Transcription

Outokumpu's Q3 / 2021 Interim Report

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PRESENTATION

Linda Häkkilä

Hello all and welcome to follow Outokumpu's Q3 2021 Result webcast. My name is Linda Häkkilä, and I'm the Head of Investor Relations here at Outokumpu. With me today we have our CEO, Heikki Malinen, and our CFO, Pia Aaltonen-Forsell.

Before we start with the presentation, I would like to remind you about the disclaimer as we might be making forward-looking statements. But now, without any further comments, I will hand over to our CEO, Heikki.

Heikki Malinen

Thank you, Linda. Good morning, good afternoon to everybody and welcome also on my behalf to this session to discuss Outokumpu's third quarter results.

Let's get straight to it. So, adjusted EBITDA of €295 million. This is in fact the best quarter in a long time and if we look at our figures for Q3 compared to, for example, the annualised results for 2015, 2019 or even 2020 for this quarter was even more than for those three years combined. It just shows how challenging the history in the past decade has been for Outokumpu.

It's been a truly exceptional recovery from the COVID bottom last year when actually last year in the third quarter, our adjusted EBITDA was only 20 million and we also, on an annualised basis, last year recorded quite a substantial loss.

While the annual demand in our global market for stainless steel, probably this year, are not going to be, at all-time highs in terms of total volume, it's still quite amazing the speed by which the demand is actually increased in such a short time in a situation where the global supply chains for stainless steel were actually fairly low when we came out of the COVID crisis in the fourth quarter of last year. And what's also quite amazing is that the rebound continues to be so robust, and we're now sort of three/four/five quarters into it and still the customers and the markets are very sort of confident that this continues.

Our execution within the company regarding our strategies moving very well forward; we're somewhat ahead of our schedule, and as Pia will show later today, we're making good progress and hence we've decided to raise our Phase One EBITDA target run rate target from 200 million to 250 million.

At this stage I also want to thank all Outokumpu employees globally for a fantastic job done. It is really tough to deliver stainless steel when utilisation is at maximum. We have all the challenges on logistics and really serving customers; it's a 24/7 job, it is very demanding. So I raise my hat to the Outokumpu people for such a good performance.

Sustainability is at the core of what we do at Outokumpu. We are the stainless-steel industry's sustainability leader, and we are also seen as a benchmark in many areas. I want to highlight on the left-hand side our safety performance where we made substantial improvements over the last years. Obviously, our challenge is to have zero accidents in our facilities and I'm actually very proud to tell you that we have a number of facilities within Outokumpu where we actually have achieved zero accidents and in some of them for quite a long period of time. And we will continue further our work to push that number even lower.

On the ESG front, I'd like to mention or report to you that we have just completed our organisational Health Index survey, which we do annually. It is a survey where all employees participate. We actually have a very high participation rate, and the data is actually then benchmarked against McKinsey & Company's global reference database of 900 companies with similar backgrounds. I will report back on those results in the fourth quarter once we have had a chance to analyse the data in more detail.

We are investing in high-quality leadership within the company. We very much believe in good leadership, good empowerment, being inclusive and then making sure all employees within Outokumpu feel that they have a good chance to contribute. Diversity inclusion is becoming more and more important. I want to highlight that in the Americas and Calvert specifically, we have initiated a number of projects to further improve our DEI or Diversity, Equity and Inclusion so that people are even more committed to work with us or for us.

And we are actively working with our suppliers with the initiative, or intent, to make our sourcing more responsible. We are focusing on human rights issues. We're doing our best to make sure that our sourcing is as responsible as can be.

This week, as you all know, world leaders are meeting in Glasgow to discuss how to tackle global climate change. I'm very proud to tell you that Reuters has decided to choose Outokumpu as a case example that they will be highlighting at their Vision 2045 conference or summit next week showcasing Outokumpu as a global leader in climate change.

I also want to remind the audience and remind you of the fact that Outokumpu is the only steel company globally that has committed to SBTI or Science-based Targets Initiatives; targets which are aiming to keep global warming at less than 1.5 degrees, and we are now in the process of finalising our targets with SBTI and I hope that the next time we meet I can then confirm to you all the details that we have agreed with SBTI.

When you look at the CO_2 emissions, it is important to not only look at scope 1 and 2, but also look at scope 3. We really believe that it is not sufficient just to focus on one part of the value chain; you have to look at everything and, as I said, we report openly and transparently our emissions end to end.

In the third quarter, our recycled content remained high. We added more to wind power, and we have made good progress in focusing and improving our yield even further. And as you know, the more we get yield up, the more we conserve energy, we conserve raw materials. And it also, of course, improves our cost competitiveness.

The trade topic has been an issue over the last few years. Obviously, that's the reason why we have felt a need to highlight it in each of these webcasts. As you know, over the last 12 months, the European Commission has taken some firm decisions to try and create a more level playing field in the industry. Decisions regarding antidumping duties on China and Taiwan are in place for five years and also similar duties are in place for India and Indonesia. I really feel good about the situation now, in the sense that trade is becoming more level.

On this chart on the left-hand side, you can see import data from third countries into Europe. The green line gives you the share of imports. It's now been fairly stable at around 26%, which in our view is sort of a more level phase. On the right-hand side you can see the data for the United States. There the import share at the moment for the third quarter was 20%.

And a few words about pricing. As I mentioned in my opening, following a really remarkably strong COVID rebound and increases in metal prices, energy, consumables, and also freight, it is obviously clear that, or not surprising, that prices are rising. But I want to remind you that if you looked at this chart 12 months ago, our price level was at a decade or even more than a decade low. That's really how deep the trough was last year.

The chart on the left-hand side shows you CRU data regarding spot prices. Naturally in a very tight market spot prices have a tendency to move, often even strongly in either direction. The CRU reference base-price data on the chart and Outokumpu's data are not comparable one to one. The reason being our contractual structure and also our product mix. So, a direct comparison should be treated with care.

