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Q3 2019 Outokumpu Oyj Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Outokumpu Third Quarter 2019 Results Conference Call. (Operator Instructions) I must also advise you, the call is being recorded today, Thursday, the 31st of October 2019. I would now like to hand the conference over to your first speaker today, Tommi Järvenpää, Head of Investor Relations. Please go ahead.

Tommi Järvenpää *Outokumpu Oyj*

Thank you and good afternoon and welcome to Outokumpu's Q3 2019 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, Pia Aaltonen-Forsell. We will be referring to the presentation that can be found on our website.

And with these remarks, I'm pleased to hand over to Roeland. Please go ahead.

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

Thank you, Tommi. So as always, we will start with the vision to be the best value creator in stainless steel by 2020. Now as you see, we are, at this moment, not repeating the financial targets [next year] because as we have said in the last quarter as well, if market circumstances like we have currently persist into 2020, obviously, targets that have been set on mid-cycle circumstances will not be met.

However, we are absolutely certain that we will make our vision of being the best value creator in stainless steel by 2020. And operationally, as far as we perform towards our customers, and as far as we are moving on to becoming a high performing organization, we are on the right path. So to the specifics of the third quarter.

We have had, as you saw from the release, a challenging quarter. In spite of the performance as a company internally where we have made tremendous steps in, for instance, productivity, where productivity year-on-year has improved by 4% in a declining market, which is a remarkable result and where we have been able to -- and we come back to it, be generating cash as well in spite of lower result. The external market is such that we have to report weak results for the third quarter.

Deliveries were down to one of the lowest, if not the lowest quarter we have seen in the last 5 or 6 years. And on top of that, with the increase in nickel price due to the sudden rise from about \$12,500 to \$17,000 in the space of 2 months, we have significant timing and hedging losses as well.

On a quarter-to-quarter basis, on ferrochrome, we went from \$1.20 to \$1.04, which, of course, is a significant negative. But then as positives, we have the improved cost efficiency that I was just talking about as well as some gains from derivatives and emission allowances, bringing us to the EUR 45 million for the quarter.

Go to the next slide, talking about the unfavorable raw material price development. The base prices both in Europe and in the U.S. more or less have stayed at the same level. But the average nickel price has significantly jumped up, which, of course, created 2 things, the



[net] of timing and hedging result and a bit of a margin squeeze as well.

And then the ferrochrome price I talked about, \$0.16 down. We have always guided about \$10 million per \$0.10. So that in itself is a \$16 million difference just on price. Having said that, in ferrochrome operationally, we have been operating extremely well. And when we get to the individual business area results, we will be commenting more on that.

The unfavored moves on the metal market have led to a margin squeeze, as I just said. First of all, of course, very directly on ferrochrome but as well on the margin in stainless steel as normally, you cannot recover fast enough in your alloy surcharge, what you see as an increase -- an immediate increase in your input costs.

If you look at the U.S., things are more stable. U.S. base prices have remained very stable. But if you look at the graph on the right hand, we're now seeing that the difference between the transaction price in Europe and U.S. and the Chinese transaction price is opening up to a very high level, which ultimately means that there is more room for arbitration of material flowing from Asia into Europe specifically, but it puts a cap as well on pricing. And because -- although there's a 25% protection through Article 232, it is still clear that, at some stage, the gap becomes so big that the importers can start paying the difference.

We are not there yet. If you go to the next slide, you will see that in Europe, indeed, this has led to a surge of imports. Imports into Europe now account for 34% of consumption in cold rolled. That is the highest import penetration ever. Even during the years 2013 and '14 when China was dumping into the European market, their share did not go beyond 30%. So this is an unprecedented amount of import that puts a big lid on the market, especially as the market as a whole, of course, is far less active given the macroeconomic circumstances.

Conversely, in the U.S., you see that the Article 232 continues to work its magic, and the imports there are at only 15%.

And with that, I would like to hand over to Pia.

Pia Alexandra Aaltonen-Forsell *Outokumpu Oyj - CFO*

Thank you, Roeland. Good afternoon, everybody. Just having discussed both the import pressure in Europe as well as the macroeconomic situation, in some combination then with the more stable situation in Americas, however, we have also there been more selective when it comes to the volumes.

This has then overall led to a low volume in the third quarter. You see it here, stainless steel deliveries of 533 kilotonnes. Obviously, seasonally, we would expect something lower in Q3 compared with Q2, but there was a very, very clear pressure from the earlier mentioned topics.

EBITDA then at EUR 45 million in the quarter. And then, I think the focus that we have had on net debt reduction and the cash flow. Here, I will have a couple of more slides on the topic to really drill down a bit more into this, but we can see the headline figures here, the operating cash flow was positive at only EUR 12 million in the quarter. Net debt then ended up at EUR 1.3 billion. Gearing, healthy at 51.4%.

And with that said, I think we can start a bit more of a deep dive then. First, into the profitability or EBITDA development of the business areas, and we start with Europe here. Obviously, for Europe, we ended Q3 at an EBITDA level of EUR 33 million. And the main negative deviation came from the deliveries. So I would still start by pointing out the underlying demand in Europe being low.

So we have discussed the import penetration, but the market also is on a weak level right now. Our market share has remained stable, but we see weakness in the market. For example, the automotive segment is something, I think, we have discussed also in earlier quarters, distributor segment as well.

If we think of Europe from a geographical sense, also in Germany, we have seen lower demand. And I think given our business, this also had a clear negative impact. So that's where we are. And you see really the big red bar here, the deliveries compared with Q2, obviously, a bit of seasonal impact there as well.

