Good day ladies and gentlemen, and welcome to the Outokumpu Q1 2018 Results Call. This conference is being recorded. At this time, I would like to turn the conference over to Tommi Jarvenpaa. Please go ahead, sir.

Tommi Järvenpää
Thank you. Good afternoon and welcome to Outokumpu’s Q1 2018 Earnings Call. My name is Tommi Jarvenpaa. I am the head of Outokumpu’s Investor Relations. With me here today are also our CEO, Roeland Baan, and our CFO, Chris de la Camp.

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

With these remarks, I am pleased to hand over to our CEO, Roeland, please go ahead.

Roeland I. J. Baan - Outokumpu Oyj - President & CEO
Tommi, thanks. Welcome to the call. As always, I would like to start with the vision. As you know, our vision is to be the best value creator in stainless steel by 2020 through customer orientation and efficiency.

And I just want to bring back to memory, when it comes to the stakeholder shareholders here, the targets that we set for 2020 are EUR 750 million of EBITDA, a 35% gearing max, and return on capital employed of more than 12%. I just want to say we are now almost at the midpoint of this journey to 2020. And as you can see from the numbers, we are well on our way to fulfilling that vision.
So, turning to the first quarter, we saw in the first quarter of 2018 the continuation of the improvements we have made since the third quarter of 2017, with sequential improvements every single quarter since. If you now look at how this was made up, then versus the fourth quarter you can see that we had significantly higher deliveries. And of course we did have the repetition of the higher maintenance that we had in Q4.

We had a special item in a gain from emission rights that we own, and the price of steel too had gone up. And then we had slight negatives on pricing, on timing and hedging, on ferrochrome because of the lower pricing from $1.39 down to $1.18, and input costs, as we had flagged already, the cost of the electrodes and for ferrosilicon, which brings us to the solid EUR 133 million quarter.

If you look at the environment in which we were trading, pretty volatile driven by many things; rumors around sanctions against certain Russians, et cetera, et cetera. Of course, the 232 announcement in the U.S. has influence as well, significantly. And overall if you look at it, we saw a deterioration of base prices in Europe. We saw an increase in base prices in the U.S., the very strong up in the nickel price but, as I said before, ferrochrome price significantly weaker. And all these have their own effects, as you are well aware.

So with this sort of general description, I would like to hand over to Chris to talk about more specifics.

Christoph de la Camp - Outokumpu Oyj - CFO

Thank you, Roeland. Good morning, good afternoon, ladies and gentlemen. Let’s turn to slide number 7 and our group key financials. Hitting some of the highlights, I think it’s good to see that our stainless steel deliveries were back up to normal, more normal levels after a very weak fourth quarter and very much in line with our deliveries in the same period last year.

Sales were driven -- the improvement in sales versus last quarter was driven overall with higher prices on the raw material side, so coming through the alloy surcharges but also from those higher deliveries. EBITDA was clearly up against the fourth quarter, albeit down against a very, very strong quarter last year in the first quarter, where of course we had the normal impact of the extremely high program prices, as you recall.

The net result was positive, though also driven by lower interest costs and the relatively low tax base. We generated a positive earnings per share and a positive operating cash flow in a quarter which is seasonally usually quite weak from a cash flow point of view, as working capital requirements increase.

And that, after investing activities, actually meant that there was a small reduction in our net debt, so that remained below EUR 1.1 billion. And we spent CapEx in line with our overall CapEx spend plan this year, which sits at around EUR 220 million. It’s a little behind that, but spent what was required on our various initiatives.

Let’s break down the results, the financial results into the individual business areas, and we now have 4 of them for the first time that we report on. Taking Europe, our biggest business area first, overall it delivered a very robust threshold performance in the first quarter.

You can see that, in line with the group results, we had a significant recovery from the very weak third and fourth quarters of last year, with EUR 83 million results, the group result being contributed by Europe. This was driven most significantly by higher deliveries. And you recall that in the fourth quarter we struggled with getting good deliveries because of the electrode surcharges, and that cost us some market share. And we are pleased to see that we have recovered that now, market share.

