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Outokumpu's Q2 2022 / Interim report

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PRESENTATION

Linda Häkkilä

Hello, all, and welcome to Outokumpu's Q2 2022 results webcast. My name is Linda Häkkilä, and I'm the Head of Investor Relations here at Outokumpu.

This time we delivered another strong, or should I say a record quarter and our adjusted EBITDA reached over half a billion.

Our main speakers today are our CEO, Heikki Malinen, and our CFO Pia Aaltonen-Forsell. But now, before we start with the presentations, I would like to remind you about the disclaimer as we might be making forward-looking statements. And now, without any further comments, I would like to hand over to our CEO, Heikki.

Heikki Malinen

Thank you, Linda. Good afternoon. Good morning, everybody. Welcome also on my behalf to our Q2 presentation here together with Pia. It's been quite an eventful Q2 for Outokumpu. We saw most of you in June when we had our CMD and we launched the second phase of our strategy, and here we are now again then to talk about our Q2. And as Linda just mentioned, Q2 really is a time when we have achieved record level EBITDA against a backdrop of substantial cost inflation, which has been going through the whole business sector and then of course, the geopolitical turmoil specifically here in Europe.

Now if we look at this quarter – half a billion result – and cover the key points. I have to say I'm very pleased with the strong performance that Outokumpu has been able to deliver. You remember that two years ago we launched a major turnaround strategy which intended to de-risk the company and to really raise the performance level of the business. We've been fortunate in the sense that we've had this market tailwind, which has helped us really to take maximum advantage of our capabilities. And I think the result we present today to you clearly just shows that what Outokumpu as a company can do at its best when the circumstances are right. So, here, we're very happy with this result; really amazing performance from the organisation.

The prices during the second quarter continued to further strengthen and, of course, that did support our profitability. It's been a period of some volatility also on the price side. I'll come back to that in a moment. On the cost inflation side, as we've discussed earlier, it's been sort of an emerging story. Last year, we were able to quite well push back and mitigate the cost inflation. But now, as we got into 2022, gradually that cost inflation has been coming through in many different areas.

And the second quarter was also a time that, especially here because of the Ukraine Russia war, we've had to spend a lot of time, put a lot of energy into thinking about how we mitigate different types of risks. Some of these risks have materialised. Some of them haven't. But in general, it's been a time of a lot of uncertainty. And I have to say, we as management have had to spend quite a lot of time trying to figure out what might be coming around the corner and what should we do about it, but luckily, I have to say, we've been able to manage very well everything that has been coming our way. So, so far, so good.

Now, in terms of the strategy and the first phase, as we said in the CMD in June, we have now completed phase one ahead of schedule. I'm very proud to say that we have achieved that ahead of schedule and we've also achieved all the targets we set out.

I can state that Outokumpu now has de-risked itself. We've come a long way from where we were in the summer of 2020. And today, just looking at the publicly available data, it seems we have the strongest balance sheet, the lowest net debt in the sector among our peers. So, happy about that as well.

And if we look at overall the performance of the company, we've also been able to develop the way we work inside. Our internal efficiency has increased. We've reduced fixed costs. We have a very lean organisation at Outokumpu across many metrics. This company is performing very well.

On the third bullet, I want to comment on long products. It's been – we've mentioned it in all of our presentations – a bit like a side note. I have said every time it's non-core. Well here, a month ago, we were then finally able to announce the signing of the [? 00:05:07] to divest long products to the Marcegaglia family. I think this is a win-win outcome for all. Long products will find a new good owner with the Marcegaglia family. It's good for our employees, but it's also good for our shareholders. If you look at the value we created over the last two years as we embarked on this very ambitious turnaround that Liam Bates from our from our company has been leading this, I would say, a rapidly accelerating turnaround and delivered exactly what we wanted, even I would say a bit more than that.

And then what we have exercised, I would say, is strategic patience. We did not rush and execute the deal, but we took our time. And I think now the outcome is good for everybody, as said, for employees, for the buyer, but also for the shareholders of Outokumpu. And it also then makes Outokumpu a much more focussed business around stainless steel and then of course ferrochrome in the backdrop.

And against, I would say, these facts and given the circumstances where we live today, I would like to state that Outokumpu is more resilient than ever before to withstand any changing circumstances that might come our way. And I said, we are living through some very turbulent times, to say the least.

You have seen, those of you who have followed this company and our strategy carefully, you know this chart very well. I said phase one is now completed. We've now started phase two, effective July 1, here in business area Europe. We now have the two business lines. We have the standard products led by Niklas Wass. You saw him on video last month. And then we have Thomas Anstots leading our advanced materials where we have the pro grades business. Those two organisations have now been established. They have started running forward, moving their business, getting themselves organised and look forward to then presenting also what they accomplish in the coming years.

The Americas business of course, very important part of Outokumpu; a very solid, I would say, second or third leg for the company, especially in these times when America is such a strong market. I'm very happy that we have a very good business in North America and then we have our ferrochrome activities here.

And so during the course of phase two, as I said, we will focus on investing in productivity. We will look to add capacity both in Europe and in the United States by opening bottlenecks, and then also in investing in activities to further reduce our CO2 exposure. As you know, we are the sustainability leader in the stainless-steel industry globally and we intend to maintain that number one poll position also going forward. So that is the strategy and now we are in phase two.

And then now that we mentioned sustainability, just a couple of highlights. You know that safety is absolutely number one topic at Outokumpu. We have the best safety record in our industry. Our total recordable frequency rate for the first half is 1.8. You can see the curve on the upper right-hand side. I think that curve just shows you how much effort and determination we have put into improving our safety. And obviously, the target is to get that to zero some time one day in the future. During that journey, we are gradually trying to reduce it every year a bit lower and lower.

Last month we introduced our new product, Circle Green. I would say that the intention of developing a product where we have a very, very low CO2 footprint, it's part of our innovation journey looking to develop solutions for customers and really looking to test the market's willingness and readiness to take on these low carbon products. And so I think we will then report to you in the coming quarters how this CO2 journey then goes forward.