On the right-hand side, you can see information regarding metals. This has been a year where metal prices, nickel among one of them being very volatile. We've seen really swings of one, two or three thousand dollars per tonne up and down. For Q3 it was up 10%.

So overall, against the backdrop of a very strong market, good performance in our plants, we've been running full across the whole mill system, and we've really worked hard to get our costs down. The restructuring we made earlier this year, reducing headcount by a thousand and then the other continuous work on cost, basically then delivers, I'd say, a result of 295 million.

Pia will go through the details in a moment. I said we've had ten tough years. This year's performance so far and given the guidance I will share in a moment here, really just shows that we are now able to move forward with the strategy and the development of the company and really continue with de-risking. And as things go at the moment, and with the good momentum we have, we have indeed made a decision that we will raise the EBITDA run rate target from 200 million to 250 million.

And before I give this over to Pia, I want to highlight or underscore the points at the bottom, which means that deleveraging will continue through the first phase of the strategy, even beyond the initial target. Remember, we had committed ourselves to getting net debt to EBITDA below three. We are now clearly below that, and we still intend to move it even further down lower. Now, why is that the case? Well, we are in a very cyclical business, and we know from history that the swings can be quite dramatic. We want to make the balance sheet very resilient and really, now is the time to reduce the debt when the going is good.

So, with those comments, I would like to hand it over to Pia, please.

Pia Aaltonen-Forsell

Thank you, Heikki and good afternoon, good morning, also on my behalf. So, let's share a few more deep dives here. First on our strategic journey and the financial targets there, and then also a bit on the quarter.

Looking here first at the strategic targets that we have had, the financial target, of improving our run rate EBITDA with 200 million, let's first look at this programme that we had and then the progress also that we have made. So, first of all, we've had a good start in Q1, continued in Q2 and in Q3. So, on a cumulative basis, we have now got up to 163 million of run rate savings.

And I have the next slides for those of you who like to use the ruler and look into the different buckets. We'll get into some more detail. But I first want to touch on the point here. What are the tools and how we have reached there? And I first want to say we have indeed already completed a number of projects. So actually, 827 initiatives have been completed by now. But we are also in a continuous ideation process relating to further improvements. Based on analysis that we did a year ago, and then also really based on the momentum that we have built inside the company and the engagement of the team.

So, Heikki has already shared his sincere thanks to the whole team for the great results we have achieved. And I also want to say that these achievements of €163 million of EBITDA run rate improvements were only possible because there's a really great number of people within Outokumpu who have committed. And I'm sharing with you these details of the number of initiatives in the pipeline really to underscore and to illustrate the point that to achieve such savings, you really need the full team.

There are a lot of savings, but there are also commercial improvements. So maybe I'll take us to the next slide here and show you the buckets, so to say, of the different savings.

So, you see that we started off strong with the reductions here from lean and agile with, I mean, a big amount of savings already in the first quarter and then tapering off a bit towards the second and third quarter. And we now have about 10% remaining of the lean and agile organisation-related improvements here from a P&L perspective.

Then you see that we have really been strong on the cost and capital discipline, which is the various areas of improvement, operational improvements. Heikki has spoken about the yield, but there's also a number of other improvements, whether it's reduction of packaging materials or whether it's various [? 00:14:47] improvements, or maybe on the commercial side, topics such as a new web shop, for example. So, these are then examples that you see sort of growing in importance here over the quarter.

And if we look then into the new targets. So, we have improved or increased our target from 200 up to 250. And you see that when we look at the three different areas of improvements, there are no changes to the lean and agile from the initial programme. But we are raising the commercial excellence targets with 20 million and we are also raising the cost and capital discipline-related targets with 30 million of impacts. And we have been through a lot of diligence and a lot of work with our teams to make sure that we are comfortable raising the target. And I would say we have the right momentum as we speak to do that right now. And just one repetition from the initial phase of this programme. This is all self-help. This is not market based and these are things that we have in our own hands.

But then let me take you through some of the highlights, really of the financials of the quarter and of the year-to-date figures in September.

And obviously, looking here into the KPIs, first, just looking at the comparison of the EBITDA of €295 million in this quarter and then compared with 22 million a year ago, this improvement certainly comes through in all of the BAs and I will soon walk through the BA specific changes, especially then highlighting the changes, obviously with the previous quarter. You see also that that is an improvement from €223 million. But at this point in time we really have a strong delivery from all of our business areas.

Another topic maybe to highlight here: operating cash flow, in this quarter, it's €180 million. And you may say that “Wow the comparison period certainly also had a strong figure of 170 a year ago with a much lower result.”, and I would say the structure of the cash flow was then different. A year ago, we had this opportunity of VAT deferral that was in total €72 million, part of the positive impact in that quarter that came through in the operating cash flow. And we also had really low inventory levels then in the middle of the pandemic trough.

Furthermore, if you look into the return on capital employed, it's now at 12.9% and then, as said, the lean and agile programme has continued and you see that the figure, the personal figure, now is at 9,137 and here the FT target then was to be below 9,000 at the end of 2022.

So, a look then through the BAs and I want to start with Business Area Europe. You can see the remarkable improvement here in the result. It's now at 149 and maybe let’s talk a little bit first about the top line and the demand situation. I think what is important to say is that this result was done with a mix that is still a lot of commodities. So, we have seen the improvements, of course, in our order intake now starting to move also more into value added grades.

So, in our order intake, we already see more sort of bigger projects, whether it's oil and gas or industrial, et cetera, growing into that more pro-grade and value-added grade sort of part of our mix. But the mix still in the realised Q3 was very much based on commodities. So, I think that's just testimony to the good and persistent good demand that we have had basically then through all of the commodity segments.

And I know you will have questions about what is going on in automotive and I think, despite the news that we hear globally, I would say from Europe's perspective, still, we have been sort of in a good position here and also relating to looking into 2022, I wouldn't report of any specific weakness in that area. However, if I would highlight then some really strong areas, I would still like to say appliances is strong and maybe one more data point: distributor inventories still remain at a low level, which I think is also telling something about the current market sentiment.

