, but you'll recall that last year, we saw very high ferrochrome prices. So the much lower ferrochrome pricing we saw this year contributed to that fall on a year-on-year basis.

Net income, somewhat lower than in the first quarter of 2018, maybe justifies an explanation. On one hand, of course, we adjusted out some of the one-off items in the first quarter results. So that was an adjustment in the EBITDA, downwards -- and the other driver that pushed the second quarter net income lower was higher financing costs related to the refinancing of our 2021 notes, and I'll come back to a bit later on.

Operating cash flow, more solid in the second quarter than in the first quarter, has improved, I'll come back to more details on that as well. But our net debt, nonetheless, increased and that was mainly due to dividend payments and share buybacks.

Capital expenditure, very much in line with the guidance we've given, you'll recall that we've guided to an annual CapEx spend of around EUR 220 million, and this number here represents about a quarter of that, plus the acquisition of 50% of Fagersta that we did not already own so those 2 items together make up a EUR 63 million of CapEx.

And then, personnel cost -- personnel numbers went up a little bit as well, again this was due to the acquisition of the 50% of Fagersta that we did not already own.

We then move on to each of the individual business areas in a bit more detail. Starting with Europe on Slide #10. Again, I think, if we look at the result and historical performance, it was a good performance. It came down a little bit versus our first quarter results, but as Roeland has already mentioned, Europe going into a very challenging period. I mean, the prices in Europe have fallen throughout the quarter to some very low levels as a result of diverted products from the U.S. into Europe. So this has been the biggest impact as you can see here, so more than offset the higher deliveries. We had a little bit of headwind from timing and hedging effects, but they were small. And in total, also some negatives from higher input costs coming particularly from high electrode costs, higher ferrosilicon costs, but good progress also in efficiencies that made up for at least substantially, if not fully, for the higher input costs.

The other items are related to inventory gains and procurement benefits and one-offs that we saw in the first quarter that didn't -- and adjustments between those on one-off effects.

If we then move on to Slide #11, on -- in the Americas, again, the business here, as Roeland's already mentioned, improved. It made a profit, and you can see that the key profit drivers were pricing and particularly mix on the one hand, of course, but also net timing and hedging contributed here quite significant. Nonetheless, the Americas business did suffer significantly from higher freight costs, that was a very big driver in Q2, but also from higher input costs as in Europe, electrodes, ferrosilicon contributing quite substantially to more costs here. Overall, however, a profitable result, and it's good to see that after several quarters when we struggled to come to positive EBITDA in the Americas. So progress here.

We then move on to the long products business, which showed very significant improvement. The key improvements came from somewhat higher deliveries, but significantly also from higher prices across both regions in which we operate, both in Europe and the Americas here. And the Americas spread out supported by some of the impacts of Section 232 there already. Again, as in the other 2 businesses, high input costs offset some of those gains, but the overall result of EUR 9 million, a very good quarterly performance for this business. It's worth mentioning that the 50% acquisition of Fagersta that we made during the course of the quarter will, in the future, be attributed to this business and does not flow into these numbers. It will only become effective in Q3. So in Q3, we'll see further benefits in the long products business occurring as a result of that acquisition.

And then last, but by no means least, on Page #13, the results of our ferrochrome business. And overall, a reasonably quarter-on-quarter flat development. The big story here is really higher prices, we moved from Q1 prices of \$1.18 per pound to \$1.42 per pound from Q1 to Q2. That drove prices up, but it was offset substantially by the planned and advised maintenance outage of one of our furnaces there, and that has an effect not only the cost of the maintenance itself, but also the lost production that resulted from that. We also saw, during the quarter, an increase in coke prices that contributed to additional costs. So overall, when you look at the higher prices, they were essentially offset by the overall impact of that maintenance and high coke prices.