We have other smaller items here. You see there was a bit of negative from the pricing and mix as well. But then I would like to focus for a short while, a bit more on the net of timing and hedging here. So the impact on this bridge looks slightly negative. But if we look at the absolute amounts in the quarter, it's clear that in respective business areas, we will find quite negative impacts.

So when we talk about business area Europe, the absolute value was of minus EUR 70 million. And I think I will still get back a bit more to the hedging impact. But I just want to bring the total picture because the outset for the group is that we have negatives in the BAs, and we had some positive in segment other. So I think it's important to see this sort of from a total picture perspective.

On the costs. You can see that we have a bit of positive movement here, but it's also typical seasonality. We have a little bit lower personnel costs due to already accrued, so to say, holiday payments that haven't been used during the quarter. Okay.

And next, let's look at the business area Americas. Here, we also already sort of visually can see that the underlying performance, we have more green bars compared with Q2, actually a bit improved deliveries, better raw material mix, pricing and mix being positive. Also, some positives may be mainly bridge effect in the others. But also here, you see that the timing and hedging is clearly negative. And this, again, if we look at the absolute amount of this one, it's minus EUR 15 million in the quarter.

So when we look at the demand side here, it has remained relatively stable. Still, I mean, the distributor segment is on a weak level in the sense that we have seen continued destocking during the quarter. We have also been much more selective in volume. So if we look at the previous year, we had, for example, export volumes during this period. This has not repeated in this quarter.

Overall, still, we have -- we can now see some benefits, really, in the underlying business, but the negative from the hedges, net of timing and hedging, have then resulted in an overall negative result for the quarter of minus EUR 11 million.

Long Products next, clearly, here, the demand is the big negative factor. You see the deliveries being on a negative trend here as well. Here, we have seen both inventory destocking, but also a decrease in end user demand. On top of that, Q3 is seasonally slow. So we have all these negative impacts in the same quarter.

We also have a negative hedging loss here. The net of timing and hedging in absolute terms was minus EUR 6 million in the quarter. You see here a small positive impact on cost. But obviously, given this very challenging situation, this has led to some further actions also in terms of balancing the cost base. But I think, Roeland, you will come back to this later. Overall, then, the quarterly results at a minus EUR 9 million EBITDA.

Finally, on ferrochrome, I think I just really want to reinforce the message that the operational performance has been good. We've already talked about the price here. The lower benchmark price clearly had an impact. But you see that on costs, we have lower personnel costs, seasonally lower cost price.

But I do want to bring up that we've had the maintenance break. It started in September, carried over into October. It has been carried out in a good way, according to plan. And beside this maintenance break starting already in September, we did have a good production -- ferrochrome production at 131 kilotonnes in the quarter. So a really good performance operationally and then ending up with a EUR 90 million EBITDA as a result. Okay.

We've added a slide here to explain the hedging dynamics or more or less the principles around metals hedging and nickel hedging in particular. And before I go into the principles, I would just repeat sort of the group level headline numbers here. So we had a minus EUR 17 million in Europe, minus EUR 15 million in Americas, minus EUR 6 million in long products and that's, of course, a total of minus EUR 38 million. And then in the other segment, we had a positive impact of approximately EUR 10 million. So this was then balancing the impact from the BAs to some extent.

I think it's obvious that with this very rapid increase in the price of nickel during just one quarter, it's really the sort of volume and timing mismatches that are the main issue here. We also have seen changes in the pricing mechanisms of sales, in particular, to some extent,

also purchases. And this refers to, let's say, the earlier principle of applying an alloy surcharge almost throughout the business. And now this is a more selective process where a part of the business is running with alloy surcharge, and a part then with effective pricing, which then leads, of course, to the necessity of constantly adjusting the pricing and being very, very diligent about that implementation.

So the typical procedure that we have is, of course, clearly monitoring our underlying positions, if we have fixed price sales or fixed price purchases. We have an underlying exposure vis-à-vis nickel and we would typically hedge that.

Then when it comes to stock, you could maybe separate 2 different types of inventories, realizing that the pipeline actually from raw material to end product is something where we have both the lead time and quite an amount of inventory. This, we call the base stock. And here, we are trying to find the right balance, balancing between managing the earnings and on the other hand, the cash flow volatility of whether we hedge or not. And during the third quarter, we have hedged the base stock to some extent.

Then something that, from a CFO's perspective, sounds a bit aggressive that we have excess stock, but I just want to say, it is the stock on top of the base stock, so on top of what is absolutely needed to run the production process. So we have something ready for sales for our customers. And typically, we would also hedge that position fully.

So those are the principles of how we apply the hedging. So we have a very diligent approach. According to our policy, we can make some choices when it comes to base stock, and we have used that option, hedging the base stock to some extent during Q3 and then the financials we already spoke about, the end result of that. Okay.

Net working capital next. And I think the headline says it all here. This has been a challenging year to work diligently on net working capital. Particularly in the third quarter, we'd had rapid increase of the nickel price. And it's quite clear that given the amount of working capital we have, these are significant impacts, purely just from the price being higher. So I would say anything between, let's call it, EUR 70 million to EUR 100 million just on top of the value of the inventories and sort of for working capital costs from the higher nickel prices.

And despite this, we have also, in the third quarter, managed to bring in some positive cash flow from the working capital. And this then brought us already now, after 9 months, to the position where we can say, yes, we've reached our targets. We've had internally tough targets wanting to achieve at least EUR 150 million cash inflow from working capital this year, and now we have reached that.

And then I think it's a fair question to ask that -- how about Q3? And what about Q4? Are you continuing to work on this topic? Of course, we are. And given the high attention on this topic, it's clear also that we will do our utmost to continue the positive trend. But what you have seen is we've had very big positives in Q1, in Q2, and we had a EUR 25 million in Q3. So now we have to work really hard, given the higher nickel prices, to be able to continue on a positive note in this area.