Then on the markets. If we start maybe on the upper right-hand corner – nickel. It's been quite an eventful year. So much volatility. Rarely seen that – I think we have to go back to before the financial crisis to see a period where we had so much volatility in nickel as we've had this year. It has been challenging to manage through that. Also, it's created, I would say, a fairly big price gap between Asia and Europe at some stage as nickel went up. But now we've seen in the last month or two, again, nickel starting to correct back from the very high levels more towards, I would say, a lower level anyway, just over $20,000 per tonne, but anyway still coming downward. And maybe something worth mentioning is that if we look at history and nickel price, one should also consider the fact that while we also think about nickel in the context of what is the nickel price vis-à-vis the corresponding materials in Asia, that also the NPI products in Asia, that their costs are also influenced by high energy costs. So, I would say that the sort of competitive advantage that the Asians have had in nickel, that is also tightening as energy costs go up in that market.

On the lower left-hand side, you can see the transaction prices. The market has been very, very tight for a long time. We've had seven quarters of increase in demand. Correspondingly, we've had transaction prices moving up. Now during the course of the second quarter, we started to see a softness in some areas of the market, more in Europe than in North America in the second quarter, partially also resulting from the fact that we've seen nickel then fall in value. But also on the distributor side, we've started to see fairly strong restocking and that has brought a certain softness which can gradually be seen in the transaction prices.

On the right-hand side, at the bottom you can see ferrochrome. The ferrochrome market also has been very strong. But in the second quarter, especially as we came into the summer, we started to see some softness and especially in the spot market of ferrochrome. In the last eight weeks we've started to see a clear softness and transaction levels have fallen quite a lot in the past eight weeks.

Now then looking at the results. From 377 in the first quarter, which was a great number in itself, now then to 547, a record number for the company, best ever results. What really drove us well, as you can see, deliveries declined somewhat. We were benefiting from the elevated prices that gradually came through the order books. That delivered quite a lot. And then, of course, we had the metal timing impact, which of course then led ultimately to 547.

Interestingly, if you look at the costs, we have been able to mitigate still the cost pressures quite well. Maybe one area where we've seen a lot of volatility recently has been energy and electricity prices.

Maybe Pia, you can lead us through the discussion on energy, when you look at the different businesses and maybe we can discuss that also in the Q&A when we get that far.

So overall, I guess you can see from my face, I'm happy, very pleased with where we are. It's been quite a journey, seven quarters looking at where we were two years ago. And now here we are, a de-risked company, a strong balance sheet, the company performing very well, motivated staff and in spite of challenges, we're in a very resilient position here to face any challenges that the future might bring us.

So, with those words, let me hand it over to Pia, who will start the discussion on the numbers. Please, Pia.

Pia Aaltonen-Forsell

Thank you, Heikki, and indeed a very good afternoon and good morning to all of you. And this has certainly been a very eventful quarter. So let me talk you through some of the highlights there. I will really start off with repeating it was not only a record, also sector, record result; definitely, also, in terms of indebtedness, our strategy is now showing the result. Our net debt reduced to 289 million. I will show you the time scale. Obviously, we can remember it's not that long ago that our debt level was still above €1 billion. So this has been a good and rapid development as well.

But when I say eventful quarter, of course, there were a number of positive things happening here. We have signed a new €700 million revolving credit facility. It's sustainability linked, it's unsecured. All of those are things that really pleased me and the team very much here. Our liquidity has improved to €1.3 billion. So maybe you remember – or at least I do – that when COVID period started at that point, roughly two years ago, our liquidity was at 0.9 billion. So I think sort of all through this period, we have also wanted to make sure we are stronger and stronger also on that side. We worked obviously a lot on the long products divestment and certainly here, we have signed the deal in July as Heikki spoke to, but this has kept us definitely busy during the quarter.

We also still have a number of smaller non-core asset divestments. So we are continuing this path to really ensure that we keep the house in good order and have the balance sheet in good order here. And we paid the dividend for the first time here again after the COVID – €68 million in April. And I think this is then followed by the renewed strategy launch, the new financial targets, the target also in terms of dividend to have a stable and growing dividend going forward. So all of those obviously very positive topics.

When I say it's an eventful quarter, obviously, the whole situation in Ukraine has also been something that I think has been weighing on everyone's shoulders from a range of perspectives, obviously also from risk management perspectives and the energy cost development. It is something that I will get back to later in my presentation.

Let's have a short look at the main KPIs that we have here. I think this is demonstrating a lot of financial strength of the quarter. So you see here record EBITDA, 547 million in the quarter, resulting also in a net result of €385 million. So definitely best result here also for us. When we look at the next phase of the strategy and strengthening the core, one of the KPIs that we want to highlight in our reporting more going forward is return on capital employed. Now in the quarter, it's 29.9%. We have chosen a method where we always count it on a 12-month rolling basis. So just a note that that's the way we are doing it. That's kind of in our mind, a good way of showing how we create results with the balance sheet that we have.

And you may note then when you look at the details of the report that we are also disclosing the BA return on operating capital figures now for the first time.

When you look at the personnel figure at the end of the period, I just wanted to add, I'm really happy to say, in this market situation, we've also had 800 summer trainees. I do hope all of the summer trainees get a good experience and we of course get the support and help that we need in these busy periods that have still been around.

So strategy phase one has indeed been completed. Heikki already spoke to the fact that we have been completing ahead of time. You remember the reporting we have done quarter over quarter building this. So I thought there were maybe one or two details that I still wanted to bring just in terms of closing this chapter and moving on into the next phase and the phase of strengthening the core.

The first one is specifically just stating the long products share of this. Obviously, being a smaller business, it is still a very significant improvement of 18 million that long products and the team have contributed into this overall. But out of the 260 million, we can see that BA Europe has been the biggest contributor and certainly then followed by Americas as well as of ferrochrome.

The other thing is that we used a method, we used a tool following up all of the more than 1,800 projects that we had here. And that's something we will take with us, along with the improved cost base, along with the improved product mix, also into the next phase of the strategy.

So next I will say more about each business individually, and obviously from a result perspective, I think BA Europe and we all can be extremely proud of the 289 million result in a quarter. This is obviously a statement of the favourable market conditions that there have been in the quarter, even though you see that volumes are slightly lower than in the previous quarter, indeed. We had a higher share of pro grades also in absolute amounts, a higher amount of pro grades, and this has certainly helped us. But the market indeed, overall, I would say when we more look at the forward-looking situation, there has been a shift with a very high share of imports, especially in the first month of the quarter and certainly then impacting the business going forward.

