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Q1 2019 Outokumpu Oyj Earnings Call

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CORPORATE PARTICIPANTS

Pia Alexandra Aaltonen-Forsell *Outokumpu Oyj - CFO*
Roeland I. J. Baan *Outokumpu Oyj - President & CEO*
Tommi Järvenpää *Outokumpu Oyj - VP of IR*

CONFERENCE CALL PARTICIPANTS

Anssi Kiviniemi *SEB, Research Division - Analyst*
Bastian Synagowitz *Deutsche Bank AG, Research Division - Research Analyst*
Cedar Ekblom *BofA Merrill Lynch, Research Division - Analyst*
Harri Taittonen *Nordea Markets, Research Division - Senior Director & Sector Coordinator*
Krishan M. Agarwal *Citigroup Inc, Research Division - Analyst*
Menno Gerard Cornelis Sanderse *Morgan Stanley, Research Division - MD*

PRESENTATION

Operator

Good afternoon, ladies and gentlemen; thank you for standing by. Welcome to today's Outokumpu First Quarter 2019 Results Conference Call. (Operator Instructions) I must advise you that this conference is being recorded today, the 7th of May, 2019.

And I would now like to hand the conference over to your speaker today, Tommi Jarvenpaa. Please go ahead.

Tommi Järvenpää *Outokumpu Oyj - VP of IR*

Thank you. Good afternoon, and welcome to Outokumpu's Q1 2019 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, Pia Aaltonen-Forsell.

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

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

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

Thank you, Tommi. So, welcome to the call, and as usual, I would like to start with our vision, to be the best value creator in the stainless steel by 2020 through customer orientation and efficiency. And to that, as you know, we have put a number of financial targets, and it is, as we have mentioned before, obvious that these were based on mid-cycle market conditions. If those mid-cycle market conditions are not met, naturally, those numbers will not be met. However, that doesn't diminish the vision itself, which is to be the best value creator.

And just to bring back to memory something that we showed before but now have updated as well for the latest numbers, since we announced and launched our vision, Outokumpu has given total shareholders' return of 37% versus our main competitors, Acerinox, 9% and Aperam, minus 8%.

When you look at our employees -- because we said there are three angles that we look at, shareholders, employees, and customers -- when you look at employees, we came in the OHI, the Organizational Health Index, from a bottom quartile up to now the second quartile, and poised to move up into our ultimate goal, to be in the first quartile. So, there again, we have delivered what we said we would.

And then on the customers, we have moved from initially when we measured in the low 50s satisfaction for the customers to now 63%, and we are 5% ahead of our competitors. So, again, we are well on our way to achieve our vision.

When we now turn to the first quarter results, it does reflect very challenging markets. You're all aware of what has happened. The market has been flooded during the initial temporary safeguard period in Europe by an enormous amount of products, and pricing has been severely impacted in Europe, but in fact as well in the U.S., where you have seen the arbitration from Asia coming in. When prices in Europe are this low, then suddenly it becomes attractive as well to move product into the Americas, specifically into Mexico, where the share of imports has grown significantly and prices have come down significantly. But even in the U.S., the threat of imports and the



actual imports that are coming in have put a cap on the market.

All together, that means that if you compare the first quarter to the fourth quarter of last year, that as always, seasonally with higher volumes, not as high as we would expect. Europe actually very decent volumes, more in line with normal seasonality; in the U.S., quite subdued, pricing and mix, however, down significantly. Pricing down as explained before, and mix has mitigated it slightly.

Then on the cost side, we have been positive. We have actually had an extremely good first quarter when you look at productivity, where we achieved as a group 2.8% productivity quarter on quarter, or year on year, better to say. So we are well on the way to achieve the goals on our manufacturing excellence and operational excellence as well.

Then bridge effects, we had the insurance claim of EUR 35 million last quarter, which doesn't repeat, and then we had currency derivative losses of around EUR 12 million that you see here, and that adds up to the EUR 54 million.