We spent significantly less on maintenance which we pushed into the fourth quarter last year. And of course that did not recur, so that was the second major contributor. And then we had minor deviations on the downside from pricing, which just tells us a little bit during the first quarter, and a very small impact from net of timing and hedging, and slightly higher input costs of course, as we’re seeing the full impact of the electrode surcharges come through, and also some other input costs such as ferrosilicon and also refractories. But overall a very positive development in Europe.
If we then move on to slide number 9 to the Americas, a very different picture. It was a disappointing quarter. And it was predominantly so because, although deliveries were up very significantly versus the fourth quarter last year, we struggled most particularly with moving our pricing up. I’ll come back to that in a moment.

You’ll remember that in the fourth quarter we had a significant positive net of timing and hedging impact which did not repeat in the first quarter. But if we look at the pricing, of course while overall base prices, reported base prices in the U.S., seem to have moved up, we struggled. And this was due to the fact that we sold a lot of our production capacity for the first quarter back in November and December. And then as prices moved up through the quarter, we had those fixed prices and contracts in place, so we did not move in line with the market there.

In terms of input costs, the same as in Europe. We saw higher electrode costs, also some higher input costs on ferrosilicon. And the final negative here was a restructuring charge that we took in Mexinox, which is an attempt to further improve our cost structure in the Americas by taking out headcount and reducing overall costs. But that of course comes with redundancy payments, and that’s what’s reflected here. It will end up being a positive for the result going forward as we continue to improve our cost base and efficiency in the Americas. But if you put it all together, it was a very disappointing result at minus EUR 6 million.

Long products was reasonably flat quarter-on-quarter, some ups and downs. Deliveries were up a little bit. Pricing was also up a little bit. We didn’t have quite the timing impacts that we saw in the fourth quarter, so that was a small deviation on the downside. And then again, same story here. Our long products business of course also has a melt shop in Sheffield. We saw high electrode charges there as well. But overall, pretty flat quarter-on-quarter.

Then moving to our new business area, ferrochrome, which at the moment is also our second biggest business area in terms of contribution to the group result, I think no surprise here that the result came in a little lower than the fourth quarter. It’s noteworthy that deliveries were extremely strong during the quarter, so we had very, very high deliveries out of that business area. All the smelters were working extremely well.

But obviously we saw a significant decline in the ferrochrome contract price, which fell from $1.39 in the fourth quarter to $1.18 in the first quarter, so that had a significant negative impact. It’s also worth pointing out here that ferrochrome is sold exclusively in U.S. dollars. And if you have been watching the development of the U.S. dollar, of course you see that in the first quarter it was significantly lower against the euro than in the fourth quarter.

So while our cost base in the ferrochrome business is based in euros, our revenue is based in U.S. dollars. And the declining U.S. dollar is bad for this business. And that’s also reflected in this ferrochrome price if you convert it into euros per tonne rather than into dollars per pound.

And then slightly higher input cost, which came in mainly from coke, so it resulted in a solid result of EUR 42 million but a little weaker, of course, than the fourth quarter.

If we then move on to our cash flow, here’s the bridge. If we add the adjustment items that we took out of our normal operating adjusted EBITDA, we come to a clean EBITDA of EUR 140 million. We saw a significant increase in working capital through the first quarter. This is seasonally normal, as after a usually weaker fourth quarter you see an increase in business, increases in sales volumes. You saw that on the previous slides already.

Although we saw ferrochrome move down, we saw nickel move up through the quarter, and significantly towards the end of the quarter. And we also had a release of provisions, some pension payments. This includes our interest costs for the quarter that are now down versus last year. It includes minor minimum tax payments and release of some provisions. That’s negative.

And then that left us with a positive operating cash flow of EUR 39 million. We used a lot of that to invest in various projects. Not just ongoing maintenance and improvement projects, but most particularly also in some of our key projects, with the Kemi Mine project now up and running, in terms of investment, at full speed. So that’s really now being worked on very hard and it’s on track, but also our ERP project, which is also consuming a significant proportion of our global CapEx spend during 2018. Overall, it left a small positive cash flow that reduced our net debt at EUR 6 million.
If we then look at the next slide, slide number 13, you can see our balance sheet metrics here. The net debt stayed broadly stable. The gearing moved up very slightly. The reason for this is that we already took the deduction of the dividend that we paid in early April against the equity, so that meant the equity base declined by about EUR 100 million. Of course, the net debt did not change but that was a small change in the gearing ratio.

And then on the right-hand side, you see the development of our leverage. And clearly with now the very, very high result of the first quarter of 2017 dropping off the LTM, back at the LTM period we replaced it with a weaker first quarter of this year so that our LTM EBITDA is now down against improved net debt last year at the same time, but similar debt as 2017. So overall, that moved the leverage up. We continue to be very confident that we will achieve a net debt of below -- a net debt leverage of 1 or less by 2020.