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Moving on to Slide #14 about cash flow. We generated solid operating cash flow. The working capital only went up by EUR 18 million, and this was a result of very, very tight working capital management throughout the quarter and the light of significant increases in materials and metal prices, of course, and we've seen nickel move up significantly during the second quarter and, of course, ferrochrome also moved up significantly. So despite that, we managed to keep the working capital increase to quite a low level. And then we had further offset on cash as a result of financing costs and interest costs. We made some contributions to pensions, and this also includes minimum tax charges here. The positive operating cash of EUR 71 million was then invested, as I said before, predominantly in capital investments and capital expenditures and the acquisition of the Fagersta joint venture that we did, the part that we did not already own. So overall that led to just a little bit better than breakeven cash flow as a whole, but as we see on the next slide then, Slide #15, nonetheless, our net debt increased by around EUR 125 million, and that was substantially driven because we also paid a dividend, the 2017 dividend in early April and that was just over EUR 100 million there, and we also bought back some shares, predominantly fund, performance share plans were rewarded to senior management in the company. And as a hedge against future tax and increase in share prices, we decided to buy those shares ahead so that we have them available to be distributed as and when their share plans become due in the future. So overall, that led to an increase in net debt to about EUR 1.21 billion and, therefore, as a result of that also an increase in our gearing to 45% and our leverage notched up to 3.0, both as a result of higher debt, but also, of course, we lost the higher quarter EBITDA from Q2 last year and was replaced by lower quarter EBITDA, so those 2 effects then led to higher leverage of 3.0, which you can see on the right. Nonetheless, the target remains here to get to a region of below 1.0 by 2020.

And then, moving on to Slide #16. Worth a quick mention as well that during the quarter we did some refinancing work. We had approximately EUR 200 million of notes outstanding due in 2021. We are paying a coupon on those of 7.25% and replace them with new note of EUR 250 million that's now due in 2024, has a coupon of 4.125%. So as a result of that a significant reduction again in our total interest costs going forward, but also because the new notes mature 3 years later and overall extension in our weighted average maturity of debt. So 2 key benefits that we achieved there. And of course, the reduction of interest costs moves us another significant step closer towards the EUR 50 million target of interest costs that we are aiming for by 2020.

And with that, I'd like to hand it back to Roland to give you an outlook on Q3.

Roeland I. J. Baan - *Outokumpu Oyj - President & CEO*

Thank you, Chris. So turning to Page 17. Our outlook for Q3. In line with the market, stainless steel deliveries are expected to be seasonally lower in business area Europe and to remain stable in the Americas. The base price pressure that we're seeing continues in Europe, but the negative impact of this is partly offset by higher base prices in U.S. supported by the steel import tariffs. Having completed the maintenance in our ferrochrome furnace, we are expecting normalized ferrochrome production at the normal rate. Altogether, it will lead to an adjusted EBITDA that is expected to be lower than the one that we have now in the second quarter, but significantly higher than in Q3 of '17.

Tommi Järvenpää

All right. Thank you, Roland. And operator, we are now ready for the questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will now take our first question from Tom Zhang from Crédit Suisse.

Tom Zhang - *Crédit Suisse AG, Research Division - Research Analyst*

I've got 3, if that's okay. Firstly, so you touched on the unreliability of some of the reference-based pricing for Europe. Can you give your take on where base-price trajectory is going from what you've seen? And Q3, what levels you're actually transacting at as clearly, the referencing pricing



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on Slide 7 suggests something close to EUR 800 per tonne. Any signs that those are stabilizing? Secondly, you've slight cost inflation on Slide 5, can you just give us your view on whether or not we should expect that to keep going whether or not that's abating, particularly with respect to freight in the U.S. in ferrosilicon? And then very finally, from discussions before the results, you guys have been saying safeguards will likely be beneficial. Can you just give us your view on the safeguards now that you've seen the detail? And whether or not you're worried that some exemption, for example, Indonesia, might make those a bit less effective than you would've hoped for?