As said, we haven't been helped by pricing. Pricing actually was, generally speaking, flat. You see here that, according to the CRU pricing, the European-based prices moved up slightly. However, if you look at the realized pricing in our own portfolio, that is not reflected. In our own portfolio, we had in Q4 significantly less effective priced material than in the first quarter, so we didn't actually experience that much the EUR 730 that is reflected here in the CRU numbers in Q4, but we did have a large chunk of the EUR 796 type of deals in the first quarter.

In the U.S., on the pressure from (indiscernible) imports, prices went down slightly. (technical difficulty) went up, and then ferrochrome of course went down \$0.12, which has a significant impact as well.

Positive side, the E.U.'s permanent safeguards have proven effective and, whereas at some stage we had a third of consumption covered by imports, that is now down to the low 20s. So, clearly, this has had its effect, as has Article 232 in the U.S., where imports are now hovering around 19%. However, again, the markets are not as buoyant as they were, so you do not see the full effect in the volumes.

Just a few reasons why not: first of all, as is well published, there is a reduction in activity in the automotive side. Year on year, automotive activity is about 3% down. And you see it as well in appliances, which used to be was a very strong market in the beginning of 2018. That started slowing down significantly through the latter part of '18. It's picking up a little bit, but it's still not great. On top of that, you see expectations from the distribution segment that the nickel prices will drop further, and distribution segment is further destocking or, what account for destocking, living hand-to-mouth. (technical difficulty) on that is that we have now seen that the inventories at distribution are really getting at very low level, signifying a pent-up demand for once it will turn again.

If you look at the prices, nothing new to say. European base prices, basically still at a low level, in the U.S. ticked down a little bit over the last quarter of '18 and stabilized around this level, as you can see here. And transaction prices in Europe, U.S.A. and China have grown more together. What you do see is that the U.S.A. is now significantly higher than China, which does open up a little bit of arbitrage, not so much direct from China, but from the other countries in Asia.

With that, I hand over to Pia for some of the key figures.

Pia Alexandra Aaltonen-Forsell *Outokumpu Oyj - CFO*

Thank you, Roeland. So, hello, everybody. So my name is Pia Aaltonen-Forsell. It's now a little bit more than 60 days as CFO for Outokumpu, so happy to be here presenting these Q1 results.

And as for the key figures table that we can find here on Page Number 10, I think I would further, to Roeland's comments, also like to comment a bit on the operating cash flow. It's not a typo; it's actually true that the figure is exactly the same as in quarter 1 a year ago, and I think given the lower EBITDA, there is other really positive parts of the report, such as the working capital change that we can come back to still a little bit more at the later stage.

You also see that there is a change in the gearing, a change in the net debt, and compared with the year-end figure, the really big

deviation comes purely from an accounting, let's say, change, the IFRS 16 and the leases. So, really, no other significant changes there. So the lease impact on the gearing, the IFRS 16 impact on the gearing is almost 5%, actually. And furthermore, then, following the result, the return on the capital employed is 4.3% in the quarter.

But turning a bit the page and looking more into the quarterly results per each BA, so we start with the BA Europe, and here, obviously, if we just take first a really quick look at the bars on the left-hand side and compare the result level of this quarter, where we have EUR 42 million of adjusted EBITDA with the result level a year ago, there is of course a significant decrease. And compared year on year, there are definitely major changes, particularly in terms of the pricing, but also higher costs, for example electrodes, also for the group. So obviously, those are the impacts that we can see here.

Then, turning to the sequential changes and comparing with the situation in Q4, of course seasonally significantly higher deliveries, even though the rebound here from Q4 is maybe not as strong as it has been in some historical periods. But, still, seasonally much higher deliveries.

And then, when we look at the negative impact of the pricing and mix, we have here particularly commented also that the contract prices has been somewhat lower, but there is also the impact of the higher share of effective prices that is playing a role here.

Net of timing and hedging, positive this time, and on the cost side we also have a slight positive, and this is primarily the maintenance type of costs. Obviously, Q4 is a quarter where we would see a lot more maintenance activity, and now in Q1, that has been on the lower level.