Then if you look at the overall cash flow, the operating cash flow was at EUR 12 million. We did end up with certain payments relating to pensions as well as provisions. Let's say, a little bit on top of the normal outflow that we would have in the quarter. But these are things that needs to be taken care of, of course. Then you see that from a CapEx perspective, we had a EUR 37 million outflow in the quarter.

And if I then jump to the right-hand side of the slide, you can see that CapEx is one of the areas where we have also focused now to really review how we can protect the cash flow and what's the right balance of that for this year. And you see the yellow part here, the CapEx reduction, it's on EUR 25 million compared with our previous estimate. So currently, now we are somewhere at around EUR 230 million estimate for the CapEx outlook for this year. And cumulatively by the end of September, we had been at EUR 156 million.

Then there is one large item that we have described earlier, talking about the real estate sale in Germany, the so-called Benrath real estate area. And this is an important point for our cash flow as well. And now the money has finally hit our account during October. So that's, of course, now an important addition then to the cash flow of the fourth quarter. And all in all, we talk about an amount of approximately EUR 90 million, and the final payment of about EUR 80 million has then reached us in October.

And I think that's a great segue to the next slide, which talks about our focus on net debt reduction, which really remains unwavering. You see here our net debt at EUR 1.34 billion at the end of Q3, and then the leverage of 4.8x. Obviously, now then looking into Q4, the

real estate sale cash flow addition is important, and we are continuing to focus on working capital as well.

However, as you can see from the planned CapEx, we still have some rather important CapEx in front of us also during the fourth quarter. And I think this is the continuing balancing that we need to do with the focus on net debt, on the other hand, evaluating both the more operational CapEx as well as the strategic CapEx.

And without sort of jumping the slides too much, I would still say that we have made the separation also in our presentation between the more operational part, the deep mine part and the other development, just to also give a clear picture in order of priority as well if facing a more severe situation. Of course, then we would have also an understanding of whether there are any areas that are, let's say, more developmental of nature that we might choose to postpone. But so far, we have not seen the need for that.

One more important topic then from the funding side. Now if you look at the debt structure as well as the debt maturity profile here, you should be aware that we have been drawing upon our new EUR 400 million term loan also in October. So in this picture, you still see this as an unutilized facility, I mean the new EUR 400 million term loan.

However, what will then happen and how this picture will change quite dramatically when you see it next time, is that the significant maturities, amongst other in commercial papers that we have, really, even in 2019, will, of course, then be -- will then, of course, be repaid, and a longer maturity until 2023 achieved by this term loan. So we are step by step improving our maturity profile, which has been an important target as well for this year.

And I think with that said, Roeland, I will hand back to you.

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

Thank you, Pia. So that brings us to the outlook. So for Q3 -- Q4, we are expecting the stainless steel market to continue to be subdued. And as a result, we -- with the seasonality as well as we typically have, especially in the U.S., we expect deliveries to be lower than deliveries in the third quarter.

On top of that, as you know, every fourth quarter, we have significant maintenance going on in the Nordics and specifically in Tornio, which, on a quarter to quarter effect will have about a EUR 15 million negative. And the last point in the equation is that at current raw material prices, we do not expect that the losses from raw material related inventories, metal derivatives will be repeated. And that altogether brings us then to an EBITDA expectation at a similar level as what we have in the third quarter.

And with that, we just talk a little bit about what we are doing in this environment because of course, this is of great importance. We do not take an environment that is challenging lying down. We fight back. We have already achieved over 10% reduction in variable cost. As I said, we are close to 4% productivity improvement year-on-year.

And this, by the way, when I talk productivity improvement, this is real productivity. This is not because, for instance, prices in electrodes went down. We exclude those effects from productivity. That is what the market helps us with. We only look at what we do ourselves. But we are doing a lot more. As we have lower volumes, we are limiting our melting. And we -- with that, optimize our maintenance connected to the lower volumes.

We can clearly see further cash flow reduction issues. We're looking at CapEx reduction in 2019 of EUR 25 million. And we see another EUR 40 million of noncore divestments in 2020. And then I think we touched on it, but we couldn't be more specific because negotiations are going on. In Germany, we are in negotiation with unions and workers' councils to restructure part of our business there, which has an effect of approximately 350 jobs that we will be losing.

And in long products, in August already, we shed 25 jobs in Sheffield because we went from 18 shifts to 16.5. We're now going down to 15 shifts, so reducing another 30 people, 55 in total, which would [waste] over 20% of the population. So we are working diligently in

making sure that the adverse effects are being mitigated by our own actions.

And then as the last point, Tommi.

Tommi Järvenpää *Outokumpu Oyj*

Yes. So operator, we are now ready for the questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question we have today comes from the line of Michael Boam from Sona.

Michael Boam *Sona Asset Management (UK) LLP - Senior Analyst*

A few questions, if I can. First of all, on working capital. Clearly, as the business has contracted, you generated cash in the first half. You said you generated small cash in the second half. But the reality is it seems the industry conditions are set to remain where they are today, at least through early 2020. I just wonder what your available pro forma liquidity is post the use of some of the term loan to pay down other debt.

Pia Alexandra Aaltonen-Forsell *Outokumpu Oyj - CFO*

Yes. So if you look -- it's Pia here. So looking at the funding pages that we have here and the liquidity profile that we have, of course, currency, now in October, we have drawn upon this EUR 400 million term loan. Obviously, that changes the picture a bit to the more positive.

We have a revolving credit facility of approximately EUR 600 million that remains largely undrawn at this moment as well as some special funding that we have for the deep mine investments where we also have a significant amount still undrawn. It's approximately EUR 100 million. So here, we have already sort of from the funding perspective like the important sources.