And with that, I'll hand it back to Roeland to comment on our outlook for the second quarter. Thank you.

Roeland I. J. Baan - Outokumpu Oyj - President & CEO
Thank you, Chris. So the outlook for the second quarter is a mixed bag of various things pulling in different directions. First of all, the market stays healthy. We see healthy demand. Because of the import tariffs in the U.S., we see still trending up pricing in the U.S. But conversely, due to the deflection of volumes out of the U.S. to other markets, we see price pressure in Europe.

We have the higher ferrochrome price which is offset by the planned maintenance in ferrochrome furnace 2, one of the smaller furnaces. And it's the maintenance that was planned already a year ago, so that is just part of normal business. And on the stainless steel deliveries themselves, we expect them to be relatively flat Q-on-Q, leading to a guidance for the second quarter to be at a similar level to the first quarter.

Tommi Järvenpää
Thank you, Roeland. And operator, we are now ready for the questions.

Questions and Answers

Operator

[Operator instructions.] We will take our first question from Michael Shillaker of Credit Suisse.

Michael Shillaker - Crédit Suisse AG, Research Division - MD and Head of Global Steel & European Miners
So my first question, could you just guide us as to the loss of EBITDA contribution from the ferrochrome maintenance in the second quarter? I guess it's something like EUR 20 million to EUR 30 million. But if you could confirm that, that would be helpful. And second question just re the planned nature of the outage, it's relatively unusual for outages to be planned for second quarter. They normally end up being taken in the third or fourth quarter, which are seasonally weaker. So is this just a standard maintenance outage that was planned a long time ago, or are there still operational issues in ferrochrome that we should be both aware of and potentially concerned about? And then just to help us on this also going forward, do you have any other planned outages through the year, or are there any other known one-off costs or disruptions that we should be adding into our models for Q3 and Q4 for 2018? And then just last question on base price trends, obviously the base price is higher in the U.S. I guess it's up about a $100 since the start of the first quarter. It looks like the European base price is lower by about EUR 40. Net-net, given you're doing twice the volume in U.S. and Europe, as of now that should more or less be netting off. But can you tell us about those trends into the second quarter and give us a little more help on the exit rate out of the second quarter? Are base prices in Europe still falling? Are base prices in the U.S. likely to rise further? And is your exit rate out of the second quarter likely to be better of worse than the entry rate as a consequence?
All right, good questions. So the lost EBITDA to the ferrochrome maintenance is about EUR 10 million. And that is about EUR 3 million of capital cost, EUR 2 million of variable cost, and then the rest is lost revenue on the 4 weeks that this furnace is off. The planned nature, there are moments that you actually have to maintain. We decided last year that we could probably stretch it to the beginning of 2018, but then we needed to do it. It’s nothing major. It’s just the normal relining of the main vessel, which happens every 4 or 5 years. But there comes a point -- you run these furnaces with thermocouple sort of sensors to see whether they have hot points. And you want to avoid that the metal burns through the refractory because then you burn actually through the shell. And what that happens you have a real problem. So at some stage you have to take the decision. And whether it is Q1 or Q4 or Q3, you don’t have that in really in your own hand. So other planned outages, not really. We have of course our normal maintenance program in two gos, one in let’s say July-August when we do part. And then again in December of 2018 we will have the maintenance stops during the Christmas break. So we try to indeed do the normal general maintenance as much as possible during the holiday periods. Base price trends, U.S. up, Europe down. What you will see is that, on the one hand, as the pricing in the U.S. goes up you will not see that 1-on-1 translated into the results because of the contract pattern. We have discussed it before. And conversely, you see the same in Europe where the hit on our realized prices will not be as large as the headline numbers would suggest. However, what we have seen, and this is why we actually think that the European business will more than offset the U.S., is that there has been an acceleration towards the end of Q2. And that unfortunately makes sense as well. It takes time for trade streams to redirect and it takes time for material to reach markets. And clearly, we see that building up and coming to a head towards the end of the second quarter. So the exit rate, as you call it, in Europe is for Q3 significantly lower than what the average for Q2 would be, and for Q3 in the U.S. will be significantly higher than what the average would be for Q2. Now this is all on the assumption that all things will remain equal. Of course, I’ve just come out of a lunch with Commissioner Malmstrom of EU Trade, where we have been extensively discussing the 232 effects on Europe and the way forward. And she has been very clear in confirming that the EU is not only prepared to take save-back measures, but will actually take those measures after having gone through the investigation period, which is currently going on and which is ending by the end of May, so that we have the rationalization -- sorry, the rationale ready under -- according to our rules to announce safeguards by June. Now what we have done in our forecast is we are not speculating on what might be. We are giving you what we see currently, and that is what the forecast is built on.
also weighed on price realizations, or was it purely an issue of timing? And when we think about the profitability for the U.S., given that you're operating what seems to be north of 100% nameplate utilization rate with strong pricing, can you help us understand if there's any reason why we shouldn't expect your margins to meaningfully expand in the next 1 or 2 quarters?