The others bar here also seems to be quite big, and I think there are actually several things worth commenting. One of them may be more of a bridge impact. In Q4, we had some positive impacts following some adjustments in the German pension schemes and payments there. But obviously, in this quarter as well, we've had some hedging losses that we have described in the report that particularly hit the European business. And you may of course ask that, you know, why is this so big in this quarter? I mean, obviously, there's been a lot of movement in the currency markets, and particularly for these currency type of derivatives, we have not applied hedge accounting. So for those of you who are more, let's say, technically interested, that might explain it. But to put it in other words, it is just to say that we have to value the hedge at the balance sheet date, but the positives from the cash flow may materialize at a later point.

Okay, looking at my notes here, I think definitely I have brought or discussed at least a major part of them, so maybe we move on then to Americas next. The Americas quarter of course was weak. We had, let's say, the trail of the high-priced inventory, so we could call this old sins, but obviously, when you look at the bridge here from Q4, there is overall a very slight improvement. Deliveries have somewhat increased. Pricing and mix is clearly on a positive improvement path here, so we can also see that the mix has improvement in Americas, which of course is a positive thing for us. But the net of timing and hedging here is negative, and this is maybe then what we could call the old sins, so to say. So still here having an impact, the high-priced inventories through the Q1, and now we are seeing that impact gradually really decrease and even vanish. And then on the costs, I mean, really, really just a very small impact.

And I still wanted to make one brief comment just looking at the bars here on the left-hand side and looking at the result of this quarter compared with a year ago, and if we just consider what the major impacts are there, it's clearly that the volumes are lower, but on the other hand, the mix is better.

Okay, then I would move on Long Products, and looking at the figures here, obviously, once again the global trade situation has had an impact, so on one hand softening demand, and also then the U.S. steel tariffs have impacted the profitability. And you can see it here compared with what we have seen in Q4, just a small improvement in the deliveries. And on the other hand, pricing and mix have declined, as well as the net of timing and hedging. And then again, some improvements in costs and some positive bridge impact from pensions, where there were some extra costs in the U.K. in the fourth quarter. Year on year, some of the changes are also caused by volumes that have decreased if we compare with Q1 a year ago, so softening demand and Section 232 clearly having an impact on the results here.

Moving on to Ferrochrome, deliveries remained here at the high level, and I think as Q4 was presented, we have really discussed the

record high level of deliveries. And I'm really happy to say that we have been able to maintain the deliveries and the production at this high level, so stable on this high level, which of course has a really positive, let's say stabilizing impact for us.

And then, looking at what's happening in the result, the really big impact here is purely a bridge impact from the insurance compensations that we got back in Q4, and that was clearly a one-time impact of EUR 32 million. On the other hand, also, we have seen the benchmark price. It's down actually 8% compared with what we saw in Q4. And on the cost side, mainly the coke prices have increased during the quarter.

So this is where we are. If we compare with a year ago, the price is actually -- the benchmark price is somewhat lower. It was EUR 1.18 in Q1 of '18, so that's sort of easy to remember, even though that was some time ago. Variable cost and the coke the same, has also increased compared with a year ago.

So I think that's it, short comments on the BA results. And then, still, turning over to the cash flow, and I think from my perspective looking at the end result here and considering the seasonality and let's say the typical pattern during this early part of the year where, let's say, the volumes are picking up, and the typical result of that is also an increase in the working capital. If I compare with a year ago, actually, in this quarter, the figure was even EUR 60 million negative for the working capital during that quarter, and now we have the swing to positive of EUR 32 million. So clearly, this has contributed a lot to the cash flow of this quarter.

And considering what are the let's say various drivers behind this development, it's clear that we have focused a lot in the area, and you have also of course listened in to the development in the Americas, the focus really on the supply chain. A lot of activities in really having better processes, better ways of operating, and a lot of focus, just simply. We can see this, for example, in absolute number of tonnes of inventories that decreased through the quarter. So, very positive impact from the working capital, then a more typical negative from provisions, pensions, financial charges, typical things, payments that occur during the quarter.

And then again, from an investment perspective, we have actually here as a cash-out this figure of 35. You could see on one of the other pages that the accounting figure for CapEx is somewhat higher, but the deviation is due to just the amount of accounts payable that we have open relating to the CapExes. So overall, I would say a very acceptable performance, and I could even say that I'm happy to see the working capital improvements that we had in the quarter.