At the same time, when you look at our maturity profile, one of the key maturities next year is then the convertible bond EUR 250 million in February. Apart from that, there are no important maturities during the next, let's call it, 12 to 24 months.

Michael Boam *Sona Asset Management (UK) LLP - Senior Analyst*

Okay. And can you talk to any covenants on any of those facilities, please? I mean obviously, your leverage is ticking up. And I dare say it will go (inaudible) in the fourth quarter. Should we have any concerns around the covenants at this point?

Pia Alexandra Aaltonen-Forsell *Outokumpu Oyj - CFO*

No. So if you would see here, you would see me smiling. I'm sorry that we don't do a video. But no, I mean obviously, we are safe and very much in line and safe with the covenants at the moment.

Michael Boam *Sona Asset Management (UK) LLP - Senior Analyst*

Can you share the covenants? Have you done that before or not? Are they net debt to EBITDA? Are they debt to this [net worth]? What...

Pia Alexandra Aaltonen-Forsell *Outokumpu Oyj - CFO*

They are on gearing.

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

That we are nowhere near -- no scenario whatsoever to even touch them.

Michael Boam *Sona Asset Management (UK) LLP - Senior Analyst*

Okay. You talked about stretching out CapEx going forward. What is the provisional CapEx budget for 2020? And how can that be tweaked if that proves necessary?



Pia Alexandra Aaltonen-Forsell *Outokumpu Oyj - CFO*

Yes. So I think when we look at one of the pages here in the presentation, it's typical for us to have this underlying level of maintenance CapEx of, let's call it, up to EUR 100 million. Then we have the ongoing deep mine investment. Both of those remain very important for us from an operational and strategic level, even though on the margin, there are all those items that you can consider.

Then we also have the bucket of what I would call more sort of development investments involving some as well into more like IT and systems, which would be, let's say, in order of importance, the first area that we would be really evaluating carefully, if need be. But so far, I think we have been carefully evaluating each and every project.

I think spending -- I don't even want to say how much hours, but a fairly large amount of hours evaluating each individual project. Most likely ending up with a CapEx budget or sort of planning figure that is somewhat lower than this year, but still ensuring that we can continue our operations and our most important strategic projects in a good way.

Michael Boam *Sona Asset Management (UK) LLP - Senior Analyst*

Okay. Can I ask, have you had any dialogue with the rating agencies while with Moody's since they put you on review for downgrade? And...

Pia Alexandra Aaltonen-Forsell *Outokumpu Oyj - CFO*

I mean it's typical. I mean it's typical that we have reviews with rating agencies. I mean that's kind of a normal routine. So it's -- however they see us, we would always talk to them.

Michael Boam *Sona Asset Management (UK) LLP - Senior Analyst*

Okay. And do you have any plans to come back? Well, I mean, given your EUR 250 million maturity next year, how are you expecting to refinance that? In the bond market or...

Pia Alexandra Aaltonen-Forsell *Outokumpu Oyj - CFO*

Yes. And really important step for that was the EUR 400 million term loan that we signed in June and that we have now drawn upon in October. So that has just given us more -- let's say, flexibility around the maturity is more options. And I'm -- of course, we are continuously evaluating also other, let's call them, attractive funding options per se. But I think we have enough flexibility in terms of our position here and now.

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

As you heard Pia say, we have ample liquidity, which is more than enough to pay down the EUR 250 million of the -- a little bit less of the convertible, and then still have significant liquidity left.

Michael Boam *Sona Asset Management (UK) LLP - Senior Analyst*

Yes. And finally, on the dividend, you reduced the dividend payment this year. Given the operating environment, are you committing to maintain the dividend? Is it a ratio of net earnings or...

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

So we have a different statement where we are aiming to have a stable dividend through the cycles. So we will have to see, ultimately, a Board of Director decision. So we'll cross the bridge when we get there.

Operator

The next question today comes from the line of Seth Rosenfeld from Exane.

Seth R. Rosenfeld *Exane BNP Paribas, Research Division - Research Analyst*

A couple of questions starting out on outlook for stainless scrap and then moving to your U.S. business, please. With stainless, just trying to better understand how the scrap price is hitting your P&L right now. As nickel has obviously rallied strongly in recent months, we've seen the stainless scrap discount to raw materials widen to close to 40%. Historical average is 10% to 20%. That should ought then to be

a big benefit for you, but we're not seeing it in your P&L.

First, why aren't we seeing that aid your cost base more than it is right now? Do you think that scale of discount versus nickel and chrome is sustainable for stainless scrap? And if you start to see that normalize into 2020, what would that do for your profitability? Is that a risk you see on the horizon?

Separate from the outlook for stainless scrap, please, on the U.S. business, please. It's been several years you've been speaking about a turnaround of Calvert, both operationally and commercially, still in the red despite multiyear high base prices.

With regards to the '20 targets, I understand that we're not focusing on the EUR 750 million any longer at group level. But U.S. base prices are close to \$100 above where they were in 2015 when that \$100 million EBITDA target for the U.S. was set.

Is that still a reasonable target just locally in the U.S. business? Or is that also off the table? And what can we do to really drive the U.S. business to a higher level of profitability moving forward?

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

Yes. Thanks, Seth. So starting with stainless scrap. First of all, you have to see how the melt works its way through the -- how the raw material works its way through the melt. One of the reasons why you see volatility in earnings is exactly that point where we are hedging the nickel and take in a rising market the hit in one go. But then, over time, it will come back in your P&L because you start melting the scrap at different levels.