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

Do you want me to say yes to the second question? Or let's start with the first. So we clearly have the converse process happening in the U.S. from what we have in Europe. So if you go back, when we contracted our business for the first 3 months, and in some cases we're at 6 months, that happens during October, November — in specifically November and December. And if you look at pricing at the end of the year last year, that was significantly lower than, for instance, in Q3 last year. There was a clear — in the U.S. a clear trend downwards, predominantly because of ATI and Xingcheng starting to market their products. So there was pressure on pricing and we decided to — in that market to go ahead and book our first quarter because 232 was at that stage still talked about and not a reality. And we were not going to wait and lose maybe both volume and price. So we booked at pricing as it was there at the end of 2017. As you know, for the 1st of January then NAS announced the 2 discount point reduction, which is a $70 to $80 improvement. So we missed that because we were booked full until at least the middle of March. So that explains why our realized pricing for the benchmark of 304 cold rolled is lower than what CRU reports. As to the mix, actually our cold rolled mix domestically was higher than it was before, so the mix improved as well slightly. A big part of the volume, however, was slab sales in the export market because that was an opportunity we had. So in the domestic market, we actually did better but at a pricing that was clearly lower than what we wanted. To your second part of the question, expecting better pricing forward, yes, absolutely. And that is what is driving the improvement that we see for Americas in the next few quarters.

Operator

We will take our next question from Carsten Riek of UBS.

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

Most of my questions have been answered but maybe just 2. The first one is on your free cash flow generation, which was comparably strong. But what I noticed is that the payables increase was quite significant, more than twice compared to the receivables. Is that likely to be reversed in the second quarter, and what does that mean for your net debt expectation in the second quarter? The other question I have is you mentioned on ferrochrome that you got hit by the U.S. dollar depreciation. Where there any thoughts on hedging the U.S. dollar given that you know roughly how much production volume in ferrochrome you will have over a year?

Christoph de la Camp - Outokumpu Oyj - CFO

Yes, let me take the second question first. Of course, we think about this. The problem is, if you look at the size of ferrochrome business and the revenue stream for that and you try to hedge it a year in advance, you end up with very, very large hedging positions, and that would extremely expensive to hedge. So it’s really too big for us to hedge a year in advance on that. So it’s not feasible to do all of that, to be honest, given the size of our company. In terms of the first question, yes, supply payables went up. The main reason for this is that generally there’s been this pickup in the first quarter relative to the fourth quarter last year. A lot of the increased level here also across the receivables is driven by higher nickel prices. I mean, nickel prices moved up significantly in the first quarter. And particularly there was a spike over the last two weeks because of the concerns around certain Russian owners, of Norilsk nickel, that you saw a very big spike in nickel prices towards the end of the quarter. And of course, when we buy material, we book it as a payable straight away, so some of that will also reflect the very high nickel price that we saw at the end of the quarter. Now over the course of the second quarter, we’ll have to see what raw material price do. But you normally expect that to work its way through into ultimately receivables and then into cash. So I don’t think we’ll remain at these levels of payables unless nickel stays at the sort of levels that we saw in the last week or 2. Does it have an impact on net debt over the course of the quarter? Well, one big hit to the net debt will of course be the fact that we paid over EUR 100 million of dividends at the beginning of this month. So that’ll have a negative impact. And then the
working capital does start to normalize and then reduce as you go through the year. So we'll have to see, but we would expect that our operating cash flow will be positive excluding some of these one-off effects, especially the dividend.

Operator
We will take our next question from Menno Sanderse of Morgan Stanley.