Many of these things have certainly already been debated and Heikki has mentioned some of them, but I'll just state at least the obvious facts.

First of all, when we look at the peak of Asian imports in April, this then followed kind of the normal pattern of being lower both in May and June. And indeed, we have again now in July seen a clearly higher market share of imports. So this same pattern seems at least to some extent still to continue here.

Then another point worth noting is that from a distributor perspective, we are indeed seeing higher inventory levels on average compared with the previous periods. So there is certainly now some inventory that takes digesting into the system.

Nonetheless, when I then kind of look at the total picture of what this paints on the market, I still think it's worth maybe saying, and especially for BA Europe, first of all, that we do have the stable part of the business here with also end users still being, I would say, in a sort of fairly robust and stable mode. Obviously, projects, pro grade business doing well under these circumstances. Oil and gas, for example, also other projects. So this is still somewhat of a situation with like almost different segments. And also overall, when we think about the third quarter, you may have noted that when we still think about what will really be delivered and invoiced, please note that we still have here also orders from previous periods.

So what is happening here and now in the spot market is not exactly what will happen in the invoicing in the third quarter. So there I still think we will enjoy some of the higher price levels also from previous periods.

Maybe this is enough said about BA Europe. I certainly want to spend a few words also on BA Americas. This is also a very strong result operationally, and added to that, maybe you have noted that the share of timing and hedging, or raw material related inventory gains and hedging, that has been a good, positive number in the quarter here as well for BA Americas. So we certainly had, strong realised prices, kind of good market momentum, good market share and also, looking forward here, I think we can definitely talk about a strong and robust underlying demand even though there are for sure inflationary pressure, consumers wondering about sort of what inflation will mean, what higher gas prices will mean, etc., going forward. So maybe some sort of cautiousness relating to inventories can also be noted. Inventories are also here a bit higher than normal. But overall, an extremely strong quarter here also for our Americas team. Another record.

Well, ferrochrome certainly as well here looking at Q2, a very good performance. A strong market momentum, high prices, but indeed experiencing some inflation here in the consumables. And when we are then looking forward, then I would move the attention quite a lot to energy and when it comes to ferrochrome, especially to electricity and it's good to remember that Ferrochrome is really out of all of our businesses, the one that is most impacted by higher electricity prices. And then of course, particularly in Finland, given the location.

And when we look at the Finnish energy markets, if we compare with the situation early in the summer, I think the fact that Russia had stopped, or there were no more imports of electricity from Russia to Finland, that has been well known now for a period of time. But on top of that, there have been various announcements relating to Olkiluoto 3 nuclear power plant. And that is pretty significant. I'm sure you have seen the forward prices also in Finland going up to a much higher level than we have seen before. And the importance of Olkiluoto 3 here, I think is one of those factors really sort of driving the energy balance and also the outlook and well, indeed, it seems that the new period of trials and test is just about to start. So certainly, we will follow that a lot.

But Ferrochrome is really the business that is impacted, and I just want to make this a little bit more tangible and also say that with the forward prices that we see right now and also with the hedging levels that we have into the third quarter for ferrochrome, I could still see a situation that if we remain this elevated, we could have 20 million to 30 million more costs in the ferrochrome business based on the higher electricity costs.

And obviously, autumn and winter will then tell what will happen next. But this is certainly a topic that we need to follow extremely carefully.

So with the BAs, I want to end here on a high note with BA long products. Obviously a very strong operational result, but also a good piece of timing and hedging included here into the record 63 million. A very big thanks to the long products team, to Liam and colleagues here for delivering the turnaround. And obviously by now then we have signed the deal to divest the business to Marcegaglia.

In this context, the Degerfors business will remain with Outokumpu also going forward on the long products side.

A few more words then on the cash flow. Here you see the second quarter cash flow first, starting obviously off with a good result, but a major investment into working capital. With our strong balance sheet now, I think we have that opportunity to invest in working capital where it's needed. But I do want to say that out of this 400 million investment, there are indeed impacts that also come from us safeguarding, mitigating risks relating to the war in Ukraine. So, for example, building some stock or rerouting some supply chains.

And I would estimate that that impact has been negative or building inventory in this case, or investing into working capital of at least 100 million out of these 400. So maybe a note overall to this.

And then you can see that even in this situation, we certainly have managed a very balanced net debt between the quarters. And the CapEx for this year will be 180 million, maybe most importantly, also, we expect to complete the investment into deep mine by the end of this year.

I promised to show how the debt has been reducing. Certainly, at this point in time you note the higher levels north of a billion of net debt in the years 2020, 2021 already decreasing. And now kind of continuing on that path, given us a very strong KPI for the balance sheet net debt over EBITDA at 0.2x.

And finally on our funding, our maturity profile here, you can see that we have been able to extend it further – liquidity at 1.3 billion. And on the left-hand side, you can see our debt structure, which I think remains very well diversified.

So with that said, I would like to hand back to you, Heikki, please.

Heikki Malinen

Thank you, Pia. Finally, we have the outlook against, I would just say again that the backdrop is that we are living through some fairly exceptional, uncertain times, much so more in Europe than the United States. The US market seems to be insulated from many of the - at least geopolitical - challenges we see coming potentially our direction.

But the outlook for Q3 for continuing operations and please notice the star in that statement. So group stainless steel deliveries for continuing operations in the third quarter are expected to decrease by 10% to 20% compared to the second quarter. Prices for stainless steel in the already-received orders have remained at a higher level. The European ferrochrome benchmark price decreased to $1.80 per pound for the third quarter.

Energy costs are expected to increase in the third quarter and impact especially negatively business area ferrochrome. Plant maintenance costs in the third quarter are expected to increase by approximately €10 million compared to the second quarter.

With current raw material prices, significant raw material related inventory and metal derivative losses are expected to be realised in the third quarter and the guidance for Q3 2022 is adjusted EBITDA for continuing operations in the third quarter of 2022 is expected to be lower compared to the second quarter.