If I look at some of the other elements in the bridge that you see here. Obviously, the pricing and the mix, higher realised prices, and that's really on the back of the key facts that Heikki has already shared. It's a strong COVID rebound. Metal prices have also increased, and obviously our order book at current is very long. This is, I would almost say, an unprecedented situation. I don't know how far in history we would need to go to look at the order book that extends even into next summer. So, all of those elements, of course, had then contributed also to an improved pricing level.

And with that, we have more than offset the cost increases in this quarter, whether they then relate to energy and electricity, freight costs, higher consumable prices, you can see here that there was definitely some inflation in the quarter. And you also see the seasonally lower deliveries here. But overall, of course, a strong performance from our team in BA Europe.

And I can continue on the same positive note. We have had the records from BA Americas now, following in several quarters we have had continuous, improved and improved performance. And again here, obviously first if we start with seasonality, Q3 is sort of a normal quarter in Americas, whereas Q4, then maybe is the one quarter that is seasonally weaker there, sort of typically seasonally weaker there. But you see that we have continued on a similar volume level and for the same reasons as we have observed in BA Europe, we have also then seen higher realised prices here.

And maybe on the market. I think this just also really shows that the market remains very robust. Again, distributor inventory still remains at a low level. And if we talk about, for example, appliances, we see strong demand. Automotive has maybe had a little bit more of a dent in the Americas. However, with the mix for us, you can still see that there has really not been any significant negative. On the contrary, this has continued on a good note for us also when it comes to the top line.

And I would say, just repeating the same elements then from a cost perspective, maybe in the Americas, it's really consumables and freight that we see in the quarter.

I'll move on to BA Ferrochrome. Ferrochrome market situation as such, on one hand, as you can see from the benchmark price, it is an exceptionally good market situation in the sense that the benchmark price is high. There is a lot of demand and it's a very tight situation. And at the same time, on the supply side, there's been a number of challenges, whether it's the energy restrictions in Inner Mongolia, whether it's problems in South Africa, etc. So, the market situation remains tight.

Maybe there is sort of one specific item that I still want to comment, and that is that some inflationary pressure, for example, electricity price inflation, out of all of the BAs I think that impacts BA Ferrochrome to the largest extent, and maybe it's not so visible yet here because of hedging, but just to remember that ferrochrome is indeed the bigger electricity consumer also within our structure. Of course, then, based in Finland.

And overall, just looking at the performance, €64 million in the quarter remains on a good and stable level here.

And long products, we continue successful turnaround. Obviously here you see that there's some seasonality in the third quarter, which has been very typical here, but the better product mix here has helped a lot. Top line has improved also somewhat and higher costs, maybe I would again then say that in the UK, certainly, the electricity prices have increased, but you see that we have been able to offset that in a very proper way.

I move on to some working capital items. Obviously, operating cash flow, 180. I already commented the comparison to last year. But if I focus into this year and particularly this quarter, I think what is now really important for us is to find that right balance of serving our customers who are in need of product and recognising also that that has led us into decision of somewhat higher finished goods inventory level that we will stick with now in this higher demand situation. Our inventory value has also increased because of higher metal prices. I think that that sort of goes without saying as well as then accounts receivable with also the improved realised prices.

So, with all of that said, we have invested in working capital in this year and the cumulative investment is now close to €350 million, as we speak, after the first three quarters. And given the market situation and given the improved EBITDA, obviously we still have a strong cash flow, and we will continue to keep a really tight control and eye on this. But as far as I can interpret the current market situation, this is not the time to release a lot of capital from the working capital. Rather, this is the time to serve our customers in an appropriate way.

And then you see that we have kept the 180 million capex frame that we have discussed before. So, 180 million for the year, that will mean 64 million in the fourth quarter to meet that figure.

Heikki has already talked about our commitment to continue the deleveraging path, and what you can see here is that our net debt reduced to €749 million at the quarter end, and obviously that's already by now a leverage at a low level at 1x.

And certainly, continuing on this path is possible with the stronger cash flows generated now in this higher profitability situation.

And then from the funding front, one news also from today, we are redeeming the 2024 notes. And that is really to optimise our debt capital portfolio. And it is also in order to reduce our interest costs, which I think then will be beneficial to all of our stakeholders. And in these charts, you can see our remaining debt structure and then also our maturity profile. What you can see here is obviously that we don't have big maturities coming up in the next years, but then in 2024, there's certainly the RCF and some other instruments as well. So, we continue to work to optimise this portfolio.

And then with that said, may I hand back over to you, Heikki?

Heikki Malinen

Thank you, Pia. So, the outlook for the fourth quarter: Group stainless steel deliveries in the fourth quarter are expected to remain at a similar level compared to the third quarter. The European ferrochrome benchmark price increased to US$ 1.80 per pound for the fourth quarter. Higher stainless steel prices are reflected in the already received orders and compensating the inflationary pressures and energy, consumables, and freight in the fourth quarter. Adjusted EBITDA in the fourth quarter of 2021 is expected to be higher compared to the third quarter.

So that is the outlook for the fourth quarter, and we look forward to your questions. Thank you very much.

Linda Häkkilä

Thank you, Heikki, and thank you, Pia. Operator, we are ready to take questions from the line.

Q&A

Operator

Thank you. Ladies and gentlemen, if you wish to ask a question, please press 01 on your telephone keypad.

We have one first question for Mr Anssi Kiviniemi from SEB. Sir, please go ahead.

Anssi Kiviniemi

Hi, guys, it's Anssi from SEB. Thanks for taking the questions. I have two of them. I will take them one by one if that's okay. First of all, you touched upon this a little bit, but could you elaborate on the lead times you see in Europe and the US to get a better feeling of what is the visibility when we enter into the first half of next year and to better understand how quickly the prices will impact the result that we are currently seeing in the market? Thanks.