Menno Gerard Cornelis Sanderse - Morgan Stanley, Research Division - MD
Two more general questions. The first one is on the slight contrast between maybe your objectives on 2020 and then the statements made. The company talks all about solid, healthy, robust results, which all sounds almost as if this is a good as it gets except for maybe market pricing. On the other hand, you have your 2020 objectives, and you made clear you’re only halfway. How do I cross those two bridges, first of all? And then secondly is really on leverage. Is 1.9 times first quarter annualized and more than 2 times last 12 months the right number, given where we are in the cycle and the fantastic trading conditions that we have in general?

Roeland I. J. Baan - Outokumpu Oyj - President & CEO
Okay. So I don’t see a contrast between our vision and where we are today. If you go back to 2015, we were at an EBITDA of about EUR 100 million. We are now whatever you want to put on us at the projection for this year in a challenging pricing environment, and you’ll see that we are actually more than halfway compared to timeline versus the target. We look very clearly at what happens operationally. We follow exactly what is happening in our mills. We measure productivity. We measure all the things that drive your financial performance in the end, things like yield, right the first time, O/E, etc., etc. We have probably, per mill, 70 to 90 different projects running always for savings that we monitor very, very specifically. We look at our delivery performance to measure stability, et cetera, et cetera. So I can only say that we have made progress continuously, which we can see back in our cash conversion cost per tonne, both in fixed as well as in variable. You can see it back in the SG&A progress we made. So absolutely solidly on track, no doubt about it. I don’t fully understand your question on the leverage. So what we have said is we want to get to a leverage of about 1. And that means that, from where we are now, just below EUR 1.1 billion, I want to get to approximately EUR 750 million to EUR 800 million of net debt, which we will have an -- which we will get over the next couple of years.

Menno Gerard Cornelis Sanderse - Morgan Stanley, Research Division - MD
My point is more do you think that is not too long a period, given where markets may or may not go, that you are too exposed in that scenario.

Roeland I. J. Baan - Outokumpu Oyj - President & CEO
Too exposed to?

Menno Gerard Cornelis Sanderse - Morgan Stanley, Research Division - MD
Most companies in your -- sorry.

Roeland I. J. Baan - Outokumpu Oyj - President & CEO
Sorry. Continue, please.
Menno Gerard Cornelis Sanderse - Morgan Stanley, Research Division - MD

Yes. My point is that most companies in the industry are significantly lower than the 1.9 to 2 times net debt to EBITDA. So don't you think you are taking too much of a risk with respect to where markets are in the next two years?

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

Look, Menno, the only thing I can see is we come from a very poor position of EUR 3.5 billion of debt as short as 3 years ago. And we have done a tremendous job in hammering that down to now just over EUR 1 billion. We do what we can, but at the same time we have to balance this well with the needs of the business to be able to keep on growing. We cannot jeopardize our future growth just with an obsession with the debt down. Generally speaking, even at 2 times EBITDA/debt, in a cyclical industry you are sitting pretty nicely. If you compare it to the current steel sector, for instance, we are in a position where even some of the investors ask us whether we are not going too far and get inefficient balance sheet. I don't believe that. I want to get down to this absolute of EUR 750 million. But I don't believe that we are at any risk at this moment given the liquidity that we have.

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

Okay, that's fair. And then finally on the U.S., one quick follow-up. The company mentioned trying to improve the client mix now that pouring quality is getting a big better. What's the magnitude of improvement in pricing that the company can achieve if you get to where you want to be in terms of product mix, in terms of dollars per tonne or any other metric you can point to?

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

You now get to the area where both the competition is listening with us and my IR head shakes his head. So the only thing I can say is that we see for Q2 a significant increase in our pricing, which you will find back as well in a significant improvement in the results in the Americas.

Operator

We will take our next question from Rochus Brauneiser of Kepler.

Rochus Brauneiser - Kepler Capital Markets, Research Division - Head of Industrial Metals

Let me come back to the issues around performance in the U.S. Maybe as a starting point, when you are liberated on the contract business, can you give us a sense where the contract share stood at the beginning of the year? And secondly, I guess in the previous quarters there was always a bit of a debate about the quality issues you had to deal with coming from your cold rolling partner. Is that now entirely resolved, and have you done any work to make progress to get any alternatives in terms of cold rolling there? And the other question is, okay, U.S. based prices are up. But knowing that the tariff impact of 25% is kind of $500 and more on current pricing, what's keeping the -- what's leading to this lag in prices moving up in the U.S.? Is it the price differential between the U.S. and Asia? Is there anything else? Is it ATI? What do you think is the reason why things are a bit slowly progressing there?