So that is the outlook for Q3. And with those words, let me hand it over then to Linda and the operator for Q&A. Thank you.

Linda Häkkilä

Thank you, Heikki. Operator, we are ready to start taking questions from the line.

Q&A

Operator

Thank you. If you wish to ask a question, please dial 01 on your telephone keypads now to enter the queue. If you find your question is answered before it's your turn to speak, you can dial 02 to cancel.

Our first question comes from the line of Anssi Raussi of SEB. Please go ahead. Your line is open.

Anssi Raussi

Thank you. It's Anssi Raussi from SEB. Good afternoon. I have a few questions and I go one by one, and I start with the basic one again. So what kind of lead times you have at the moment? And also, again, about your Q3 deliveries, as you guide still high prices in already-received orders. So what kind of mix you have in your Q3 deliveries in terms of timing in bookings? So are these orders from March to Q3 months or how is it? This is the first one. Thanks.

Pia Aaltonen-Forsell

Right, thanks Anssi. Maybe, first to say that where we are booking new orders right now in Europe in cold rolled is early in the fourth quarter. In US of course the cycle is a little bit shorter, quite following normal practice. And when I look at the mix quarter on quarter, first of all, in the product mix, I really don't see any significant changes. But when you are asking when did we book this, I think we have started to see shorter lead times throughout the spring and the summer. But I cannot really give you an exact, 'Hey, we booked all of this in March' or something like that, but clearly on a shortening cycle for sure.

Anssi Raussi

Okay, thanks. And the second one is about your delivery guidance as it is a bit on the low side, some could say. So what kind of factors we are looking at here? Is it all about maintenance or is the underlying demand affecting this? Or how much do you expect to lose volumes due to maintenance?

Pia Aaltonen-Forsell

Well, first, maybe I can start with having maintenance in this quarter is quite seasonally typical. And I would say the seasonality is definitely a part of this guidance. And then on top of that, this sort of destocking, I would say, is more important, and then really being able to say that the underlying demand *per se* would have changed. I do say this having in mind the macroeconomic backdrop that certainly gives a lot of negative signals as well. But just if we really listen to our customers on the end-use side, it is clear that there is still some sort of robust or stable situation in the Americas and even in Europe, I would say, still on that more elementary kind of looking at de-risking, destocking in the face of a lot of uncertainties.

Heikki Malinen

And just to build on that. First on the US. So the US market of course has been extremely strong. The COVID rebound was just unbelievably strong. So I guess from the underlying demand, I would say we're more moving towards a phase of normalisation. Pia already talked about the restocking by the distributors. I would say the stocking issue is much less a topic in the North American market than it is here in Europe.

In the US, some of these sectors, if we look at automotive, seems to be quite okay, but I would say not especially strong – so okay-ish. On the white goods side, we have had a huge phase where people have bought a lot of microwave ovens, et cetera. There's been a lot of money also supplied in the US to consumers. That is now, I would say, starting to come to an end. And some of the white goods suppliers are indicating that we're moving more to a more normal phase rather than the super-hot phase.

But overall, I would say the big trends in the US are positive and now just have to see what the next quarter brings. If you look at the US consumer, for example, we have fuel costs that are very high in the US, housing costs have risen. I think the consumer has less disposable income, although they have a lot of savings. So it will take now some time to see how this really flows through into the consumption.

And then as Pia said, here in Europe, we have seen that the fairly large, or the price difference between Asia and Europe, which sort of started to grow as time went by, led to a fairly substantial import volume from Asia. And that volume has been coming in. We saw that in the first month of April in Q2, and we've seen that volume also come in in the month of July. So gradually, the Asian imports are moving in. Let's see how long that takes. I think the European destocking of our distributors will probably take a couple of months to normalise again.

Anssi Raussi

Okay, thanks. And the last one from me, for now at least, about still your guidance and raw material inventory and relative losses for Q3. Any ballpark here? Like something in Q1, or—?

Pia Aaltonen-Forsell

Yeah, Anssi, thank you. I do think it's a relevant question and maybe I can get back to, when we guided for Q2, we talked about this figure potentially being a significant positive. And now you've seen the figure. I do think that we could see sort of similar level, but with a negative sign in front of it into the third quarter. So it's clear that there is a swing. The dynamic also is one where Q2 in elements of that broad positive timing saw raw material related inventory gains, but negative hedging. And now when we move into the third quarter, it will be the opposite. So we will see negative timing, but we will see positive hedging.

Anssi Raussi

Okay. That's clear. Thank you.

Operator

Thank you. Our next question comes from the line of Patrick Mann at Bank of America. Please go ahead. Your line is open.

Patrick Mann

Good day. Thank you very much for the presentation. I just wanted to ask around capital allocation, Pia. You’re sitting with the lowest net debt ever. Can you just remind us the sale of long products? Is that all going to be received in cash, and just the timing around near the end of the year? But you're effectively in a net cash position with arguably working capital unwinding, still sticking to the capital discipline, sort of €180 million or €200 million a year for the next two years. At this rate you're going to build up quite a cash pile. How are you thinking about deploying that? Thanks very much.

Pia Aaltonen-Forsell

Thank you, Patrick. And I can say I love that question because now we are living a period with a lot of uncertainty. And that's really the macroeconomic situation that's obviously here in Europe, very much the war in Ukraine and the energy issues around that. So I think just for the time being, I feel super comfortable. I think it's a good position to be in to have this pile of cash. But you are right, of course.

If we look a little bit more, we take a bit more perspective a couple of years, I think this CapEx guidance in the next strategy phase, or this ongoing strategy phase, now of around 200 million per year is correct. I mean, this year of 22 will be still 180, but then kind of for the next period of 23 to 25, these 200 per year is what we have talked about before, or more precisely 600 million over three years. But yes, indeed, that's about 200 per year.

So I think this gives us some room to consider and to manoeuvre and think about various options for that. Definitely paying a stable and growing dividend is one of those important points there. And I think once we are over this period of big uncertainty, it's a big opportunity for us then to come back to this topic.

Patrick Mann

Got it. Thank you very much. And just in terms of how and when the receipts for long products comes through.?