Roeland I. J. Baan - *Outokumpu Oyj - President & CEO*

Okay. So the -- it is difficult to say what are the base prices exactly at. We have -- for ourselves, we have, of course, a mix of long-term contracts with base prices, long-term contracts at fix prices total, et cetera, et cetera. So we do not see -- clearly, you can see this from the numbers, if you just look at the revenue and volumes, we don't see it as low as what you can see on the CRU. However, it has come down probably by -- on an average with about EUR 100. So I think, that's as much as I can say about it. When you look at where is it going, is it stabilizing? Definitely, we -- I always say that you saw imports peaking at 34% of consumption in April, May, 110,000 tonnes import per month. We have seen that come down to 90,000 tonnes in June and further to 82,000 tonnes in July. So we see that pressure abating and, of course, gives opportunity for restabilizing and reversing the price flow. Of course, one of the things you -- and I go to the safeguards. One of the reasons why we think that, that import number came down is that people, of course, knew that safeguards were coming on and importers did not want to take the risk to actually have product come into Europe when it could actually land after the safeguards would take hold. So safeguards already seem to do their job. If you look at the specifics of safeguards, the cold rolled quota that is set, which was the average of 3 years, would equate to about 70,000 tonnes a month of imports. So again, you can see a reduction not just from the numbers I just gave, but you'll see a reduction that is actually a reduction from 2017 monthly numbers as well. On the other hand, the safeguards themselves, as you probably have seen, do not specify country-specific volumes on the quota and they are not calendarized. So it will be interesting to see how the market deals with this. Because on the one hand, I have read reports where analyst say, well this is going to be a tsunami in the first 3 days of the period and then it dries up and the market is saturated in between. I think, what the more rational behavior in the market will be is that no one will know, at the moment, he/she puts an order in for imported material that takes 6 to 8 weeks to land, no one will know whether they will be inside or outside the quota. So no one will know whether they will be at the import price as they thought or at actually EUR 600 extra, because that's what we're talking about. And I think that you'll see restraint, because no one wants to be in that position and be completely out of the market and lose their share. Cost inflation, we have seen strong cost inflation in ferrosilicon, it was already up significantly in -- compared to last year. It went up another almost 20% Q2 over Q1. And again, we do not see that really abating. We know that several parties looking at extra investment in the same space, same goes for the electrodes. But overall, it takes some time to turn that ship around. On freight, there's a temporary shortage in the U.S. of trucks that will definitely go away. In the meantime, we are taking a number of mitigating actions, and one of the simple ones is make sure that we put more material on trains and barges into intermediate storage in the center of where the markets are. So we are in the process of securing intermediate storage, where we then can ship in larger quantities by rail and barge.

Tom Zhang - *Crédit Suisse AG, Research Division - Research Analyst*

That's great. Could I just ask 2 very quick follow-ups? Firstly, on the base price, as you said, EUR 100 per tonne, was that Q2 to Q1? Or was that what you're seeing now versus Q2?

Roeland I. J. Baan - *Outokumpu Oyj - President & CEO*

That was Q2 to Q1.

Tom Zhang - *Crédit Suisse AG, Research Division - Research Analyst*

Q2 to Q1. Okay. And with the 70 kilotonne per month on cold rolled, is there any risk given that Indonesia has been exempt from the [quotas] tariffs? Is there not a risk that they can basically swamp the import market?



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Roeland I. J. Baan - *Outokumpu Oyj - President & CEO*

Yes, sure, that's an interesting one. Indonesia is -- for instance, contrary to Malaysia, which is included because their imports into Europe are above the 3% share of imports, Indonesia's are not. So theoretically, they can now ship through quickly up to 3% of imports, so 3% of 70,000, which is 2,000 tonnes, which doesn't really move the needle. As soon as they come above that, then automatically, we can go to the commission and say, this country is now having more than the 3% share, so they are not protected anymore by the developing country clause, so -- and then they will be included in the safeguards. So there is little room to maneuver in that sense.

Operator

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

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

I'd just like to understand a bit better how the impact of extended lead times in Europe is going to impact the expected P&L in the region recognizing the weakness in spot prices during the second quarter. You obviously touched on the fact that you sell quite a lot on longer-term contracts, but just concerning your spot sales, do you think the third quarter will fully reflect the decrease you saw on spot prices during Q2? Or should we expect another step-down going into Q4 all else equal? So assuming spot prices flatline where they are today, is that baked in, in Q3? Or is there another let down in the fourth quarter? I'll start there, please.

Roeland I. J. Baan - *Outokumpu Oyj - President & CEO*

That's a simple one. It will be fully reflected in Q3. We, in our models, see already a reversal in September and we expect that to continue into the fourth quarter.