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

All right. So on contract business, we have always said we can't disclose how much we do on contract. I can tell you that the majority, so clearly over 50%, is on contract. And as we are getting deeper and deeper into the domestic cold rolled market, the percentage of contract business will increase. Now within that, you have a second layer, which is you have contracts per quarter, for 6 months, and for full year. I would say that within our contract business probably the bulk of that contract business, again above 50%, will probably be more on the 6 month, and the rest is a bit of a mixed bag. And then of course you have -- within those contracts as well, you have the leverage of working with the volumes where you can --
in the min and max environment, you can move the volumes to coincide with where you want them to be, given the prices. So there's a lot of possible levers and buttons you can push to optimize that mix. If you look at the quality issue that we had with AM/NS, and I said at the last call as well, we have been working extremely closely with AM/NS. They are great partners. They're very responsive. And currently we actually not only have these issues behind us, we have seen clear improvements in the quality, leading into improved operational parameters within our own operations. And on the U.S. basis, why are they up $500, don't forget at this moment there is a whole host of temporary exemptions. For instance, Europe is exempt. Korea has gotten their exemption based on a trade deal. So it's not a free-for-all. Yes, there is clearly opportunity for driving it up, but you're not in an environment yet whereby you can do what you like. Canada and Mexico are still exempt. Mexico is still an import market where there are no barriers. So there are still – you have to be intelligent on how you move in that market. You can't just do what you like. And you have cautions as well, by the way.

Rochus Brauneiser - Kepler Capital Markets, Research Division - Head of Industrial Metals

Okay. I also asked about alternatives for cold rolling, if there's anything you're pursuing at this moment, or is this now off the table? And maybe also on graphite electrodes, I think you had been saying last time that you had problems with your market share and now you have recovered that. But are you still pursuing this graphite electrode surcharge, or is this now removed from your pricing mechanism?

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

So qualifying our mills, we said last time we have qualified another mill just in case. So we have an alternative. If something goes wrong, then we have a qualified third party source that we can use. We are not actively doing that because it is much better to have the relationship that we have with our neighbor, and we do not want to, in that sense, do something that would be bad for that relationship. However, if there is a nonperformance on that side, then the agreement between AM/NS and ourselves, it's clear as well that we can go out and get what we need from our side from this source in that event. Graphite electrodes, the pricing of graphite electrodes is still on the high, running at the spot market around $20,000 a ton. We are covered, not at that price, thank God, but we have introduced the surcharge and actually reintroduced that even stronger in the U.S. as from the 1st of April. Sorry, we announced in April. That's for the 1st of May. No, 1st of April, actually. As from the 1st of April, we are charging $80.00 a ton electrode surcharge to our customers.

Operator

We will take our next question from Luc Pez of Exane BNP Paribas.

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

A couple of follow-ups if I may. So, starting maybe with what you finished with, the graphite electrode issues, are you going to experience extra cost Q2 versus Q1? So that's my first question. Secondly, with regards to working capital requirement, which you managed very well over Q1, what are your expectations, best guess, I suppose, given the current volatility of course for Q2? Should we expect some further buildup here? And one last question maybe once again on the U.S., I do appreciate that each quarter you come up with good explanations for this weak performance. I must admit I am always puzzled by the continued growth in shipments. In utilization rates you are now almost at 100% and the profitability, which is not picking up. So could you help us maybe better understand a kind of normalized profitability or pass to a normalized profitability that you would have in mind over the, let's say, next quarters, years even? Thank you.

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

So I'll start with the electrodes. Yes, we see a quarter-on-quarter increase in costs on electrodes. Again, we're covered through long-term contracts, but contracts over time lapse or are being renegotiated. So there is an increase, not very significant, but there is an increase Q-on-Q. Chris?
Christoph de la Camp - Outokumpu Oyj - CFO

Yes, working capital, obviously we try to stay on top of this as best we can. It’s always a bit of a difficult one because there are things that you can influence, such as your inventory levels, to some extent the payment terms that you negotiate from your suppliers and negotiate with your customers, and those things that we have under our control, to a large extent. But the one thing we do not have under control is the movement of raw materials. So, if we see a significant surge or a significant decline of say, for example, nickel and ferrochrome -- ferrochrome is now fixed for Q2, so we know that. But if we see a significant variation in nickel through the quarter, it could well lead to a further increase in working capital. So I think fundamentally the key drivers that we can impact we will continue to improve. We have significant improvement potential still on the inventory side in terms of the inventory volumes that we have. But I'd be a very brave man if I told you exactly now what nickel was for the rest of the quarter and then draw conclusions on working capital on that. So as far as we can, we will continue to manage this tightly, continuing to improve. But it is -- substantial parts of it are out of our control as well.