So normally, you have to say -- let's say, it's about a 3-month cycle from the purchase of your scrap until it hits the cost base of your melt. So you will see it come in, but it takes some time. The advantage is that if nickel reverses, you still have then an advantage that go through. Then your second -- I can't even read my own handwriting here, or is it sustainable? We see a shift in thinking in the scrap market, whereby as we have argued before, the link between scrap and the LME has not -- makes no sense. And just to make the argument again. You can use nickel scrap or nickel containing scrap for only one purpose and it is for stainless steel. You can't use it to make batteries. You can't use it in any other nickel-using application. So there is absolutely no reason other than convenience to have nickel scrap connected to the LME. And if you take that down to the next level, where you say is basically the same as carbon scrap, but there is nickel in it, and you look then at the carbon scrap pricing in the market, which is about \$300 to \$330, the collecting, the processing and the distributing of carbon scrap or nickel scrap has the same cost base. So theoretically, there's no reason why there would be a link between nickel-containing scrap and the LME, because from a cost base, it's not there. So we see a decoupling coming. And I think it's not a risk. It's actually a fantastic opportunity that is coming to us.

Americas. Again, first of all, want to correct. We are not at -- not at multiple year highs in pricing. We are pricing at \$1,300-something. Actually, we have seen far higher pricing in the past. So -- but it's not bad. I have to grant you that and our performance has not been where we want it. We have acknowledged that. We have changed out the management in order to have now a group of people in place to make the next step. I'm not saying that the previous group hasn't done well, but they have done a fantastic job of stabilizing operations. Commercially, we have done not a good job. When you look at some of the supply chain operations, we have not done a good job. What I think is extremely positive and gives us great confidence is that even at a low level of shipments of 150,000 tonnes, we are basically underlying in positive territory. And we can see that continue into Q4 and then beyond. And are we still confident that we make the target that we set? Yes, we are.

Unidentified Analyst

Just to follow-up on the U.S. business, please. In the past, you've walked through a number of steps, changing your freight strategy with new warehouses, turning around Mexinox, et cetera. You've already commented earlier, exited the export market of semis. What's left in terms of the self-help measures into 2020? There's obviously a big gap between where we are today and EUR 100 million run rate EBITDA. And I would assume we should be taking that to perhaps a lower level, given where prices were back in 2015?

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

So one thing is that the measures we took on the logistics do not immediately take effect. So yes, we have our warehouse outside of Chicago. We have now just contracted the warehouse close to Pittsburgh, and a third one on the West Coast, but those product streams are just starting up now because it's not just getting the warehouse, it is moving from truck onto rail and box, and you cannot just go to the railway and say, "Oh, by the way, I now have 20,000 tonnes of steel that I would like to transport as from tomorrow." There is a lot of scheduling that comes. So that will bleed into results over time. It is not going straight.

The second thing is we have been relatively poor on using scrap as our main ingredient for the melts. So our scrap rate in the U.S. was typically 55%, 60%. We're now driving that to get to 90%-plus. That will be another big driver. Commercially, we have been very much concentrating on distribution and the large ones and then single product. So that is another thing where we are now starting to be much more diverse, have a much broader portfolio. We are introducing some new grades like duplex that we haven't produced yet in the past, but we are now producing. We are giving other gauges that we didn't do in the past. And then, of course, the big one is the ferritics investment that we did a bit later than we wanted because of the cash flow in the Americas. But actually, the cash flow has been fantastic. They have produced -- released over EUR 100 million of cash flow out of their working capital. So that funds the investment in the ferritics that is coming on stream in the fourth quarter of 2020. And that in itself will be a very big step towards the EUR 100 million.

Operator

The next question comes from the line of Anssi Kiviniemi from SEB.

Anssi Kiviniemi *SEB, Research Division - Analyst*

It's Anssi from SEB. Just continuing on the scrap discounts because when I look at the nickel impact on derivatives and timing, it was minus EUR 15 million in Q3, then in Q4, maintenance break in Europe that's negative EUR 5 million, also. But those basically net them -- each other out. Just trying to find out the drivers for earnings to be flat. I mean, scrap discounts will support increasingly. Volumes will come down. Are there any other elements that I should -- or large factors that I should kind of calculate into estimates?

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

Well, let me start, and then I'll let Pia [give it a go]. Just first, on the misconception on the discount. If the discount goes up, but the LME price has moved from EUR 12,500 to EUR 17,000, the net result is 0, if you're lucky. Secondly, the alloy surcharge that actually takes care of that increase in nickel pricing that should help, bleeds in over time. There's a formula. It doesn't go in the U.S., for instance. It's a different formula. It works immediately. In Europe, it takes about 2.5 months to see that come in.

And thirdly, what you have seen in Europe due to the imports, is that a larger portion than the past of sales is now on basically effective price, so not anymore on alloy surcharge. So that has a margin effect. Or in other words, it pushes your base price down.

So those are a few of the elements, and you say you have a non-repeat of the hedging loss, which is correct. But indeed, then you have the EUR 15 million extra of maintenance. And then you have ferrochrome being lower even again in Q4 over Q3. I think that probably hits most of the buckets unless, Pia, you have anything else there?

Pia Alexandra Aaltonen-Forsell *Outokumpu Oyj - CFO*

No, I think it's just from a breeds perspective, that's exactly important to remember that when we have some topics that are highly negative in the third quarter, if we expect them not to repeat then, of course, it's a positive. There is one going the other way. You have noted that in segment Other, we had quite a positive, and I already referred to the derivatives there. But there were a few other positive items as well. For example, some sales of emission allowances. And then those positives will not repeat. So again, you have a negative bridge impact. So I think we have talked about the most important topics here.

Anssi Kiviniemi *SEB, Research Division - Analyst*

Okay, good. Then continuing with emission allowances that you sold. You're currently allocated more of those than you are using. So my question is, how much do you have excess inventory in your balance sheet? And should we expect this kind of, let's say, still one-off effects to come in the future also?