Pia Aaltonen-Forsell

Oh, yes. Thank you. So, of course, this now depends on those closing procedures being finalised, and I think we are foreseeing that that would happen by the end of the year. Not everything of this is fully in our control. There are, for example, these competition clearances, et cetera. But given that, I think that by the end of the year and obviously looking at a clear cash payment here.

Patrick Mann

Thank you.

Operator

Thank you. The next question comes from the line of Ioannis Masvoulas of Morgan Stanley. Please go ahead. Your line is open.

Ioannis Masvoulas

Hi, Heikki and Pia. Thanks very much for the presentation. A few questions left from my side. Starting with the first one. Looking at the EBITDA bridge pricing and mix was over €100 million positive in Q2. Can you give us a rough idea on the share of mix improvement within that and how we should expect this to develop in the second half?

Pia Aaltonen-Forsell

Thanks very much. The majority of that was still price improvement. So the mix was a positive boost there. Definitely, that's why we mentioned it. But really, the majority was on the price. And obviously, I'm not able to really give you the specific price guidance into the third quarter, but somehow just with this focus on the current market dynamics or looking at CRU price list, et cetera, I just still want you to remember that we will indeed invoice a lot during the third quarter where we have already priced this in at an earlier point. So, with that in mind, I'm sorry that there's not really more light than that that I can share, but certainly still with some upward trend in the pricing to some extent being what we will invoice in the third quarter.

Ioannis Masvoulas

Okay. Thank you very much. And the second question, on working capital. You've built around €670 million in H1. You talked about 100 million of that being a safety stock as you adjust the business. But thinking about the second half, should we expect that perhaps more than half of that H1 investment could be released?

Pia Aaltonen-Forsell

Thank you, Ioannis. I think it's a fair assessment. There's many elements here that are also dependent on, for example, nickel prices. So with elevated nickel prices also, the full price invoice, the accounts receivables, et cetera, have through that mechanism been higher. And we see that already now with nickel at around 20,000 that these levels will come down. So I don't think that there's no doubt about the direction. The direction is clearly that we will get the cash in here. Then what exactly is the magnitude? I think that will depend to some extent on the market dynamics and how low inventories can be taken.

I would just remind that the seasonality for us usually, always is significant working capital reduction in the third quarter with typically the lowest inventory points towards the end of the third quarter. And then as we go to the fourth quarter, a little bit of pickup before the end of the year. So with that said, certainly following all normal patterns, there will be a good rebound of that in the third quarter and into the fourth quarter.

Heikki Malinen

Now that you talk about working capital inventory, I could just take another topic here, if you don't mind. And that relates to the natural gas situation in Germany. And as you know, there's a lot of news flow about what will happen to natural gas flows this winter. We're waiting for more information from the German government on how they potentially would guide the industry in a situation if there is not sufficient supply.

Our plan is to supply our customers, take care of them in all circumstances, and for that reason, we are now going through all possible contingency plans so that we can take care of our customers. And that may potentially involve also creating some buffer stocks in some products. And of course, that would then be in the working capital figures then potentially in Q4 and so forth.

So we'll come back to that later. But I just wanted to mention that that is, in my view, relevant, topping at least the top management CO agenda at the moment.

Ioannis Masvoulas

Thanks, Heikki. And is that part of the €100 million in Q2 or is there more to come in Q3 on buffer stocks?

Pia Aaltonen-Forsell

The buffer stocks that I was talking about around Q2 were really more on securing supply and kind of the raw material flows in various ways, also readjusting some of the supply chains. So I think to a very large extent that has been completed. So I wouldn't really foresee further impact of that. And then I would say, based on building then on finished goods side any buffer stock that is then relevant towards the winter. So if that is the conclusion, and if that is necessary, then that would certainly impact again in the Q4.

Ioannis Masvoulas

Okay. Very clear. And just the last question from me, Pia. You mentioned the pickup in EU imports in July. Is that peak higher than what we saw in April?

Pia Aaltonen-Forsell

No, not as far as I know right now. We are still looking to some extent at indicative figures because the statistics are always coming only a little bit later, but it doesn't seem higher, but it still seems high.

Ioannis Masvoulas

Great. Thank you very much.

Heikki Malinen

Slightly lower.

Pia Aaltonen-Forsell

Slightly lower, but on a high level, for sure.

Ioannis Masvoulas

Okay. Very good colour. Thank you.

Operator

Thank you. Our next question comes from the line of Bastian Synagowitz of Deutsche Bank. Please go ahead. Your line is open.

Bastian Synagowitz

Thanks and good afternoon. My first question is on the performance of your European unit. And I've got to say I was quite amazed, particularly in the context where you basically say that the impact from raw material and hedges was close to zero while it was obviously very positive in the other units. Is it fair to assume that there still has been some positive effect from selling products which still benefited from the lower lagging sector costs in a rising price environment? Or was this really fully underlying? That is my first question.

Pia Aaltonen-Forsell

Hi Bastian. I can indeed confirm that the net of timing and hedging impact was really low in the quarter for BA Europe. So I would emphasise that net, because indeed there could have been some benefits as you just mentioned. But then when we sort of netted off with any hedging losses there might have been, the net of those certainly was zero. So that's one I can just confirm because it's part of the reporting that we do every quarter.

Bastian Synagowitz

And then if I bridge that into the third quarter, if we basically look at your gross margin and obviously you just told us that at least in Europe, it seems like your gross margin in the second quarter was basically fully reflective of current, I guess, reality, i.e., the cost you see in the market and the price you see in the market basically reflecting gross margins. We then think about the third quarter, you talk about still slightly higher cost, but you have just said that also your ASPs are actually still going to rise. So are you expecting that you can preserve these gross margins into the third quarter, even though your volumes will be coming down, obviously?

Pia Aaltonen-Forsell

Maybe there's a couple of elements to watch for, and one of them is that if we are now focusing really on the BA Europe, I would say that as part of the overall guidance that we had on net of timing and hedging being significantly negative in the quarter, I would indeed see some of that actually hitting BA Europe as well. So I don't think that will be neutral for the BA quarter on quarter. So that's kind of one element to take into account. And then certainly there are developments on the cost side that are putting some pressure on the margins. Energy could certainly be one of them that I think is worth mentioning here.