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

And then normalizing America, as long as Trump is there, that’s impossible. But if you look at what we had in Q4, where we had about a zero line, we are now just under. So I still see it as breakeven. But the big impact was a difference of EUR 10 million on timing and hedging. So if you think about normalizing, that’s the first step. We had the restructuring costs of EUR 2 million, so that’s the second step. So that is let’s say EUR 12 million of normalization. And then you should indeed look at the expected price improvements including our surcharge that we put on to give you an indication of where those results are going.

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

If I may add a follow-up then on the U.S. market outlook, I do appreciate of course the recent swing put on the U.S. market in the context for section 232. But as far as I understand, a number of countries are so far exempted. Let’s wait for the final scope of these measures in the end, of course. And at the same time, ATI is continuing with its ramp up with and without exemption on the slab sourcing. So to what extent this could spoil the party, I would say, in the current U.S. pricing conditions?

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

Actually, I understand that ATI has changed their tune a little bit. There is no reason, by the way -- there are two things. First of all, there’s no reason they would get exception. We actually have offered to sell ATI slabs. We have slab capacity. So it’s not as if there’s no slab in the market. And this is -- of course one of the grants for exemption is that you have to prove that there is no alternative sourcing in the domestic market. So secondly, they have now started to bump up their prices as well to match where we as a market are now going to in Q2 and Q3. So I don’t see that as a significant thing.

Operator

We will take our next question from Cedar Ekblom of Bank of America Merrill Lynch.

Cedar Ekblom - BofA Merrill Lynch, Research Division - Analyst

I’ve got a few more questions mostly focused on the U.S. Can you talk about what feedback you’ve had from customers in terms of their experience so far with ATI and Xingcheng? The fact that you were forward selling product in Q4 for Q1 suggests to me that you are a little bit concerned about your position in the market, and I just wondered if reality has been any different from what your expectation was coming into the event. Secondly, have you done anything similar on the Q2, so forward selling product and therefore not exposed to where spot prices may or may not go? Thirdly, how are you thinking about your decision to provide an explicit surcharge on graphite electrodes, considering some of the pushback that you have had from customers and the fact that your peers have not gone the same way? Is it something that you are rethinking? And then lastly on
the Mexinox restructuring, can you just give us some idea if there are any more costs to come in the future? And maybe quantify what you think the benefits are from that restructuring.

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

All right. So it’s interesting. Have we been too eager to book in Q4 for Q1? Reality is that you have to, because you have to plan ahead. Lead time are normally 6 to 8 weeks. So if someone wants to have delivery in the first week of January, then the order has to be in November. Otherwise there will be no production and no product. And that’s not something product specific. This is just how a steel mill works. It takes time for material to be bought and run through the mill to come out, be shipped, etc. So there has been no pre-selling, forward selling into Q1. This is just the normal cycle of selling products. Second, November is always questionable.

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

Sorry, Roeland, can I just -- sorry, just to ask you on that, the comments that you made earlier talking about ATI ramping up and you wanting to -- unless I interpreted it incorrectly, ATI is ramping up. And in Q4, you wanted to get some kind of certainty around volumes. Is that not what the comment meant when you spoke earlier?

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

No, what I said was that at ATI started offering material in Q4 for Q1, they pushed prices down because they were literally offering 3 to 4 discount points below the market. Now that doesn’t meant that we follow that. We haven’t. But it does mean, as you can see as well from the CRU number month on month, that pricing in the U.S. has gone down over that quarter as the price pressure from ATI started to take its toll. Does that clarify?

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

Yes. Yes.

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

So no forward selling for Q2 other than what we normally do, so you see the same cycle. Now was it a wise idea to have the electrode surcharge or not? We were the first. As you know, we were not followed initially. We see that we are being followed now broadly. ATI has followed. AKS has followed. In Europe, we can see from the alloy surcharge that there has been -- that our competitors put an extra element into the alloy surcharge. So broadly this has been followed and broadly this makes sense because we all are facing the same reality. And it is that input prices are going up. On Mexinox restructuring, it’s ongoing. There is probably in the next couple of quarters now EUR 2 million to EUR 3 million to expect from there.