Pia Alexandra Aaltonen-Forsell *Outokumpu Oyj - CFO*

Yes, Anssi, I think that's a really fair question after this quarter. But you know that there are kind of several variables in that. So if you just think about this year and you look at the lower volumes as well. I mean, generally, that has a direct impact, then, as well on the emissions. So it's clear that this is something that we can use also pending the production volume. We have a different balance. So then this is kind of a balancing act to that. So you would always have that variability, pending the business situation. Of course, the variability as well in the value of the allowances, even though they have been stable at this EUR 25 per ton now for a while. So you have all these different elements. I would just generally say that, over the period of years, it gets tighter and tighter, but we are quite good at productivity improvements and various other improvements. So I mean, we are having efficiency targets that are helping us to this direction. We don't have huge excess inventories. You should see it more as a balancing element in case our production is lower.

Anssi Kiviniemi *SEB, Research Division - Analyst*

Okay. That's pretty clear. Then continuing on ferrochrome. You've previously highlighted that the maintenance costs are like EUR 5 million to EUR 10 million Q3, Q4. How much were they in Q3? And how much they're going to be in Q4?

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

So can you -- I don't understand the EUR 5 million to EUR 10 million? Maybe you can repeat the question, Anssi?

Anssi Kiviniemi *SEB, Research Division - Analyst*

Yes, I think you have indicated that the ferrochrome maintenance break will impact the profitability by EUR 5 million to EUR 10 million in Q3 and Q4. So what was the cost -- extra cost in Q3? And what will it be in Q4?

Pia Alexandra Aaltonen-Forsell *Outokumpu Oyj - CFO*

Okay. Now I got you. It's EUR 5 million and EUR 5 million.

Anssi Kiviniemi *SEB, Research Division - Analyst*

EUR 5 million and EUR 5 million. Okay. Clear. Then perhaps 1 more question left. The European Commission announced the anti-dumping case against the stainless hot rolled coil from Indonesia and China. If the preliminary and the permanent duties come in the next, let's say, 1-year time frame, kind of -- what kind of effect you expect coming from a cold rolled market from this decision and kind of a disturbance in the markets?

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

Yes. So let's be clear on the timing. We launched the complaint back in June, July. The Commission acknowledged in August. There is, let's say, a 9 to 12 months, which stands for [growing] (inaudible). So we expect them, by summer, to come out with a preliminary. So it's not that long. And then secondly, what we will do as an industry, and this has been supported by the Commission, by the way, is to ask for registration as from January. And what that means is that as from January, we will register all the imports that are coming in, the volumes, et cetera, from the countries. And as a result, these are then subject to retroactive tariffs the moment the antidumping tariffs are put in place. So that, in itself, will stem the flow.

The second thing to remember is that hot-rolled coil is not just black hot coil, it is white hot coil as well. So there is both part of that hot-rolled coil works as a semi product that is being rerolled into cold, and part of it is direct into certain market segments in direct competition with our own products. So the potential effect was quite big on pricing. First of all, if you look at the semis that is coming in, it's probably close to 300,000 tonnes, 400,000 tonnes of semi black hot coil that comes in, that has been rolled into cold roll and that has a tremendous effect on the pricing cap put on cold rolled product in the market. And then secondly, the pressure -- price pressure on the white hot band has been tremendous as well. So we expect that it will be a significant game changer when that is being called.

Operator

The next question today comes from the line of Alan Spence from Jefferies.

Alan Henri Spence Jefferies LLC, Research Division - Equity Analyst

A couple of questions. The first one is just on -- following up from the last point, you mentioned the white hot band competing directly with some of your products. Can you give us a sense what end markets, it's been the most impactful on?

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

A lot of it goes into pipes and tubes. So that is probably one of the largest markets. Some of it would go into the oil and gas sector, but not that much. But pipe and tube is a very large market where it goes straight into.

Alan Henri Spence Jefferies LLC, Research Division - Equity Analyst

Okay. The EUR 40 million planned non-core sales in 2020. Is there any contribution to earnings those are currently doing?

Pia Alexandra Aaltonen-Forsell Outokumpu Oyj - CFO

Yes, I think. I don't have an estimate (inaudible) here. I don't have an estimate to give your figure here right now. But I think if you kind of look at...

(technical difficulty)

...[RK] space. It's clear that when we are talking about, for example, real estate, the book values would typically be quite low. But I don't have a figure to give you.

Alan Henri Spence Jefferies LLC, Research Division - Equity Analyst

That's fine. And the last one coming back to Americas. What amount of this 100 million improvement relative to 2018 needs to be achieved so that the Americas can achieve its cost to capital?

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

That's extremely difficult to answer because the book value of the Americas is a number that was put in there out -- all of an acquisition of 3 -- over EUR 3.5 billion back in 2012. Not necessarily does it reflect the real capital cost. So I don't have a real answer to that.

Alan Henri Spence Jefferies LLC, Research Division - Equity Analyst

Okay. If I can try to maybe ask this a bit of a different way. Group level return on capital employed has been below 3% the last few quarters. Now you mentioned in your opening remarks that you want to be the industry leader in value creation whether you get to that EUR 750 million number or not. As it currently stands and with Americas in your portfolio, is that a realistic target?

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

Look, the EUR 750 million, again, is -- was in a different market. If we would have the pricing and the volumes from that market, then you would see that number. If you look at the CMD numbers of the last CMD, it shows clearly that we were on that path. Relatively speaking, yes, I'm sure that we will get there. But of course, in this market, you will see that returns on capital employed across the industry will be done.

Alan Henri Spence Jefferies LLC, Research Division - Equity Analyst

Okay. Correct me if I'm wrong but in your opening remarks, I thought you said, you think you can be the industry leader in value creation next year even if we don't get that 750 million target because yes...