Then I have my final slide, which is on net debt, and it's really not that exciting because we can say it's an accounting change that has caused the deviation here. So at the end of quarter 1, we have EUR 1.37 billion of net debt, and the change vis-a-vis the year end is simply the IFRS change. In terms then of the leverage, we are now at 3.4x. and I would say from my perspective and reviewing some of the materials also we have in the appendix on the maturities on our portfolio of debt, et cetera, I think what really remains a priority is decreasing the short-term part of the financing, and certainly something that we are focusing on and working with the team, even as we speak.

So with that said, thanks very much. And, Roeland, over to you.

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

That sort of brings us to the outlook for the second quarter. So we do not see any significant changes in the stainless steel market for the second quarter compared to the first quarter. As a result, deliveries are expected to remain at a similar level. When you go to Ferrochrome, we have a positive impact from the higher ferrochrome contract price, but this is partly offset by planned maintenance work in the ferrochrome operations, specifically in the beneficiation of the ore before it gets into our furnaces. All that together leads us to expecting an adjusted EBITDA to be higher than the EBITDA of the first quarter 2019.

And with that, Tommi, back to you.

Tommi Järvenpää *Outokumpu Oyj - VP of IR*

Thank you, Roeland, and Operator, we are now ready for the questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Krishan Agarwal.

Krishan M. Agarwal *Citigroup Inc, Research Division - Analyst*

Yes, thanks a lot for taking my question, and congratulations to Pia for becoming -- coming on board as CFO. My first question is on the guidance. I mean, can you help us to understand the magnitude of increase for the second quarter '19? Because right now, that is more qualitative and kind of very broad. I mean, if I were to put the (indiscernible) guidance in two points, one is directionally, I mean, if you look towards unit, okay, Europe will contribute the largest increase while Ferrochrome, I mean, sort of flat in America. I mean, that's the key there. So if you can help us understand (indiscernible) is moving each and every division?

And second question is on Ferrochrome. So you said you have planned maintenance, so should we take the second quarter of 2018 as a (indiscernible) for the production volumes for -- given the impact of the plan maintenance? Thanks.

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

Let me first take the second question. The maintenance does not impact at all the production, nor the sales volume. It is just a cost issue. So volumes is the same, but because we have been pre-producing the benefite ore, so no operational hindrance, just cost.

As to help on the guidance, look, you can do the bridge. And, actually, I have seen the bridges that came out from the analysts. I've seen the consensus, and the only thing I can say is those are not that far off.

Krishan M. Agarwal *Citigroup Inc, Research Division - Analyst*

Okay, I understand. So what is the expected cost for this ferrochrome maintenance, in that case?

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

EUR 5 million.

Operator

Your next question comes from Michael [Bowen].

Unidentified Analyst

Hi. Obviously, you face a challenging operating environment at the moment and have alluded to the fact that that's likely to continue through the second quarter. When, if at all, do you see any turnaround? And can you share with us bank covenants, because you know, I have leverage going up into the close to 5x by the end of the second quarter. I just wondered if there's any issue with respect to bank covenants.

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

So let me -- I don't know where your 5x comes from. It's an audacious number, but, I mean, I'll leave that to you. It's not our number.

As far as covenants are concerned, Pia?

Pia Alexandra Aaltonen-Forsell *Outokumpu Oyj - CFO*

I don't think this is anything that we would comment at this stage, but, yeah.

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

Basically, we have no covenants that come anywhere near to where we are or where we, in the worst case, could be projected to be. Let me put it very clearly.



Unidentified Analyst

Okay, sorry, your CapEx slide for this year, can you tell me exactly how much you expect to spend on CapEx? It's not very clear, or not perfectly clear.

Pia Alexandra Aaltonen-Forsell Outokumpu Oyj - CFO

Yes, it's in the range of EUR 240 million.

Unidentified Analyst

EUR 240 million.

Pia Alexandra Aaltonen-Forsell Outokumpu Oyj - CFO

Yes.

Operator

Your next question comes from the line of Anssi Kiviniemi.

Anssi Kiviniemi SEB, Research Division - Analyst

Yes, it's Anssi from SEB. Let's kick off with Americas. I will take these one by one. The mix effect was positive in Q1. Where does it come from, and could you a little bit elaborate on that one? And do you expect it to continue into Q2?