But there are also kind of a combination of topics here, including the price development, as you mentioned, that are also to some extent supporting the margins. So it's clear that we are now living the next era of orderly pressure on the cost side, the pricing momentum in the market having changed, et cetera. But looking at the third quarter, I don't want to be overly negative *per se*. I mean, this is still a quarter of adjustment if maybe that would be a word to explain it.

Bastian Synagowitz

Okay. Got you. Thanks, Pia. Then maybe staying on the cost topic. You talked about another increase of 20 to 30 million of cost headwind in ferrochrome. Is that a quarterly number or is that an annualised number?

Pia Aaltonen-Forsell

Yeah, that is a quarterly number, quarter on quarter, because based still on both what was the actual electricity price in the second quarter combined with a fairly high hedging level, I wouldn't really talk about any significant energy inflation at all *per se* in ferrochrome. But then when I look from the second quarter to the third quarter, I think with the hedging level that we had and the very elevated spot prices that we have seen recently; that in combination to me would mean from Q2 to Q3 between 20 and 30 million more costs.

Bastian Synagowitz

Okay. Perfect. And then the last one is on mix. And I guess like roughly a year ago, you basically started to talk about a significant improvement in mix, which obviously, however, at that point you said it would only become visible in the course of this year, pretty much around the current time, basically second quarter. So I'm wondering, is there any sense you could give us maybe for how much additional EBITDA you have been receiving from mix and pro grades in the second quarter, comparing this maybe with the second quarter of last year, is there any way you could frame this for us?

Pia Aaltonen-Forsell

Yeah, Bastian, maybe that's really when we take the annualised completion, I would almost maybe need to come back to that in some later comparison, simply because I think when we look quarter over quarter, the development has been very incremental. And now clearly from Q1 to Q2, we did see a positive boost. It was just overshadowed by the other positives from the pricing. That was my earlier comment. I think we need to come back in some later communication, if we could give an annualised view on that development. I would expect there definitely to be positive development, but it's still building for the future. I would not expect that to be in any way hundreds of millions. But certainly, it could be tens of millions. Absolutely. But need to come back to that one later.

Heikki Malinen

As we said in June, the prospects for the pro grades business, the prospects are good. And now with our new structure, with advanced materials, we're putting even more focus on the global sales and marketing of this product category, and I'm pretty confident that we will be able to gain results here. Underlying demand is good. There's a lot of activity happening. The energy transition, oil and gas is very strong at the moment, so I'm confident we will be able to get more business in the future.

Bastian Synagowitz

Okay. Understood. I guess that was my question, because I guess the trends for these pro grades are still very favourable. So I'm just trying to get a sense for how much earnings portion you're basically able to preserve in what is an otherwise falling price environment. I guess the price trend in those grades is probably materially different. So that was exactly my question. But yeah, if you could give more colour later on, that'd be great.

Operator

Our next question comes from the line of Carsten Riek at Credit Suisse. Please go ahead. Your line is open.

Carsten Riek

Thank you very much. Two questions left from my side. The first one is on the Americas business. Given that the US dollar has appreciated against the euro quite a bit, I'm just curious whether you had substantial FX gains or were they part of the hedging gains and raw material gains you booked in that business? That's the first one.

Pia Aaltonen-Forsell

Hi, Carsten. They were not part of the hedging gains. They are actually still in the second quarter. We had hedging losses in the net of timing and hedging, but those hedging losses refer to nickel. So that is not as such currency hedging. Obviously, our US business is in that sense local. We both have the top line and then we have the costs in the US dollar. So obviously then when we are having a result, of course, that gets translated at various exchange rates into the group figure, but it's not impacting the local margins in any meaningful way.

Carsten Riek

Yeah. So you had some translation, positive benefits out of the US dollar. Okay, cool.

Pia Aaltonen-Forsell

Yes.

Carsten Riek

Okay, cool. And I'll take it from there. Then on the outlook statement. We have seen your peers guiding significantly down on EBTIDA quarter on quarter – we're talking about 30 to 50%. If I do it on the back of an envelope and take your comments here that the inventory and hedging related gains could actually reverse, taking 10 to 20% of the volumes. Would you be in the same kind of ballpark as you have seen guidance with peers? Because it looks like reasonable.

Pia Aaltonen-Forsell

Yeah. I'm always a bit sensitive commenting their comments. But if I focus on the Outokumpu comments, I would say first, indeed, quarter two was exceptionally good. It was a record quarter. So I think this is a sector joint factor that it's clear that the third quarter will be lower. And even though it would be quite a lot lower, it's still a very positive figure that comes out. And I think that's what we have seen in the market recently. And indeed, this inventory related gains and losses with the hedges, that is quite a big sum, of course, already taking the result down.

Maybe I need to say one thing, that when we guide for continuing operations, I just also want to make that really clear that once now we have taken this decision to divest long products and we have signed, we will in the third quarter report, treat long products as a business available for sale. So it means that in the P&L it just goes into one line and it's not visible in the EBITDA. So into our figures, you need to build that first. And I know the accounting treatment is not so simplistic, but simplistically, as a CFO, I would still say look at the second quarter EBITDA. That's about the ballpark figure that you should first deduct before you even start counting something, just so that we get this right. Going forward, we will focus on what is the continuing business for us.

And I think the tricky thing here is on the ferrochrome business, obviously, I wanted to be fairly open that this electricity is a big cost increase quarter on quarter. And in the ferrochrome business, the negative, of course, also includes the lower benchmark price that we have also shared and that is out there in the market. So that's kind of clearly a step down. But then we still have some of the positive elements here as well, keeping, I would say, still an overall extremely reasonable level. I'm happy to talk about any of the details, but I just don't want to give a figure because that's not how we guide.

Carsten Riek

Okay, perfect. That helps already a lot. Thank you very much.

Operator

Thank you. Our next question comes from the line of Tristan Gresser of BNP Paribas Exane. Please go ahead. Your line is open.

Tristan Gresser

Yes, hi, thank you for taking my questions. The first one on energy costs; I think you've quantified it in the past. So could you please quantify energy costs in Q2? You flagged a bit the inflation, potential inflation to Q3, especially for ferrochrome, but any kind of quantitative guidance as well here. And I don't think you've done it in the past, but would you reconsider maybe implementing energy surcharge for the flat steel products business in Europe, given the rebound we've seen in energy costs?