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

Correct.

Alan Henri Spence Jefferies LLC, Research Division - Equity Analyst

Is Americas -- if we don't have that pricing environment, is that something -- how much of a drag is on -- is that?

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

Again, we have been talking about the expectations of Americas, what they will deliver. And we are still committed to it, and we're convinced that they will deliver those numbers.

Operator

The next question today comes from the line of Bastian Synagowitz from Deutsche Bank.

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

I've got a couple of questions. And just firstly, on your European business. I'm not going to question on some of the pricing details. How has your customers responded to the higher nickel price environment in the transaction price business? And how far have you been able to push through just any price increases in that part of the business? Then also, have the customers, which are still on the traditional price methodology, accepted the price increases for the alloy surcharge? Or are they putting a lot of pressure on you to discount why the base price or even switch to the transaction price method as well. I've got a few more questions but I'll stop there.

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

Yes. So customers are never happy when you give them higher prices. It's very funny, but it's always the same. So not necessarily are people very happy. What you have seen this time, actually, which is different from other cycles, where when you see nickel price go up, you see, especially, the distribution segment to increase that by -- in order to gain some inventories. (inaudible) I think the market is skeptical that the high nickel price will hold because the high nickel price was [premeditated] by 2 movements. One was 1 specific company, Tsingshan, buying a lot of nickel in July, and it [stays] for 4, 5 weeks, which drove the market up by roughly \$2,500, \$3,000 a tonne. And then, of course, totally unexpected and not connected, Indonesia came out with the announcement that there's a ban on export of the nickel ore. And as you know, some of like 50% of all nickel ore consumed by China comes from Indonesia. So that underpinned the next set. However, we do know that there's an enormous amount of shipment now happening from Indonesia into China. Philippines is capable of ramping up as they have done as well in 2014. So there's (inaudible) in the market that nickel will stay at these levels. So that has not helped the volume. As to -- have you been able to move prices up? Yes, we have. The nickel surcharge (inaudible). The effective pricing in Europe has moved up, not as much as you would have expected given the nickel move, but it did, and it has been accepted.

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

And then just to follow-up on that, have several of your traditional customers, which are on the old method, trying to switch on the transaction price business as well following the move in nickel?

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

It depends. If you talk about customers, for instance, that are end users and want security of supply and are looking at an annual contract, then absolutely not. They stick to the model because that model works for them and it works for their security of supply and their security of pricing. One or 2 customers who traditionally have been on the other surcharge might have been pushing back here and there. And that is, again, no issue. As I said, it's communicating vessels in the end. If we can decouple the scrap price from the LME, then it becomes much more easy to actually start selling at effective pricing.

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

Okay, understood. Then just following up on international markets. If we look at the various sources, which are reporting on the Chinese market, I think some show an uptrend in prices on the back of nickel prices and some, like you say, you obviously pay prices are even flat to down. What are the price trends which you are seeing in the Chinese market? And when do you expect the cost pressure from the Chinese NPI route producers to come through and force them into price decreases?

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

So the Chinese market has been flattish. As I said earlier, you could see it on the graph I showed that the gap between China and European pricing has opened up further. The main reason of that is that in, I would say, the sort of middle part of the year, March to August, melting rates in China have been tremendous. And there is, if you look at the inventories in the 2 main areas in China, the inventories of cold rolled finished stainless steel have increased exponentially. So there's a large overhang of material in that market.

That overhang cannot find easily an outlet because both the U.S. and Europe are close to Chinese material. So that will keep a lid on Chinese prices. However, that is not necessarily something that can overflow into the European market.

Bastian Synagowitz Deutsche Bank AG, Research Division - Research Analyst

Okay. Then just moving on to your U.S. business. If we back out the hedging loss, your performance was obviously significantly up versus the last quarter. Now in Q4, volumes obviously get weaker. That's seasonal but you also get the hedge reversal, and then probably the benefits from higher nickel prices and better scrap discounts. As you already said, the lower surcharge works a bit more promptly in the U.S. Is the volume decrease you're seeing in Q4 more than the usual seasonality? Or is there any other reason why Americas would not be able to show a positive result in the fourth quarter?

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

So it is normal seasonality. And we would say that you can see the improved performance coming through, as well, in Q4.

Bastian Synagowitz Deutsche Bank AG, Research Division - Research Analyst

Okay. Then just a very last one on the restructuring measures, which you have been announcing. Are there any extraordinary charges, which we should expect for the 350 people? And will they come through either this year or next year?

Pia Alexandra Aaltonen-Forsell Outokumpu Oyj - CFO

Bastian, Pia here. That depends really on the negotiations and how they are proceeding, because simply said, there needs to be enough agreement alignment and people need to be aware of the situation for us to book a provision. So there is, I would say, a likelihood that we could book a provision already this year, but it really depends on the outcome of the negotiations.

Bastian Synagowitz Deutsche Bank AG, Research Division - Research Analyst

Understood. But then would your colleagues report that as extraordinary, I suppose?

Pia Alexandra Aaltonen-Forsell Outokumpu Oyj - CFO

Yes. Yes. It's likely. Yes.

Operator

The next question today comes from the line of Luke Nelson from JPMorgan.

Luke Nelson JP Morgan Chase & Co, Research Division - Research Analyst

You've guided to lower shipments in Q4. Is it possible to quantify that by division? And then also looking into 2020, any indication of how you're thinking about shipment levels given the current outlook? That's my first question. Second question is just on the underlying improvements of EUR 270 million improvements by 2020. Obviously, I know it's sitting on a base of historical pricing, et cetera. But can you maybe give an indication of how you're tracking towards that goal by the end of this year on a sort of equalized normalized level? And then...