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

Great. Thank you. And a separate question on Americas. Stripping out the raw materials inventory and derivative gain, that business appears just been barely breakeven EBITDA, can you give us a bit more color on some of the steps you're taking to try to turn around this business? Obviously, the strong uptick in spot prices hasn't already hit your P&L, you already commented on that. But from a self-help perspective, what's it going to take for the margins to actually start to perform closer to that of your peers? And on the mix shift in the U.S., can you give us a little bit of a sense of, is that shift already complete? Or will there be another step higher in your product qualities going into Q3?

Roeland I. J. Baan - *Outokumpu Oyj - President & CEO*

Yes. So although normally we do not comment on results in specific business areas, I can say on Americas that we will expect a sequential better EBITDA in the third quarter. And that is -- so that is with actually a reversal of the metal effects that you, so that it is really on its own steam -- under its own steam. Why is that? A number of reasons. One is, as I said in the earlier call in -- after the first quarter, we locked in a tremendous amount of business on contract in the fourth quarter for the first half and literally the majority of our sales in the first half were on contract. So as that rolls off in the first half, now finally, you will see the price increases fully reflected in the realized pricing in Q3 and onwards. On top of that, there are a number of things I can point to, in spite of the increase in input cost that we are seeing in the freight costs, we have seen as well further significant improvement in the SG&A controls in the Americas. We are in the middle, as you know, of restructuring in Mexinox that already has led to a big drop in our cash conversion cost per tonne, and we see as well that our ongoing manufacturing excellence activities in Calvert have led through if you split out meltshop from the rest of the plant with a clear drop in our cash conversion cost per tonne in the, let's say, downstream activities. And with -- in spite of the higher electrode costs, stabilization of the cash conversion cost per tonne in the meltshop. So a lot has been done there to further improve the cost side. And as I said, the pricing will now come through in Q3.



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Operator

We will now take our next question from Anssi Kiviniemi from SEB.

Anssi Kiviniemi - SEB, Research Division - Analyst

It's Anssi from SEB. A couple of questions from my side left. First, looking at the cash flow and looking at the working capital, you highlighted there that there has been a good working capital management and thus, the negative figure there wasn't as big as, for example, I expected. Could you guide a little bit more on Q3 dynamics, how we should think about the working capital and, kind of, what you can still do on that side?

Christoph de la Camp - Outokumpu Oyj - CFO

Yes. So I mean, the overall -- the absolute number of working capital is always very dependent on the movement of metal prices, of course, so I'll, sort of, put that out there as a previso and as a caveat, if you like, on what's going to happen. But generally, what we have been doing is we've been focusing, particularly in Europe, on managing our neutral inventory levels down. We have much more potential to do that in the U.S. and we're currently working on that there as well. We are working, at the moment, extremely hard on restructuring some of the payment terms for contracts, where there are long payment terms and U.S., you may recall from previous conversations, we used to export quite a lot of our products that was not only lower-margin product but also on long payment terms. As that is coming back into the U.S. now, clearly, we're replacing those longer payment terms with payment terms that are much shorter, and that will continue to have a positive cash flow impact. There are ongoing discussions, and this is an ongoing exercise all the time with our suppliers to try to improve not only the actual terms of the contracts in which we buy various raw materials and metals but also the terms around which we pay for those. So these are just some of the ongoing opportunities that we continue to see.

Anssi Kiviniemi - SEB, Research Division - Analyst

Okay. Should we expect positive number going into Q3 or will there be still small negative one on working capital?

Christoph de la Camp - Outokumpu Oyj - CFO

Well generally, the dynamics in this business are that you see a significant increase in working capital through the first half of the year, often because in the second half of the year, particularly as you get towards the end of the year, business tends to slow down a little bit and that releases working capital. And that then picks up as we go into the first part of the next year, again it picks up and increases working capital. So it's somewhat cyclical that you tend to see a buildup of working capital in the first half and the reduction in the second half, prices being somewhat equal. So if prices stay at a constant level, we would expect to see a reduction in working capital through Q3 and Q4.