Heikki Malinen

Maybe if I take that. So, as Pia said, indeed, in Europe, the order book is very long. I think on a quarterly basis, I think well into the second quarter, we have orders into June, on the pro-grade area, and this is mainly on the classic grade. So, 304 and 316. On the pro-grade side, I would say that that cycle is sort of gradually accelerating. We have certain sub areas like, for example, the scrubber business which hasn't really even started, or it hasn't started at all yet. And that usually will come eventually when oil prices stay high for some time. In the United States, the order cycle is a bit different. It's very much distributor-led business. It's going, let's say, from a month to month. So, the order lead time is somewhat shorter over there, but that is more a reflection of the structure of the market rather than anything else.

Anssi Kiviniemi

Okay, thanks. Then a follow-up on that. You highlighted the pro grades, how significant increase in demand you have seen currently? How large are the projects? What should we expect from that business when we enter into 2022? Thanks.

Heikki Malinen

So, the pro-grade business is almost completely project business. Remember, just as a reminder, so the end-use applications in the pulp and paper, chemical petrochemical industry, oil and gas, construction industry to highlight a few. The duration of these projects is long and the orders when they come, it takes quite a while to get them processed through. As I mentioned, our order book at the moment is very strong. Our mills are running full. So even if we've got a huge amount of pro-grade orders at the moment, we just have to kind of run the existing order book first out of the system.

So, what does it look like? We have started to see the pro-grade share gradually increase, but so far that increase has been fairly moderate, simply because we have to get quite a large amount of classic volume, commodity volume, out of the system first. So, if history were to repeat itself, this industrial investment cycle will last some a longer time and it should be good for us. But let's see.

Anssi Kiviniemi

Okay, thanks. Then the last question is on Europe and the US and the trade agreement we saw a couple of days ago. So, there will be no more Section 232 tariffs. There'll be a new quota tariff rate quota system. Can you talk a little bit on the direct impact for your business? How much volume you bring from Europe to US? And has the volume been excluded from the tariffs? Also, from product perspective, I mean impact for European markets and US market, what's your idea on pricing market dynamics? How do you see the situation? I know it's a broad question, but a little bit flavour on that would be helpful, thanks.

Heikki Malinen

Well, let me answer that in two parts. But before I do that, let me just first give background. Remember that we are the second largest manufacturer of stainless steel in the United States and therefore actually we don't really export much volume from Europe to the US at all. So the only products we export are mainly certain pro grades that go into industrial applications in the US. Some of them have been exempted from duty because we had received the exemption. So the volume is very low and the impact of the trade deal in itself isn't really material to us.

My second point is really that of course we very much see positivity in having good open trade between the two continents. It's important for us. I think philosophically it's important. And then the thing that I found was very good was that the US and Europe both made at least a verbal commitment that they will be looking to support or create a good sort of operating environment for companies who are producing steel that has low emissions. So, the big problem for us of course is the large amount over capacity in Asia where the CO_2 emissions are three/four/five times.

So, while it was only a verbal statement about the commitment, we still feel that it was a positive step from both EU and the US.

Anssi Kiviniemi

Great, thank you. That's all from me and congrats for the great performance.

Operator

Thank you, Sir. Next question is from Mr Ioannis Masvoulas from Morgan Stanley. Sir, please go ahead.

Ioannis Masvoulas

Hello, good afternoon and thanks for the presentation. Two questions from me. The first on your EBITDA improvement target. Really, really good progress there and good to see the increase in the overall target. But how are you thinking about the net debt to EBITDA target? It's still at 3x times or below 3x times and you are at 1x as of the end of Q3. So how are you thinking about it and how does it play into capital return decisions? And I'll stop here for the first question.

Pia Aaltonen-Forsell

Thank you very much. I think it's a great question, of course, given that our leverage is already at 1x. But now we saw also this is an exceptionally good market situation. It's an opportunity to further decrease our debt. Obviously, I've been sort of giving a lot of thought to what is the comfortable level of debt. Our financial target remains this leverage below three, but also in order to steer things, obviously to sort of think about what could the level be? And I think it's clear that we still have room to go lower. We were now at 749 and just still thinking what is the impact on the interest costs? And how can we drive this lower? So, I may have said somewhere before that I would certainly be comfortable to be below the 500 million mark for net debt. And we continue to push and make sure that we generate a good cash flow with really the target of still reducing the net debt.

But maybe, Heikki, I should check with you. This is not a target. This is just to say sort of a comfortable level is still clearly lower than where we are today.

Heikki Malinen

If I can just continue. Over the last years, we have spent over, I think, 85/90 million euros just on interest expense. I mean, that is a lot of money, especially in tough times. So, I would actually like to see that amount be reducing substantially. As I said earlier, this is a very volatile industry. The volatility from metals and the volatility of earnings in itself is a challenge. I do feel that if we can reduce the amount of leverage even further, hopefully that would have a positive impact on lowering our data, which of course, is a question in itself. With respect to the amount of debt, as I said, we have not made any firm decision on that.

Pia talked about 500 million. I would like to see it well below 400 million. So, we are having our internal discussion, or not [ph 00:36:50] argue amongst ourselves. But I think the main message here is we're both of the view that we need to further materially see the debt go down. Don't forget that we have certain companies, peers in the industry, who basically have no net debt or even negative net debt. So, this is sort of a reference point that we also have to factor in.

Ioannis Masvoulas

Understood. That's very useful. And a second question: You mentioned that the energy cost inflation for now has been well managed, partly due to hedging. How should we think about the hedging contracts you have in place and what sort of energy cost inflation we should expect for Q4, for example?

Pia Aaltonen-Forsell

Right. This is an important question. And let me just first sort of paint the background clear here, that obviously energy is important for us. And we are a big electricity consumer. However, two thirds of the electricity that we consume is consumed in Finland and even though I absolutely share the concern of the rising prices of electricity and natural gas and the whole sort of package of energy, I still want to remind that the higher prices that we have seen in the Nordics have been still clearly lower than increases that we have seen in countries like Germany or France or Spain, or why not the U.K., as well, as we have felt. So maybe that's sort of a first statement.