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

Right, so the mix effect is basically more cold rolled, so more conversion of low added value into high added value. So we had a higher proportion of cold rolled in our sales. That will continue. We are not expecting that to fall back, so that is one of our main objectives as well in the Americas is to keep on improving that mix, because that is what's bringing the money.

Anssi Kiviniemi SEB, Research Division - Analyst

Okay, good; thanks. Then continuing on Americas, if we had just for the raw materials and derivative losses of EUR 40 million, it was slightly still loss making on the EBITDA in Q1. Should we expect this to continue? And I'm asking this because the result on Americas has been quite volatile lately, so any indication would be good. Thanks.

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

Yes, so let's put it at break even for Q2.

Anssi Kiviniemi SEB, Research Division - Analyst

Okay, that's pretty clear. Then last question on raw materials, and you highlight electrodes there. How much was the impact from higher electrode costs in Q1 compared to previous year, and in euro millions, please. And is there any other raw material item popping out that you want to highlight?

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

So on the raw materials side, apart from the electrodes, there's not a lot of others that we see moving. We have seen slightly higher electricity prices. We see ferrosilicon and refractories at the same kind of levels. And when you get to electrodes, we actually see two different moves. We still saw higher pricing, higher costs in the first quarter, mainly due to the role of contracts that we had, high-priced contracts, so we had more high-priced material in Q1 than before. Going forward, we see the electrode situation easing up, with two provisos, or one proviso. In the U.S., we still have contracts at relatively elevated levels that will run until mid-year, whereas in Europe we are already getting into a point where better priced electrodes are moving into our cost base.

Anssi Kiviniemi SEB, Research Division - Analyst

And could you give us the magnitude in Q1 compared to previous year? That would help a lot.

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

Yeah, I would prefer not to do that because I don't want my competitors to take a pencil and start calculating what we pay for our electrodes.

Operator

Your next question comes from the line of Menno Sanderse.

Menno Gerard Cornelis Sanderse *Morgan Stanley, Research Division - MD*

Just two questions, please, just the first one on the commercial benefits under the improvement program of EUR 110 million. Can you just give us a bit of an update where we are on that journey? Is it harder to achieve now or no different, given that market conditions are a little bit tougher?

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

So there are basically two big programs here. One is where we are moving more and more of our portfolio into specifically what had been produced in Europe, not necessarily consumed in Europe, because we export the product both to the U.S. as well as to Asia. It's to move a larger portion of our portfolio to the so-called pro grades. We come from a proportion of maybe 7%, 8%. We are now getting in the territory of already 13%, 14%, and that trend is still continuing, so that is very successful that is moving. And to give you a bit of an idea, on a tonne-for-tonne basis, the contribution margin on the pro grade is at least 3x, 3 to 4x as high as it is on the standard.

The second one is what I referred to earlier, which is in the Americas, we are moving our portfolio into a richer mix. Two steps in there. One step is from more hot band into cold. So as you have seen, we stopped all our exports. We are not going to have these low added value products going anywhere anymore that do not bring anything. It's better to control the cost and not produce this stuff. And then secondly, within those cold-rolled products, we actually have been very one-type-minded, and we're now moving into more differentiation in gauges, width, et cetera. Plus, we have added polishing capacity as well in Calvert to bring that extra step to bring more money in. So those are the two biggest moves, and both of them are developing well.

Menno Gerard Cornelis Sanderse *Morgan Stanley, Research Division - MD*

Great, thanks. And then the second -- well, big changes may be a big word, but the overall change in leadership in the U.S. last week, is there now going to be a whole sort of review of the position or the strategy, or is this just a question of sharpening up the plans, sharpening up the execution of those plans, rather than a wholesale review?

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

It's the latter. We don't need a wholesale review. We are very happy with our position. I mean, we still are by far the number 2, with number 3 a long way behind us. We need to concentrate more -- we had done a fantastic job, and the team in the U.S. is great. They've done a fantastic job in stabilizing the plant and getting operationally the advantages that has brought it from a big loss making position into a break-even position, and now we need to make the steps to actually bring that decent profitability, as we have called it, into the plant.