Anssi Kiviniemi - SEB, Research Division - Analyst

Okay, great. Then another question on Americas. The profitability level there has been impacted by the, kind of, contracts you have made for the first half of the year, but just looking at, for example, Q1 2017, Q2 2017, with lower deliveries, lower base prices, you were able to deliver EUR 30 million EBITDA roughly on -- in Americas. Kind of big question that is the main factor of the current results level, is it cost, is it something else or what is cooking there? And kind of, follow-up to that question is that now that we have seen Section 232 tariffs -- how is the dynamics working with you having hot rolling mainly in U.S. and cold rolling in Mexinox that's not the optimal for the cooperation, right?



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Roeland I. J. Baan - *Outokumpu Oyj - President & CEO*

All right. So let me we first correct your statement. Base prices in Q1 and Q2 of '17 were actually higher than in Q1 of '18, realized base prices and similar, maybe at best, to base prices in Q2. And you can -- again, you can get an approximation you take the revenues over all volumes in the Americas. So we are actually now with the -- in Q3, sorry, in Q2 with the increase that we have seen, we are now slowly getting back to the same realized base prices as we had in Q1, Q2 last year. So that shows as well the impact of, what I said, the delay in the contracts but as well as the market had gone very low. If you look at Q4 2017 versus Q1 2018, there had been a very steep drop of over \$100, I think it was -- I don't have the number ready but it was a pretty steep drop during the year. You see that going forward, as I said, this will now work its way into our realized numbers. The flip side, of course, as I said as well, there are some cost increases, which we have been flagging, ferrosilicon, the electrodes and then the freight, which we have, to a large extent, mitigated, but probably not fully. However, with all things equal, it still will be a very positive mix between the elements. On the Section 232 dynamics, there's a number of things here. First of all, it's interesting if you look at the price development in stainless steel base prices and you would compare that to the price development in carbon steel and you see that stainless steel has been lagging significantly in that price development, which is interesting moreover, because if you think about it, the 232 import, 25%, is on the full price. So it's not just on the base price, it's effectively as well on the nickel content, et cetera, et cetera, so on the alloy surcharge. In other words, 25% increase or tariff on stainless steel is a virtual 50% on the base price. So the dynamics are, I think, far from over is my point. And then coming back to Mexinox in the U.S., yes, there is notionally a 15% duty from U.S. into Mexico. However, we are exempt from that, so we do not pay that. And yes, there is -- then the 25% coming back from Mexinox into the U.S., currently our customers are accepting that and absorbing it, we don't, because it's a product which is just in short supply in the U.S. itself. And secondly, we have asked for exemption through our customers for those products. And this has just been posted, I understand, this week. So we would know in the next 4 weeks, 5 weeks whether we get the exemption or not. Then I go back to the overall dynamics. As I expected, there is still more price movement to come, of course, the potential absorption for our customers will become less and less as the whole level of market rises.

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*

Most of my questions have been answered, just 2 left, one more general. We talk a lot about base prices, transaction prices, surcharges and all of that. The interesting part is we can't track it anymore and so can lot of the customers not track it anymore in Europe or in U.S. Is that the first move going back finally to transaction prices again in your opinion? Or will this system continue to be base price plus surcharge in North America as well as in Europe? That's the first more general question. Because it apparently works very well on the way up, but it just doesn't work on the way down.

Roeland I. J. Baan - *Outokumpu Oyj - President & CEO*

So this is -- we have had a discussion in the past as well, when I got questions on something that opens up a perceived gap in the base prices with imports from Asia. No one ever asked me the question as it goes the other way around when, for instance, the alloy surcharge some of the -- or when input prices, nickel, ferrochrome suddenly go up and the alloy surcharge has not yet gone up. You see the converse. You see then that suddenly the relative -- the derived base price from the imports shoot up by \$200, \$300. So I don't think this is the end of the system as we have it. And one very important reason is that our customers who ultimately sell to OEMs, et cetera, need the system to make it transparent for their customers, because they can pass on alloy surcharge. It's much more difficult to pass on an effective price. So I don't think that, given the fact there is volatility in nickel and ferrochrome, as I said, it will remain forever. Our customer base would not want to shed the surcharge system. Why did it happen this time? Very simple, because there was a whole lot of distressed volume on the water, in some cases diverted from the original destination in U.S. back into Europe that were desperate to get prices. And of course, you will find people who worked it. So ultimately, what you see is that the portion of the market that worked on this effective transaction price is not that large. And again, it will disappear as soon as these desperate distress cargoes disappear.