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

I didn't understand the second question, to be honest. You lost me. So maybe you can do that again.

Luke Nelson JP Morgan Chase & Co, Research Division - Research Analyst

Sorry. The EUR 270 million of total gains by 2020, which is within the EUR 750 million. Just assuming the base for the EUR 750 million, how would you be tracking towards that EUR 270 million as things stand? So how much do you think you've achieved of the commercial growth and the efficiency gains as things stand?

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

Yes.

Luke Nelson JP Morgan Chase & Co, Research Division - Research Analyst

And then the final question is just a modeling question on the inventory and hedging where you say losses are not expected to repeat. By that, do I take it that there will be a full reversal or that the impact will be 0 in Q4?

Pia Alexandra Aaltonen-Forsell Outokumpu Oyj - CFO

I think -- it's Pia here. I think that the third question is maybe the easiest just to answer straightaway. So that they will not repeat. It just means that given the current metal prices, as we see it, they will not repeat. So as I went through earlier, the group level impact of the net of timing and hedging was about minus EUR 30 million, and we would not expect those derivative losses there to repeat. But of course, pending metal prices, I mean.

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

Yes. So -- and if I got your first question right, you are interested to understand the volumes in Q4 by business area, which I cannot give you. I can tell you that the overall volumes will be down to Q3. And that is something that is a misery being shared by all BAs.

Luke Nelson JP Morgan Chase & Co, Research Division - Research Analyst

So sorry, if I just push a bit hard on that. So I mean, in Europe, I think you've guided to real demand down 2% and America is flat. Is it possible to give an indication of where you expect your market share and maybe inventory moves in Q4?

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

No very difficult. So clearly, we don't want to give up market share. And that is what we will not do. We have maintained our market share this year and actually versus the end of last year, actually, gained both in Europe and in the U.S. I'm not thinking of giving it up. So on the EUR 270 million gain, look, it was commercial growth on the one hand and (inaudible) gains at the other. The efficiency gains, I think we can comfortably say that, yes, we are delivering them. As I said, our productivity is close to 4%, whereas we said, we are targeting 3%. We are making our procurement savings and we have been on this path of raw material optimization, where in the U.S., we're now getting the last bit, where we are optimizing the scrap mix. The restructuring in Mexinox is now fully done and the run rate is coming in. The logistics cost reduction is going slower than expected because of the operational issues that I mentioned earlier. Scheduling it onto railways and barges is harder than we thought. But it is coming in, and we'll reach what we need to reach in 2020 at some stage. So generally speaking, on track, delivery reliability very well in Europe. In the U.S., still a bit more spotty. It's dependent on our partners in Calvert [AMNS]. For instance, last month, they had a breakdown in their hot mill. It went down for 11 days. And it then means that we will have less product than we expected, and it will influence our delivery performance. But it's nothing dramatic. So we are on track.

The commercial growth in a market, I mean, it's -- it's easy to see, right? The U.S., in spite of all the great news, has now for 2 quarters in a row, announced a lower decrease in manufacturing activity. Europe has decreasing manufacturing activity. Automotive is down 10%. China, they reported the lowest GDP growth number in 30 years. Automotive is down for [15 month] every single month. So clearly, commercial growth is something that, in this environment, is near impossible.

Operator

(Operator Instructions) The next question we have comes from the line of Olivia Du from Bank of America.

Olivia Du

I have 2 questions, please. So first one, can you give us a bit of color on how the import trends has been since 1st of October this year? And related to that, how's the antidumping investigation going? So as I understand, it's mainly targeted against China and Taiwan imports, but as it stands, Indonesia is actually the global price setter as of now. So I guess, longer term, where do you see should be the normalized level of import as a percentage of total European market? And that's my first question, please.

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

So if you look at imports and we track imports against quota, then you see that in there, there are some countries that are all proportionately on quota. There are some countries that are ahead of quota, but nothing extraordinary there. On the anti-dumping, the anti-dumping investigation is, again, 3 countries: Taiwan, China and Indonesia. So they're all 3 included.



Olivia Du

And where do you see -- should be a normalized market share of imports over the longer term?

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

Well, if you look at how the safeguards were designed, again, based on an average of the '15, '16 and '17 figures, which is, again, sort of mid cycle. It should come to about 22%, 23%, 24%, depending on where the market goes and how much relaxation there is. So that is where it should land back in when the market returns to normal.

Olivia Du

Okay. And second question, very short one. Can you just clarify that, do you still have any nickel price hedging in the fourth quarter?

Pia Alexandra Aaltonen-Forsell *Outokumpu Oyj - CFO*

Yes. It's Pia here. Yes, we do. So based on the principles that I explained through the slide, we would typically hedge if we have entered fixed price sales contracts, which we do, if we have fixed price purchasing agreements, which we also do, and then on top of that, if we have finished goods inventory, which is readily available for sale, we would hedge that. So the answer is yes. And we also had base stock hedges during Q3. And you know those were on a certain level, and they are continuing, at least in the early parts of Q4.

Olivia Du

Are you able to share how big is your position?

Pia Alexandra Aaltonen-Forsell *Outokumpu Oyj - CFO*

No, not at this point. But I think when you are evaluating the impacts, it's important to take into account that this price movement was extremely, extremely abrupt during the third quarter.

Operator

There are no further questions. Please continue.

Tommi Järvenpää *Outokumpu Oyj*

All right. Thank you. And as a reminder, Outokumpu will be hosting a Capital Markets Day in London on March 18, 2020. Please save the date already now. The formal invitations will follow. At this point, I would like to thank you for attending our earnings call. Goodbye.

Operator

Thank you very much. That does conclude the conference for today. Thank you for participating. You may all disconnect.

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