Operator

Your next question comes from the line of Harri Taittonen.

Harri Taittonen *Nordea Markets, Research Division - Senior Director & Sector Coordinator*

Yes, good afternoon, Harri Taittonen from Nordea. Can you give sort of your view on what might be what you're seeing in the ferrochrome market further in the second half of the year? Is that sort of possible to give kind of your take on that and what might be driving it?

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

If you have a second, I'll just get my glass ball. So the second half is difficult. I'll give you a more general description. We saw the China spot prices drop significantly towards the end of last year, down to \$0.78, \$0.79. Then it stabilized in the first quarter at about \$0.82, and then it has been moving up to about \$0.87. Currently, it's probably about \$0.85, so these prices are fluctuating. The general trend has been an underpinning of pricing, rather than anything else.



Why I'm careful for the second half is, as you know as well, you see Mr. Trump sending out a tweet that he is slapping on more import duties on China's material. The world interprets that as a slow-down in the Chinese economy, which means less metals being bought, which means the whole metal complex is under pressure. Now, tomorrow he will tweet something else and we will be up again. Very difficult to say.

More fundamentally, you have seen a continuing consolidation in the ferrochrome markets to the point where, virtually now, you have a duopoly where we are basically the third largest producer in that duopoly. My guess is that, as we have said before, this has a positive underpin to the ferrochrome market, medium term.

Harri Taittonen *Nordea Markets, Research Division - Senior Director & Sector Coordinator*

Okay, thank you for that account. Maybe one more question on the Long Products, that sort of -- if you can remind how that sort of deviates from the -- I mean, in terms of driving forces and the sort of volumes were quite a lot lower compared to the development in the flat product side. And just sort of remind how -- what are end use drivers, how they differ and what explained the sort of somewhat more rapid weakening this quarter compared to the flat.

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

Yes, so one big driver is the fact that the deliveries are -- so not external, but internal -- internal deliveries to the BA in Europe were down, and that has an immediate effect. Orders were down in Europe, as you probably know. SMACC is our swing plant when it comes to slab production, so that got out there.

The second one is pricing. In the U.S. specifically, we have encountered of course the Article 232 and we didn't have exemptions yet, and as a result we have decided to share the pain of Article 232 with our customers. So we have absorbed part of that cost, and that has influenced the pricing, and it is probably the biggest contributor.

And then we have a almost as large timing effect. If you look to second quarter and further, the timing effect will not repeat. On the pricing, we have obtained a number of exemptions, plus we have changed a number of the contracts, so that will not repeat either as far as we can see. So we see a significantly better future in Q2 and forward than what we saw in Q1.

Operator

Your next question comes from the line of Cedar Ekblom.

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

I've got two questions, guys, one follow-up on the U.S. and then another on your raw materials. On the U.S., can you talk about the fact that you are now producing at lower utilization rates? Obviously, your product mix has improved, but what that means in terms of actually realizing the potential of the Calvert mill. We know in steel that these are generally higher fixed cost assets, and lower utilization rates can impact profitability.

And then on the second point, can you please talk about what you've seen in terms of scrap discounts in stainless? With the nickel price rallying over Q1, have your scrap discounts come in or shrunk, or are scrap discounts still pretty wide in stainless? Thank you.

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

All right, so let's start with the Americas (indiscernible). Yes, the utilization rates are down, logically. And this is not because we lost market share. This is -- actually, we've gained market share in the first quarter, so this is clearly the market that's being slow at the moment. It has an effect undoubtedly. We have been able to take out cost as well, but if it stays at this low utilization rate, we will not go into a loss making position, but it will affect of course your up side.

Now, these volumes are really low. If you look at it, we are about 20% down on what we had in late '17, early '18, when we had a more normal market, and I assume we will come back. If not, yes, it will have a cap on our ability to get to higher profits. Again, it will not influence -- put it a different way. Our break-even point is lower than what these low volumes indicate. So I'm not saying that I'm not

worried about the overall situation, but it doesn't hurt us either.

On scrap discounts, I can't comment. These are things that we negotiate individually as companies with all the big scrap suppliers, and I would not want to make clear what we do on that front.