And lastly, in your operations in Germany, are you able to replace natural gas with propane as well? Or if there is some gas rationing, it just would imply maybe lower finishing production.

Heikki Malinen

So Tristan, thank you for those questions. Maybe I address that. First of all, on pricing and pricing policy, we don't really comment on that forward looking at all. We make comments retroactively, but let's see. I cannot really comment at all on your question about the surcharge.

Now, with respect to Germany, as I said, natural gas is the primary source that we use in our annealing and pickling lines. Here in Finland we have been able to build that propane inventory option, but in Germany, it is very much dependent now on natural gas. So we are looking at all different options which could be available to us. In some cases, switching source from natural gas to something else would take some time, so there would be a lead time and therefore it is not most likely possible to get it in time for the winter of this year. There may be permitting things and stuff like that. So, therefore, as I said, we have chosen to look at how we can optimise our total production system, including Sweden and Finland. And if there were to be some disruption that impacts either Krefeld or Dillenburg, then we will have the potential buffer stock, and then of course we will look at using Tornio and Avesta more extensively.

But as I said, this is very much a process in motion. Every day brings new information. We are preparing for all kinds of scenarios and then we'll execute at the moment we have more clarity; we will then make appropriate decisions. The key thing here I want to say is we will do our utmost to make sure our customers get what they have requested.

Tristan Gresser

All right. That's helpful. My second question is on imports in Europe. Can you please share some thoughts you have on the new circumvention trade case against Indonesia, being trans-shipped via Turkey, and especially given Turkey's also increased share in the CRC market, do you think this trade case could also be applied to CRC volumes or do you think it's not a fair assumption?

Heikki Malinen

Well, first of all, we are pleased that the European Union is active and that they are looking into this case. We have seen how systematic and active the US government has been on these topics. So of course, I'm very happy that the EU is acting in a similar manner. I can't really comment on the specifics of the Turkish case. I think there are experts who are more into the details on that. But I think my only message here is we believe it's relevant. We believe there is substance, and we look forward to seeing the results. I think that's all I can say about it at the moment.

Beyond that, I think in terms of imports in general, as I said, a lot has come in. I think some distributors in Europe made a choice that when the price gap widened, they decided to go and buy a lot from Asia. However, you have to look at the distributor sector in Europe and there are different distributors. There are distributors who still, even though they had a chance to bring from Asia, they very much stick to European suppliers. And then there are distributors who I would call are more like traders. They are very opportunistic to always go and buy, let's say, get the best deal.

And so if we look at our customer mix on the distribution side, we have customers who are, I would call, more traders and we will see less volume from them. But we also have a very substantial amount of distributors who are very stable and who do not come in and out of the Asia market. So therefore, I just want to highlight these two types of distributor customers that are out there in Europe.

Tristan Gresser

All right. Thanks a lot.

Operator

Our next question comes from the line of Rochus Brauneiser of Kepler Cheuvreux. Please go ahead. Your line is open.

Rochus Brauneiser

Yes. Hi. Thanks for taking the question. Let me push again a bit on the outlook. I think you made clear that there will be a reversal of the windfall gains of Q2 to Q3. I guess at least one of your competitors has said that the magnitude of the losses could be equal or similar to the gains in the second quarter. Would that be the kind of magnitude we shall keep in mind? Or, from your hedging positions, you would say that it could be materially better in your case?

Pia Aaltonen-Forsell

I could, of course, try to elaborate on this even deeper and explaining the kind of various elements. But, as I've said before, my clearest guidance on this can be when we guide it from Q1 to Q2 that it would be significantly positive. You have seen the outcome and now we are guiding for the vice versa. And I think it's fair to assume that the order of magnitude will be the same but negative this time. It was positive in the second quarter. So as such, I hope that this brings some clarity to why we are saying that this could actually be significantly negative. It is exactly because of that dynamic. The timing losses are quite significant in the third quarter, whereas the hedging is then a little bit buffering that for us.

Rochus Brauneiser

Okay. Great, Pia. Then secondly, on the follow up on this volume questions before. I think what we have seen is that US shipments were a bit more down than Europe in the quarter – quarter on quarter. You mentioned destocking dynamics. So how should we think where the better or weaker end is in the third quarter? Would you again think that the US business is more aggressive in the destocking process than Europe beyond the effect from seasonality?

Pia Aaltonen-Forsell

No, I would have started by saying that seasonally, clearly, Europe is weak, and Americas is not. Q3 is nothing special in America, but in Europe, of course, we know that this is summer season and maintenance season, et cetera. And I still perceive some of what Heikki also said before, talking about the US market, maybe more normalising from this sort of COVID rebound to kind of a more normal robust underlying demand type of market. Whereas again, in Europe, we have these distributors, some of them having bought imports sitting with quite high inventories. So kind of without going into further details, I do think those comments are describing pretty well, and we did indeed see already during the second quarter as well some downtick also in the European business for sure.

Rochus Brauneiser

Right. Then on America's margins. Based on my calculation and if I take out the inventory gain effect, which was substantial in the Americas, the EBITDA per tonne went down even though, as you described, market conditions were still very favourable. Was there anything in particular, mix effects, or other drivers which led to the decrease in America's profitability?

Pia Aaltonen-Forsell

No, I think mix effects were actually a little bit positive, but of course, we don't have really the same dynamic with mix in America. I mean, predominantly it's standard products and it's kind of the mix within that. In Europe, we then have the more advanced materials business and the standard business. So that was a little bit positive. I would say the inflationary pressure for sure has been visible in the US already over an extended period of time. So we get some of the push there on the consumables, on the freight, et cetera, quarter on quarter on quarter. Energy has not been the same broad topic as in Europe.

And then just overall, we already saw actually in 2021 fairly quickly the way the contracts work in the Americas market make on the way up when we saw prices increasing that really fairly quickly came through in our invoicing. So we were earlier on, on that more rising price curve. So maybe this is a more stable or mature state and then combined with some pressure from inflation.