Secondly, I want to say our hedging policy is one of looking two years ahead and then sort of having a gradually declining hedge ratio. So, if I look into the fourth quarter now, sort of sequentially from the third quarter, we have some impacts in ferrochrome, we have some impacts in long products. And I think it's probably 10/12 million – depends, of course, a bit also on the spot because we always have like a layer of spot, even though we have hedges there as a backbone, we always have this layer of spot as well to keep some flexibility.

So definitely there is a negative cost impact from Q3 to Q4, and it's not a small number, but I think at the moment we are definitely speaking about our manageable number. Then, of course, the question is more long term, if prices were to remain elevated; I don't think the future curves are showing in that direction, but that is obviously a topic. No hedging can protect you forever. And as the quarters go by, we are in a situation where we have then also potentially hedged from a higher level. So without, let's say, giving the exact data for next year because simply, I think still at this point there might be also a turn in the prices, then at some point. But for the next quarter, it's a bit more than 10 million, the negative impact.

Heikki Malinen

If I can just still make one remark. Price electricity cost levels here in Nordic have hovered probably around 60 to 70 euros per megawatt hour, depending a bit on the type and source. If you look at other markets, for example, southern Europe, Spain, France, we've seen public information €100/150 per megawatt hour. So, as in Finland, we have two thirds of our power consumption, it does at least give us a chance to have at least some sort of cost benefit from there.

Ioannis Masvoulas

That's very clear. Thank you both.

Operator

Thank you, sir. Next question is from Mr Carsten Riek from Credit Suisse. Sir, please go ahead.

Carsten Riek

Thank you very much. Two questions from my side. I also take them one by one. The first one is on the EBITDA uplift. You mentioned the 50 million and you mentioned already that you are on a good track to achieve that. Could we actually see further improvements coming from this kind of targets post 2022? And where could it come from? When do you think we could get an update on this one? Thank you. That's the first one.

Pia Aaltonen-Forsell

Thank you. And obviously what we have now shown as a target is something we worked on extensively within our teams. And I would say maybe one dialogue that we have had quite a lot is to say, yes, we have a good method, we have continuous improvement, we have a number of projects. And I think many of us, me included and us included, recognise that this is also the nature of what you need to do in a heavy industry like ours. So, I think the commitment and the understanding that continuing to pursue these types of activities is fundamental, is certainly there.

Then what goes beyond 2022, we are, of course, then in our next strategy phase. And as we have described it before on the strengthening of the core, we could then also look at some sort of capex of the nature of whether it's debottlenecking or whether it's really sort of quick payback type of productivity improvements. And I do think we have sort of a long list of those that we are assessing and evaluating.

So potential is there, but of course, requires sort of continuous digging and work on it and requires also people to work together on it quite a lot.

Heikki Malinen

Yes, indeed. Obviously, as we get into the phase two part of the strategy, which according to our original strategy schedule, will start in January 2023, one of the most important decisions for that phase will be how do we think about capital allocation? I don't really want to rush at all into that phase. We're committed to taking this phase one to completion. I still think that we have more work to do on de-risking. We can take it even further, as we just discussed. Over the next two or three quarters, we will then prepare a plan for the second phase and as we get well into the second, probably into the second part of next year, maybe around the summer, perhaps at that stage, we are then ready to start talking about phase two. But as I said, I want to first complete this phase one de-risking, get that done and then we'll talk about phase two.

Carsten Riek

Perfect. The second question is more for Pia on the net working capital. We have seen an increase in the third quarter. But if I look at, at least, the move of the inventories in the balance sheet; that has been quite steep and was partially offset by higher payables, is there a risk actually for higher net working capital in the fourth quarter?

Pia Aaltonen-Forsell

So maybe first, the operative decision that we always need to take is the sort of amount of tonnes, and we took a decision also now during the third quarter that given the good demand situation, we have still lifted that up a little bit and that is really to serve our customers. And I would say as we see the situation right now, that decision remains. So, there can always be a little bit of fluctuation, but certainly sort of not looking to drive that down. So that keeps the working capital elevated. And then with the finished goods, there is really some fluctuation with the metal prices. So, the chart that Heikki showed, nickel being up sort of 10% from quarter end to quarter end. That's really then also pushes through in the inventory valuation.

So, I would answer your question like, yes, the risk is there. I would keep an eye on the metal prices for sure because that is something that could have an impact. And then the fluctuation really from the tonnes, that could be more of some sort of modest fluctuation rather than some sort of step change.

Heikki Malinen

Maybe just too small comments on that. Don't forget that the first quarter is seasonally the strongest in the industry. Our capacity in Q1 is never sufficient to meet that need of Q1. So we have to produce also in the fourth quarter just for the need of the market.

Secondly, when you come to the second part of December, many of our customers start closing shop. So, it will be difficult to deliver a product to their facilities in that, simply because they're closed. So, there is a tendency then to build some inventory in the last weeks. Of course, we will try and ship an invoice as much as we can, but we have to recognise these couple of operative constraints.

Carsten Riek

Perfect, thanks. Thank you very much; that helps a lot. And well done on the results.

Operator

Thank you, sir. Next question is from Mr Krishan Agarwal from Citigroup. Sir, please go ahead.

Krishan Agarwal

Hi, thanks a lot for taking my question. My question is more longer-term, forward looking. So, you delivered close to 250 million on average in the worst of the year of 2019 and 20 and then you are delivering 250 million of incremental run rate of EBITDA improvement by 2022. How do you feel about, or how confident are you, in terms of 500 or 600 million, a normalised run rate of EBIDTA even if the cycle was to turn back from the current levels?