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

Okay. The second question I have is on the North American operations. At least, we have seen a bit of an improvement, but similar to Seth we're still at a very low level. I was just wondering, given the -- and you mentioned it, Roland, given the very good pricing we have currently in the U.S. on the carbon steel market, it's actually pressure on Outokumpu to renegotiate the higher rolling fee with ArcelorMittal? Or does the company currently stick to the contract despite the very good profitability levels in the U.S.?

Roeland I. J. Baan - Outokumpu Oyj - President & CEO

Well, Carsten, we are partners. We have a partnership in good times and bad times. And it's funny, as you mentioned it, I was there a few weeks ago, and I paid a courtesy visit to our colleagues. And it was very clear, there were times -- basically it was, we -- your volumes were the cork in which we were floating and you stuck to the contract, although maybe you could have done better by reducing volumes. And now it's the other way around. We know that it happens. So this is a partnership, it works well, we're not there to try to go for short-term gain and lose a long-term benefit.

Operator

(Operator Instructions) We would now take our next question from Johannes Grasberger from Nordea.

Johannes Grasberger - Nordea Markets, Research Division - Senior Analyst of Materials

It's Johannes here from Nordea. I've got 2 questions left here. The first one would be on the recent Chinese antidumping investigation. If you could talk about that little bit, how you feel that impacts you or if it even does not impact you at all? And the second question then on Americas and just wondering the Section 232, how that would be impacting the mix? Do you think you will get a tailwind on the mix as the imports are leave the market? Those are the 2 questions.

Roeland I. J. Baan - Outokumpu Oyj - President & CEO

So the China antidumping investigation is an interesting one. First of all, if you look at the product categories, we are only impacted on hot rolled that we would be exporting and on quarto plate. Both are very, very small volumes -- about 10,000 tonnes. So it's, for us, pretty irrelevant. However, as a matter of principle, we will fight this because, of course, we are not dumping, it's the strangest thing you can bring up. The reason, I think, why the net was cast wide is that China is targeting very clearly -- and this is Tisco specifically and Bao, very clearly, they are targeting Indonesia. 80% of the Tsingshan plant productions are going into China and that has had major disruptive influence. This is one of the reasons why prices in China at the end of last year and the beginning of this year dropped so much before recovering again. So obviously, this is targeted at that plant, those imports, but it is -- if you package it in a larger antidumping case, it's easier to actually get it through. On the Americas, absolutely, we have already seen our mix improve, whereas we had last year, as you know, quite significant exports from America into the rest of the world that has now dwindled to about 3% of our volume is export. We have seen our cold rolled mix significantly improve as well. So yes, this gives a very strong tailwind to us.

Johannes Grasberger - Nordea Markets, Research Division - Senior Analyst of Materials

And just on that note you mentioned that they will be targeting Indonesia with this antidumping investigation, I'm wondering here, did you mention on the call that the Indonesians are allowed to bring in about 3% of demand as imports?



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Roeland I. J. Baan - *Outokumpu Oyj - President & CEO*

Not of demand, of imports.

Johannes Grasberger - *Nordea Markets, Research Division - Senior Analyst of Materials*

Of imports.

Roeland I. J. Baan - *Outokumpu Oyj - President & CEO*

So the quota, as I said, if you take the quota and you make that into a monthly, it's about 70,000 tonnes, and they will be allowed to get up to 3% of those 70,000 tonnes into the market without triggering the safeguards. Once they get past the 3%, they lose their developing country status, and then we will bring them into the safeguards.

Johannes Grasberger - *Nordea Markets, Research Division - Senior Analyst of Materials*

All right, so 3% out of 70,000 tonnes, which is the quota?

Roeland I. J. Baan - *Outokumpu Oyj - President & CEO*

Correct.