Operator

Your next question comes from the line of Bastian Synagowitz.

Bastian Synagowitz Deutsche Bank AG, Research Division - Research Analyst

I just have actually a couple of questions left, and the first one is on the U.S. business. Roeland, Mike was obviously one the key guys behind your action plan, and I know Olli-Matti has been around for some time now as well, but to hire a new head. How come you let go Mike without the transition period in the current situation?

And then my second questions are on the European business. In your bridge chart, you show that the negative impact from contract prices in the first quarter seems to be around EUR 30 to EUR 40 million, which is mostly annualized around EUR 120 to EUR 160. Now, given that at the Capital Markets Day I think you felt that contract prices would actually not see a meaningful drop, that is awfully a pretty large number. Is this already baking in the price improvement on the [spot] market, which we've seen in the first quarter, or are these higher base prices for the first quarter mostly to be realized in the second?

And then, maybe, can you also give us an update on the market and the trends you're seeing? It seems like the price recovery we saw in the first quarter didn't go too far, despite the safeguard measures. And do you see [scope] for a second leg in price recovery this year? Thank you.

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

Okay, let me start with the easiest, and that is the contract prices. The EUR 30 million is a bucket with many different things in there, of which contract pricing is one. What we said, the prices are not down significantly year on year is true. We are down probably about EUR 30 over all our contracts on contract pricing '18 over '19. So in spite of the much lower base price market, contract prices have hardly suffered.

The larger explanation is that we have had, in the first quarter, a lot more sales done at effective pricing. So when you get to let's say distributor sales, non-contract sales, that used to be all on either daily or monthly alloy surcharge. Now we see that 70%, 80% of that goes on effective pricing, which is basically the pricing that is being dictated by the imports that come out of Asia, so that has eroded pricing power in the current environment.

If we go to the U.S. business and why no transition, look, we had moved our man in position, and he has done the transition. He is fully capable of running that business area, so we did not have need for further transition.

And then the update on the market price recovery, look, it all depends. We have seen, indeed, a price recovery on the back of rising nickel prices. Now you see nickel prices dipping, as I said, so especially the distribution segment is holding back from buying and is watching how far can nickel drop. So I would say that yes, there will be, because of the dropping nickel, in the effective pricing there will be a lower pricing going forward. That doesn't necessarily mean that we will have lower margins on that.

Bastian Synagowitz Deutsche Bank AG, Research Division - Research Analyst

Thanks, Roeland. Just a quick follow-up on my question regarding pricing. So from what you say, [she] has been a bit of a customer mix change and a bit more higher portion, which you saw to the service center segment, probably slightly lower demand from the OEM segment, which obviously makes sense in terms of what's been going on in the market. Will the customer mix change in the second quarter and you will be moving back some of those volumes to slightly more favorable pricing terms, even though the actual base prices haven't gone up?

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

It's not so much the customer mix, Bastian. It's within the segment of distributors that used to buy on alloy surcharge, you see now a trend towards effective pricing because that looked, after the enormous influx of imports in 2018, that looked the cheaper way to go. Now under the safeguards, I'm pretty convinced that you will see with the far lower imports, and as the markets return to normal situations, that that will reverse. When it will happen, difficult to say, but I don't think this is something that you can say, okay, this is a big change in our customer mix portfolio. It's more how the market is reacting currently on the imports that came in in 2018.

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

Okay, clear. Just maybe one very last question on the ferrochrome business, if I look at the business, of course you were facing a price decline, but overall the performance was still probably quite weak, and as far as I understand, this was mostly due to higher coke prices which have been hitting you here. Can we expect these to ease in the second quarter or in the third quarter, or will there be basically a drag for the rest of the year, just looking at your contract terms?

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

So, difficult to say. For the second quarter, I think we'll see a similar cost base, and throughout, I can't tell you what is going to happen.

Operator

(Operator Instructions) There are no further questions at this time. Please continue.

Tommi Järvenpää *Outokumpu Oyj - VP of IR*

Thank you very much for attending our earnings call. Our second quarter results will be published on the 1st of August. Until then, thank you and goodbye.

Operator

This does conclude our conference for today. Thank you for participating. You may all disconnect.

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