Pia Aaltonen-Forsell

If I can first just sort of say a mathematical joke. Of course, if I look back into certain historical years, it is obviously possible to arrive to that amount. But as you rightfully point out, I mean, just looking into the very recent history, the COVID year was, of course, very different and very difficult. But also already in 2019, we saw a downturn, less demand in automotive and then also a much lower result there. So, I think it's clear when we gave the 200 million target – now up to 250 – we said that is all market independent. That is our own work, that is things that that we are working on. And really then with the idea that we can elevate this sort of level of EBITDA that had become very low during this difficult period. But maybe I'll sort of leave it there just to say that normalised, the EBITDA in our industry, you probably need to look over several years. That's kind of the only way to do it.

Krishan Agarwal

I understand. Very clear. My second question is on your contract exposure. I mean, some of your peers have guided that the annual contract will renegotiate from January. So, can you also drill into how much of the exposure you have in terms of the annual contract which might get reset from 1 January in terms of pricing?

Heikki Malinen

Typically, as we've said before, the share of annual contracts for us on a Group level is about 50% give or take. So that's roughly the situation on a Group level.

Krishan Agarwal

So, is it correct for me to understand that 50% of your volume at the annual Group level will be renegotiated in terms of pricing, also from 1 January? That means Q1 should have significantly higher EBITDA.

Heikki Malinen

The annual contracts, some of them may be analysed quarterly, half year, depends on the customer, depends on the relationship, depends on what the customer really wants, what type of end use industry they have. But these contracts, as I said, they do move more in staircase manner up and down. The movements are not that dramatic downward and also, they're not dramatic upward. So, that was my distinction when I talked about the CRU prices that you have to make a clear distinction between looking at price curves that talk about spot prices and then looking at contractual arrangements where it is much more staircase models. So yes, as I said, on a Group level, roughly about half of that moves and usually it is beginning of the year. Of course, again here, customer by customer, there may be differences.

Pia Aaltonen-Forsell

Indeed. And I think still to be specific on your question and I won't go into detail of sort of contractual share per BA, but I just want to say there are also some differences in the pricing mechanisms. And, if I look at the European sort of typical way, it could really be this exactly that 1 January is a very significant date where some annualised contracts are renewing. Maybe some are then for half a year, for example. So, you have these sort of step changes, whereas of course, for example, if you look at ferrochrome, you might find that there's often sort of benchmark pricing related mechanisms, and they would change quarterly, etc. So, when you look at that, you just need to factor in that there are some differences in the mechanisms between the different BAs.

Krishan Agarwal

I understand. My last question is on your financials. You had this capex ceiling of 180 million for 21 and for the last two years. So how confident are you that you will be able to operate with that 180 million ceiling and the capex is not going up? Or do you have no projects in the pipeline which might see some more higher capex in the next 12 months?

And then on the Q4 guidance, how much visibility would you have in terms of the mark to market positive from inventory revaluation? Or the other way of asking is, does your guidance include any kind of a positive mark to market from inventory revaluation for Q4?

Pia Aaltonen-Forsell

Thanks. Two very different questions. I'll just maybe, sort of half-jokingly say that we have an organisation with a lot of really good engineers. So, it's clear that we have a pipeline for capex. But then we also have control over capex. So, I'm really confident that we can keep with this 180 that we have planned to do. And we also have the necessary means to assess that and always sort of prioritising then what is most relevant for the Group. So, I think that remains solid.

And then your other question on the mark to market on the inventory. Well, obviously this has been the year where we have actually had some of those positive metal impacts also through the inventory. And even though the third quarter wasn't that big, I mean, it was still in absolute terms, I think €22 million, but at least order of magnitude is there.

And now looking into the fourth quarter again, sort of with the current pricing, I wouldn't expect any sort of significant amount there. But that's sort of given the current metal prices. So, I think that's sort of all I can say at this point in time.

Krishan Agarwal

Very clear. Thanks a lot. That's it from my side.

Operator

Thank you, sir. The next question is from Mr Patrick Mann from Bank of America. Sir, please go ahead.

Patrick Mann

Hello, good afternoon. Well done on a very good result. I wanted to ask on the 2024 bond and the redemption there. You spoke a little bit about possible net debt targets. How are you thinking around gross debt? Would you look to refinance that? Or just maybe the splits between how much cash you probably need to keep on the balance sheet as kind of your working level of cash through the cycle?

And then, Pia, I wanted to ask if maybe you were feeling a bit more confident about giving us an update sensitivity to ferrochrome prices. I remember at the [inaudible 00:53:05] you said it was a little bit tricky, but obviously we've now got the reset for the fourth quarter, if you're feeling ready to give us another number to think about. Thanks.

Pia Aaltonen-Forsell

Fair enough, absolutely. So first of all, on the cash: Pre-pandemic, we had this working figure of 100 million cash plus minus 50 million and you might say, “Why plus minus 50? That’s a lot.” But that can really be the fluctuation on sort of single big days of cash out, for example, on raw material, etc. So, that was sort of the hundred million figure. And then in the heat of the pandemic, we actually hiked that up a lot. And now we have settled at a slightly lower figure. And the target figure that we are internally working for now is around €200 million. And I think that's sort of a comfortable figure for us. Perhaps it can be lowered again at some point, but that's sort of the level that we are working with right now.

Then on the sensitivity question, I sort of assumed the question would be there and I will try to be as clear as I can. I think when we have given this, 10 cents on the benchmark price means 10 million euros on the EBITDA in the quarter. I think that has been given with kind of our fairly normal mix and we always have internal customers, and we have external customers, and we tend to have a certain balance there.

And I would say we are tilting a little bit here in the fourth quarter. It seems that there is a lot of internal demand. We have a high internal demand and with that, obviously our pricing is arm's length. But still, when I'm trying to do my best to sort of deep dive into the figures and try to look at something. If normally this was like 10 million, I would say now we are lower than that. I don't want to give an exact figure, but we are some millions lower per the impact there, per 10 cents on the benchmark price. So, a little bit lower. I'm sorry that I won't give an exact figure because this is really specific to this situation and to the mix.

And then I'll just say, one more time remind that out of the electricity and energy inflation that we face as a Group, there is a chunk to ferrochrome, for sure, because ferrochrome is a big electricity consumer for us.