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

Okay. And then the last question, I don’t know if you’ll answer it. Have you had any feedback from customers on the new ATI product, just any tell on the market?

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

I can’t talk about my competitors’ products and their perceived qualities.
Operator

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

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

I have a couple of questions left. The first one is again on the Americas. I’m wondering, if we look at the business and the performance, you obviously have been essentially selling product at a cash loss. And we all know that the export business is much more -- or much less profitable than the domestic business. Now, have you really been running the mill at the, say, operational optimum? I.e., have you really been optimizing the mix, or has the problem been you have been producing and then you were rejected in the domestic market and you were forced to ship into the export market, but you would have been cost wise much better off if you wouldn’t have had produced this sort of material? That is my first question. I have two more.

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

Okay. So absolutely not. We haven't sold a kilo that doesn't have a contribution. That’s an absolute rule. Nothing is being sold for prices that will not give contribution. So it is of course true that a slab has less contribution than a ton of cold rolled. Now on the slabs, again the slab sales that we had in the first quarter were orders put in during Q4. For instance, in Europe, as you remember we had -- in Q4 we had an issue with our cast house in Tornio after it came back out of maintenance. And as a result, of course we had a shortage of slabs, which was made up for by Calvert producing slabs for our own system. That counts as volume, but there’s very little EBITDA in there. So that probably explains the higher volume, higher than normal, without you seeing a significant increase in profitability.

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

Okay, thank you. That’s been helpful. Then one more question on U.S. prices. If we compare U.S. versus European alloy surcharges, it seems like the U.S. alloy surcharges have gone up much more meaningfully versus Europe. And I know there is a different way of calculating the alloy surcharge in both regions. But is my impression correct that you got a bit of margin out of the higher U.S. alloy surcharge as well? And then my last question is also just to get your view on general markets. What do you make out of Chinese prices here? They are going down as nickel and chrome are essentially going up, and hence Western market prices are rising. Is you view here that the Chinese players are facing massive margin pressure, or are they simply not facing the same degree of cost inflation on variable cost, i.e., they are basically buying chrome and nickel much cheaper than Western players are ever able to?

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

Yes, 2 very insightful questions, Bastian. First on alloy surcharges, actually if you follow the trend, the alloy surcharges in Europe and Americas have been following, with some lagging here and there, ultimately the same trend. They are calculated slightly differently, but the main drivers, nickel, ferrochrome, and steel and carbon steel, are the same. So they do follow the same route. It’s a more immediate relationship in the U.S. they way they calculate it, whereas there is more of a evening out calculation in Europe. So again, you will see -- quarter-on-quarter you will see differences and month-to-month you will see differences. But if you would even it out, trends over a longer period of time, you will see that they behave exactly in the same way. And then on China, China is an interesting thing. In short, you can say that's the Indonesia effect. If you look at the trade figures in China, Indonesian imports into China have skyrocketed. And this is of course the Xingcheng effect that has been putting enormous amounts of Indonesia product into the Chinese market, and that has depressed pricing in that market.

Operator

We will take our next question from Kevin Hellegard of Goldman Sachs.
Kevin Hellegård Nielsen - Goldman Sachs Group Inc., Research Division - Analyst

Yes, just one quick follow up here. In your guidance, are you baking in any gains or losses from hedging and timing effects in 2Q?

Christoph de la Camp - Outokumpu Oyj - CFO

No.

Kevin Hellegård Nielsen - Goldman Sachs Group Inc., Research Division - Analyst

And given nickel prices are higher, ferrochrome prices are higher, wouldn't that normally lead to a gain?

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

Well, yes, so to the extent that we know what the prices are. And again the assumptions -- the answer is yes. But we don't know of course where nickel in particular is going to land at the end of the quarter, so factoring in hedging effects is very difficult. There is some timing assumptions in there, but we tend to assume that there aren't such big movements up or down on raw materials unless we have very strong indications to the contrary.

Operator

As we have no further questions in the queue, I would like to turn the call back to the speakers for any addition or closing remarks.

Tommi Järvenpää

All right. Thank you very much for attending our earnings call. Outokumpu’s second quarter results will be published on July 24th. Until then, thank you and goodbye.

Operator

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