Operator

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

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

I have got 3 quick questions left at mind. Just firstly on Europe, you mentioned, obviously, that the very severe part of the price pressure on Europe only started towards the end of the second quarter and we've all seen the CRU numbers. If we put through this \$200 drop, which CRU is suggesting, it obviously puts Europe into a loss-making EBITDA territory next quarter, but that obviously does not appreciate your contract business. And also the fact that, as what I understand, purchasing conditions for stainless steel scrap, in particular, seem to have improved a lot, which could help you on the margin. How much of the price pressure have we seen already? And can you give us any sort of color as to how much worse the third quarter Europe can really get? And then secondly, just on the other slide in this more technical question, you said you've been benefiting from hedges. Will this normalize in the third quarter or will these hedges run for longer? And then just lastly, can you please give us a quick update on your cash requirements bridging from EBITDA, you're obviously spending EUR 220 million in CapEx. At the current earnings run rate, how much do we have to budget for cash interest, pensions and then also cash taxes all combined?

Roeland I. J. Baan - *Outokumpu Oyj - President & CEO*

Well, I'll take the first question and then the timing effect this has plus the cash requirements, Chris, I'll move to you. So as I said before, the price pressure that you're referring to is -- probably dropped to its worst in June, July, stabilized in what I see -- what we see from our order book, it isn't reversing into September. So it's definitely not as if we would go into negative territory and that is absolutely not happening. We -- as I said, we -- one of the things which, strangely enough, we enjoy in this environment is that we have now proven to ourselves that with all the initiatives that we have deployed and all the must-win battles that we have been working on that we have reduced our breakeven pricing level by literally hundreds of euros. So even in this environment, we are still capable of returning good results due to all this work. So it's actually not black at all. Chris?



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Christoph de la Camp - *Outokumpu Oyj - CFO*

Yes. Hedges and timing. So Bastian, actually in the second quarter our net -- if you -- for the group as a whole, our net of timing and hedging impact was de minimis. It was a EUR 1 million impact. So we're, obviously, trying to maintain that at as small level as possible, but we didn't get a big impact from that from the nickel hedging and timing in the second quarter. Now we do hedge other things as well. Of course, we hedge FX to some extent, we hedge energy, we hedge interest costs even. There's a lot of other things that we -- even in this quarter, CO2 credit, there are a lot of other things that move up and down. And some quarters, we may get a positive impact from the net impact of all of those and some quarters not so much. From those, we did get some positive impact in the second quarter, and I would not expect that to continue. So you can see in the others, at the financial results, there is a EUR 5 million like corporate benefit, a lot of which came from the impact of those other hedges. And going forward, I would not plan on it, I would expect it -- that to disappear, because normally at the corporate level, we ought to have some central costs, not big, but there are some central costs, so more normalized level would be a small charge rather than a small benefit that we see in there. So I think that would be a more realistic assumption going forward. Then moving onto cash impact. I mean, as we said in the past, our cash taxes at the moment are relatively low, because we have tax loss carryforwards in most of the legal entities in which we operate. I would underline the word most, because we do have 1 or 2 legal entities in which we operate where we do not have tax loss carryforwards and there we do have to pay tax. And even in there where we do have tax loss carryforwards, some countries such as the U.S. and Germany have got minimum taxation as well. So we do have to pay some taxes, we're not totally tax -- cash tax exempt. I think overall, this will be at a relatively small level for the foreseeable future, say, EUR 10 million to EUR 20 million in cash terms overall on, sort of, normalized profitability. In the future, that could rise, obviously, as we start soaking up those tax losses, and Finland will be first in line then we start having to actually pay cash tax, but not something for this year or potentially even next year. Then on the CapEx front, the CapEx guidance has been for this year EUR 220 million and that's the sort of framework that we are looking at going forward as well, and we will be there. The Fagersta acquisition was an opportunity that we used, that's up and above that. So, say, it's going to be EUR 235 million for that this year, but that was not a CapEx as such, that was an acquisition. But EUR 220 million is the cash CapEx out. And then on the interest costs in terms of cash impact, it was rather large in the second quarter, because we redeemed the old, more expensive notes, and there was early redemption fee associated with that, about EUR 11 million, and then also some fees to our arranging banks and then advisors and so on. So there was a cash out associated with that. And obviously, the ongoing normal interest costs that we have of a cash out. Our interest costs are now running in the, sort of, low to mid-60s after this refinancing. So I think if you work on the assumption, it will be -- and it won't be the same every quarter, because foreign interest, is of course, is only paid biannually, but I think if you work on the assumption of EUR 15 million to EUR 20 million of cash interests per quarter or about EUR 65 million for the nearer future, that will give you a reasonable cash out on interest. Does that, sort of, answer -- fully answer your question?