Patrick Mann

Thanks. That makes sense, and just so that I completely understand on the ferrochrome, it's because there's a higher proportion being consumed internally than is normal or it has been in the past. So, you'll have a lower EBITDA than if it was the kind of historic level between internal and external. Is that right?

Pia Aaltonen-Forsell

That is one reason, and I tried to simplify things. So, I think I could list like seven or eight other elements as well. But just to somehow kind of keep this manageable, I'm just saying that's one reason. So, our mix is a little bit tilted. And with that said, the impact is also a little bit smaller.

Patrick Mann

I understand. Thank you very much and well done again. Thank you.

Operator

Thank you, sir. The next question is from Mr Alan Spence from Jefferies. Sir, please go ahead.

Alan Spence

Good afternoon. This is Alan Spence from Jefferies. Hi, Heikki. Hi, Pia. I've got two questions and the first one's on guidance. The language around it, as it pertains to the stainless side, was that the higher prices would compensate for inflationary pressures. If I take that along with the flagship and guidance, should I assume that the stainless EBITDA contribution is probably going to be flat in the fourth quarter and then the uptick will be coming from ferrochrome?

Pia Aaltonen-Forsell

Yes, the tricky thing here for me now is that I would like to add more words to it, but of course, our guidance is somewhat limited to that. But I try to say a few more words around it. First of all, if you pay attention to our volume guidance, we have there been sort of saying that it's fairly flat and there I would remind that in BA Europe, in the European market, we probably do get usually a bit of rebound from Q3 to Q4 because Q3 is seasonally the weakest, whereas again, BA Americas is also really important for us from a profit generation perspective. And again, there you have Thanksgiving, you have Christmas. And Q4 is also historically for us and in the market has been the weaker quarter volume wise.

So, we have a little bit of a tilt there. And then that sort of plays into the overall mix of our profitability as well. So, you have to count in these elements. And then I think we just wanted to be clear that we have an order intake and with the long order book that we have right now, obviously we can see from that order intake that price level is still increasing.

And as you may have noted, also from the way how we changed the guidance for the third quarter, there are some elements into the realised pricing that we will then observe as the quarter goes. So, I that's why I don't want to give a definitive euro amount to the one or the other. I think we just wanted to be clear to say we recognise there is inflation, but we do also recognise that we have higher prices. And I hope I haven't said anything that sort of led you to believe that there is some extra happening in ferrochrome outside of the fact that there is the benchmark price with some impacts that we have just described. And then there is certainly inflation, particularly then from electricity.

Alan Spence

Okay, so perhaps a bit of conservatism in that, one way or the other, but I guess [inaudible 00:59:11]. Capital allocation, and I just want to be quite direct about this. Clearly, you're prioritising de-leveraging and I get it, whether we take this 500 or 400 million as a new goalpost or target, however you want to talk about it, how do you think about resuming the dividend before you get there? Heikki, would you feel comfortable proposing a dividend to the Board before reaching that conceptual 400 million level?

Heikki Malinen

We still have a couple of months here to go before we get to that point. Obviously, within the Finnish governance system, the Board makes the dividend decision, not the CEO. I really don't want to publicly or even otherwise sort of state what I personally think about this. It's a Board decision and the Board will weigh the facts and then decide what the right amount is.

My personal view, as I said, was that it's important to de-risk the company and I gave you some reference points from peers. I also talked about the data and also the fact that this is a super cyclical business. There are good times and then there will be tough times, and I really don't want to be in a similar situation that we were in last year with Pia [ph 01:00:22] when our Moody's rating was as low as it was, and times were tough. Next time around we're going to be in a much stronger, resilient shape.

Alan Spence

Okay. Thank you for that.

Operator

Thank you, sir. The next question is from Mr Eric Nelson from JPMorgan. Sir, please go ahead.

Luke Nelson

Hi, I'm not sure who Eric Nelson is, it's Luke Nelson here from JP Morgan. I've got three questions. I'll take them in turn. Firstly, just on prices, you mentioned that you haven't yet seen a single large effect from positive mix coming through; but given the duration of some of the project businesses coming in, it sounds like it could be a bit of a tailwind clearly, over the next couple of quarters. Can you maybe just give us a sense or quantify what potential benefit you expect from mix, maybe starting with Q4 and what's potentially in guidance? And then maybe any sort of qualitative comments on the quantum of that tailwind would mix into 2022? Let's start there.

Pia Aaltonen-Forsell

I'll just try to make it more tangible from what we experience right now. And it's starting to move a little bit improvement on the mix side. And obviously, if you look into, for example, BA Americas' figures as well, you will find that even there, there is a comment of some positive movements in the mix. But if I then would focus on BA Europe, I just want to make this tangible. I mean, we are still now in a phase where there's really small incremental improvements, only mean something like on EBITDA level it's maybe six or seven million from the second quarter to the third quarter.

At the moment the impact in EBITDA is small when you compare it with the overall positive impact that there was from the pricing. And then from this very gradual improvement that we have seen right now. It really depends, as Heikki said, on we have these projects, they start coming in, we see it in the order book. But there is really long lead times, and we have to clear a bit also space for them.

My assumption is that still in the next quarters, we have this like small, gradual improvements. And then of course, this can be significant amounts then when the mix is back to some sort of balance that we had – I don’t know – just before the pandemic, for example, when we had the scrubber business, and the mix was really good. So, we are still fairly far from those highs that we have experienced before.

Luke Nelson

Okay, that's very useful. Secondly, just on Americas and more, just in terms of shipments. It's been running, I think it’s 180 or 190,000 tons per quarter over the last couple of quarters. Obviously, you've talked about Q4, and we know the seasonality, but maybe thinking about 2022, is that run rate per quarter now a sustainable base that we should be thinking for next year? Or is there any other element say from destocking that that's helped shipments there?