Rochus Brauneiser

Okay. That makes absolute sense. And then finally on energy costs, I guess you talked about the dimension of cost increase on ferrochrome. Is it possible to get a number of what you see for the whole group in terms of the energy compartment for your profitability?

Pia Aaltonen-Forsell

The reason I mentioned it for ferrochrome was that it was so potentially significant and of course really impacting that business. The reason I'm not mentioning it for the others is that it's smaller, but fair enough, I would say, for the European operations obviously, there is an uptick. So this is not really an Americas question *per se*. So that's the reason why we didn't give a number. It is clearly lower than that what is impacted in ferrochrome, but there is indeed an increase.

Does it then mean that it's 10 million? Is it 15 million? I think we will then see when we get the final situation for the quarter.

Rochus Brauneiser

All right. That's very helpful. Thank you very much.

Operator

Our next question comes from the line of Moses Ola at JP Morgan. Please go ahead. Your line is open.

Moses Ola

Hi, Pia, Heikki. Thanks for taking my question. Another great set of results this quarter. So I just wanted to ask on the strategy to normalise EBITDA run rate target. Obviously in this quarter here, you've got the tailwinds of good pricing, especially in Europe where you've got a greater than €700 per tonne steel margins. But if I look at that mid-term target, should we essentially expect a collapse in margins just to meet that normalised target? Or is there room possibly to upgrade these targets within phase two? That would be my first question.

Pia Aaltonen-Forsell

Yes. Moses, thanks very much. Thanks first for the kind words, and I certainly want to say that our target is really further improvement. So we want to further improve our profit by 200 million by our own actions. But of course, as we have seen, this is an industry where market conditions keep changing. And the reason for giving that sort of normalised range, which obviously is now, compared with the second quarter result, it's looking low. And one may then talk about is there a collapse here or there? Well, how did we do this? We wanted to stimulate the situation where prices came back to a more normal historical level.

So with that said, obviously, if the prices are decreasing from that peak, we will see a compression of margins and that's then what we can see in the normalised. So that was really the method of doing that. But I certainly want to say that's not our target, but I think it's there to bring the view of where we see the more normalised long-term capability of the business. And then we strive to further improve that.

Moses Ola

Thank you. And then also on the balance sheet; it's quite strong, net cash end of this year. Should we still expect you to maintain a net cash position mid-term? Or how should we evaluate your capital allocation priorities, especially on shareholder distributions?

Pia Aaltonen-Forsell

Indeed. We stay very committed to the dividend distribution policy that we have said here, stable and increasing. Absolutely. But then what could happen over and beyond that? I think now with the great uncertainty that we feel, the pressure of the war in Ukraine, at least here in Europe, I think the time for further consideration of that comes once we are out of this period of uncertainty. So now we will stick with this stable and increasing dividend next year, about 200 million of CapEx, and then keeping up this discipline. And then we are happy to come with more information once this period of uncertainty is behind us.

Heikki Malinen

I think this uncertainty is— There's a lot of things which are completely out of our control and also many things which are not typical cycle. We have a war in Ukraine and massive inflation. So I personally feel that we need a couple of quarters here to get some more visibility on how are these things in Europe going to play out. And before, if we were to make any bigger decisions here. We need to wait a bit here, see what the coming months bring.

Moses Ola

Okay. Thank you. And then finally, just from me, do you have any exposure to the low Rhine levels in Germany? Are there any impacts from low water levels to shipments of raw material supply to your operations in Germany?

Heikki Malinen

It is true that the level the water level on the river Rhine is very low and it is impacting raw material and cargo shipments in Germany. I'm not aware that it would have impacted us, but there is of course correspondingly greater demand now for trucks. And then of course, truck availability has been very tight. A lot of the truck drivers came from Ukraine. They've gone back. So trucking business is even tighter now in Germany. But I have not been informed that we would have had any delivery disturbances because of this low water levels.

Moses Ola

Thank you.

Operator

And we have one further question in the queue from the line of Anssi Raussi of SEB. Please go ahead. Your line is open.

Anssi Raussi

Thank you. One more from me. About North America, as we saw today that CRU estimate, that the base price was actually stable in the US during July and will also remain at the same level in August. So how much of cost inflation we should model in for Q3 compared to Q2, thinking about North America's EBITDA in Q3. Of course, we have this negative timing and hedging net impact, but if we think about the underlying EBIDTA. Thanks.

Pia Aaltonen-Forsell

Yes, thank you, Anssi. And on that backdrop, of course, the negative timing and hedging is there. Overall one of the important components. And then I would just say that there is no individual item *per se* that we would have guided on, but we have seen fluctuations or increases in freight costs and in consumables in the previous quarters. And that is not yet fading off. So clearly, looking at some of the historicals, telling the story of the dynamics that we have seen to date. But then, of course, on the other hand, if you just look at some of the commodities, the nickel, et cetera, clearly here on our raw material cost, we have already seen the decreases during the month of June, for example.

So in that sense, I would say I don't want to sort of exaggerate the topic of inflation here, not in the same way as I did for, for example, ferrochrome really explaining kind of individual line items. But certainly, there is pressure still from inflation.

Anssi Raussi

Okay. Thank you.

Pia Aaltonen-Forsell

Thank you. Anssi.

Operator

As there are no further questions at this time, I will hand the floor back to our speakers.

Linda Häkkilä

Thank you, operator. I have one question left which I received via email. So this would be towards you, Pia. And this is regarding the convertible bond due 2025. How are you planning to acquire the shares of the convertible bond?

Pia Aaltonen-Forsell

Thank you, Linda. Well, interesting to answer this detailed funding question. And I have to say, obviously, here the maturity is 25. So at this point, we really haven't made decisions about that yet. So I can only more speak about it, what's possible. Obviously, we could issue new shares. We could also be buying shares. These options are still available. We will take the decision then clearly only much closer to the real maturity of the instrument. And the convertible bond, of course, works the way that we have to go over a certain strike price also to repay it as shares. So this is certainly something we will come back to in a later phase.

Linda Häkkilä

Thank you, Pia. So this was our event today. Thank you for all your questions. Thank you, Heikki and Pia. Before we close the event, I would like to remind you that we will be publishing our Q3 results on November 3rd. But now, thank you once again and have a great summer.