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

Yes. Maybe just one missing part. You obviously pay something of pension and actually we, kind of, relate the EUR 60 million you pay out for pensions, it's actually a high number relative to your pension provision. Now I don't want to get overly into the detail here, but that -- I mean, EUR 60 million relative to EUR 300 million of pension provisions is typically a relatively high pay down ratio. So therefore -- so is there any addition -- so I think the EUR 60 million according to your cash flow statement we have reflect as well, is there any additional offset via deferred taxes? I mean, some of your lines are not, like, fully split up and that's why I'm asking.

Christoph de la Camp - *Outokumpu Oyj - CFO*

Did you say EUR 16 million or EUR 60 million?

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

So I think 6-0, so EUR 15 million per quarter, EUR 60 million I think per annum? But I think it seems like there is some of the additional offset potentially against it?



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Christoph de la Camp - *Outokumpu Oyj - CFO*

no we don't pay EUR 60 million of pensions a year, it's much, much, much less than that.

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

(inaudible)

Christoph de la Camp - *Outokumpu Oyj - CFO*

No, no, that would be huge indeed against the provisions. What we did is we made -- but it was low-ish single million, so to put it in perspective, so lower single million contribution to one of our pension plans in the U.K. in the second quarter, but we did not pay more than that. So the cash out apart from normal contributions into pension plans that you make on an ongoing basis, that they are relatively small. They're certainly only single-digit millions and not double-digit millions a year.

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

Okay. So basically EUR 220 million CapEx this year roughly whatever you paid for Fagersta there, that's been, kind of, an acquisition one-off and then, yes, basically EUR 80 million for taxes and interest rate -- interest costs roughly combined. So all in basically puts you comfortably at or below EUR 300 million cash requirements?

Christoph de la Camp - *Outokumpu Oyj - CFO*

Yes. Plus swings in working capital of course, but yes.

Operator

We will now take our next question from Luc Pez from Exane.

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

I have one last remaining, which is connected somehow to the reply you made on Indonesia. I do find interesting as well that China is targeting Tsingshan. Part of my questioning is twofold. First of all, do you have any commence update on the exemption process that ATI Tsingshan is seeking in the U.S.? I understand that the conclusion is not yet out, but they are trying to get it first of all. And secondly, don't you fear, are you concerned, I don't know, that Chinese restriction on to Indonesia imports would likely lead to some increased pressure in the U.S. particularly, so I suppose if they get an exemption here?

Roeland I. J. Baan - *Outokumpu Oyj - President & CEO*

Okay. So no update on ATI Tsingshan. It, of course, is running. It's taking very long, don't know why, but we'll watch that. Again, I would be highly surprised if this exemption will come up, because it flies straight in the face of the reason why 232 is put into place, which is to make sure that domestic mills produce domestically and not shut down their operations in order to import, which basically did this. Do we feel the China action against Indonesia would result in more pressure on the market in Europe? No, I don't think so. Don't forget, there is a 25% tariff on it -- that's 25% tariff, I repeat it, on the full price, so including the metal. As the metal is 50%, it basically puts a \$500 to \$600 penalty on these imports. So unless Tsingshan is prepared to run this at a loss, which doesn't make a lot of sense, I don't see that there will be any pressure from there.



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Operator

As there are no further questions in the queue, that will conclude today's question-and-answer session. I would now turn the call back to your host for any additional or closing remarks.

Tommi Järvenpää

Thank you. And thanks, everyone, for attending our earnings call. Our third quarter results will be published on October 26. Until then, thank you and goodbye.

Operator

That will conclude today's conference call. Thank you for your participation, ladies and gentleman. You may now disconnect.

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