Pia Aaltonen-Forsell

Yeah, I don't think we can expect anything sort of significant in terms of inventories that we would be able to push out more to the market, et cetera. I mean, we are running a very tight ship on that in the Americas as we speak. And at least if you look at any measures, whether it's DIO or any other relative measures, they are in really, really good shape. And I don't expect anything significant to push out of there in that sense in the Americas.

Then again, this is a constant continued improvement. So at least without investments, it's not going to be step changes, but there are certainly going to be small incremental improvements also all the time, debottlenecking and working on, for example, both cold rolled [ph 01:04:45] side and in the melt shop. But I think we are, as a team right now, the team is really committed to delivering according to customer needs and really working at a very high level of capacity utilisation and as well big team effort. So, I don't think we can expect a big step change in 2022.

Heikki Malinen

Exactly. So obviously, I will be challenging the team to even further improve yield, make sure that the mill is balanced as well as possible, that we can squeeze out even more from the BA America system. Don't forget, we also have Mexinox in Mexico that is being partly fed locally or partially from Europe, depending on the grade. But any big step change will not happen, but definitely I'm going to be wanting to see more volume. Let's see if the team can deliver.

Luke Nelson

Very clear. And final question, just going back to the questions on power, I think you mentioned the 10 to 12 million sequential headwind Q4 versus Q3. Can you give any sense of the breakout that is, [? 01:06:00] obviously the lion’s share within ferrochrome, but a bit more of the split? And then if we look into Q1 relative to Q4, does the Q4 base reflect the energy inflationary environment currently or would there be another step change on top of that?

Pia Aaltonen-Forsell

So Q4 is still protected by some of the earlier hedges or contracts that have been there from a lower price level. So obviously, if we continue – but I'm sure you have also noticed that there has been somewhat of a drop again in the prices or it's been extremely volatile, let's put it this way – if we were to continue at such a high level, then it would certainly mean that still from Q4 to Q1, there would be one more sort of step up. So, first, just to make that clear, but I think it's too early really to say because we have seen so big movements as well in India's energy prices and in the forward prices as we speak.

But then when you ask for the BAs, I would only repeat this: Overall of our electricity consumption, it's actually two thirds in Finland, and Finland, obviously, is ferrochrome and then it's the melt shop in Tornio. But there is a fair dose to ferrochrome, for sure. So just to say let's not forget about that. We really do use electricity there as well.

And then long products, of course, being a smaller BA and then being impacted by the higher energy prices in the UK. So, I think that's a significant topic to deal with in long products as well, even though, of course, we are not talking about some sort of mega amounts of millions here.

Heikki Malinen

In Scandinavia, we had a super dry summer and a big part of the power in the Nordics comes from hydropower. So obviously, we need plenty of rain in the Nordics and a very snowy winter to get those water reservoirs up. And then, of course, get more sort of hydropower production. So, this will probably at least— That sort of cost the inflation element will probably be around for a while. I've been told that it takes usually two quarters for the reservoirs to go up. So, at least that's what I understand to be the case. This will take a bit of time before we see more hydropower supply, which would then give some pressure on the electricity price downward.

Luke Nelson

That's very clear. Thanks a lot, and congratulations on a good result.

Operator

Thank you, sir. The next question is from Mr Bastian Synagowitz from Deutsche Bank. Sir, please go ahead.

Bastian Synagowitz

Yes, good afternoon, and thanks for taking my question. I only have a quick one left and that is on your earnings improvement target. Pia, are there any onetime costs or capex which are associated with the additional 50 million uplift which you have been putting out today?

Pia Aaltonen-Forsell

Brief answer, no, because these are more improvement targets of a continued improvement nature. So not to these ones.

Bastian Synagowitz

Okay, perfect, thank you.

Operator

Thank you, sir. Next question is from Mr Tristan Gresser from Exane BNP Paribas. Sir, please go ahead.

Tristan Gresser

Hi, it's Tristan. Thanks a lot for taking my questions. Maybe the first one on prices. And I know pricing questions are tricky, but I just want to make sure that the data we all look at is not too dissimilar with the market reality you're seeing, especially in Europe. So, I keep my questions very general. But do you actually see European-based prices at their highest level in Europe since 2007? And are you still seeing base prices increasing or have them stabilised in Europe?

Heikki Malinen

I think with respect to prices, I don't really want to add anything other than what I said before, and I will add the comment that the share of, let's say, base price in alloy surcharge has really now increased. There was a time when we were very much in effective pricing, and if we look at Q3 more and more, we see base price and alloy surcharge being adopted. But I don't want to comment on specific price levels beyond that.

Tristan Gresser

And maybe on automotive, that's 9% of your direct sales. Can you help us maybe quantify the weakness you've seen there in Q3? How much auto demand maybe has been down in recent months, and do you expect further weakness into Q4?

Pia Aaltonen-Forsell

I think here I would make some distinction between BA Americas and in Europe. And obviously, as you may know, there's also already to start with a difference in that business area. The US market is very much a distributor market, so the share of distributor business there is really big. So, I have commented that we have seen some weakness in automotive demand really based on the supply chain issues more on their side. But that was really relevant to Business Area Americas. And then, as you have seen, that has not really had any significant impact in the figures. They have remained strong, nevertheless.

Then, obviously we also have an important customer base in BA Europe out of automotive. And I still checked, even this morning when I checked, the information and how this sort of is visible to us still is that this question of the lack, the supply chain issues there, is certainly all the time being discussed. But sort of the practical consequences to us have still until now been fairly limited. And I would also say that just any negotiation into next year has also followed a very constructive pattern.

So, I really couldn't say that this has impacted us that much. I don't know, Heikki, if you want to sort of share any more detail on this. It is still an important customer base for us, and it has worked out in a good way.

Tristan Gresser

All right, thank you.

Operator

Thank you, sir. We have no more questions. Back to you for the conclusion.

Linda Häkkilä

Thank you all for your very interesting questions and thank you for following our webcast today. Now it's time to close this event and continue next year with our full year results. But now thank you once again and have a good evening.