Outotec

Rita Uotila

Welcome all to Outotec's January/June Interim Report briefing; my name is Rita Uotila. We will hear soon our CEO Pertti Korhonen's presentation of the results, but let me introduce first a few other people here: our CFO VP Takala and Jari Rosendal, who is from the non-ferrous business area. Before we go to the presentation, let me just remind you that this is a live webcast and teleconference and it will be recorded and the on-demand recording will be available on our website later today in our webcast centre. Please switch off your mobile phones and we are ready to start. So please Pertti, the floor is yours.

Pertti Korhonen

Thank you Rita, good afternoon everybody both here on site in Helsinki and then everybody on the lines. Let me start by highlighting and reminding that this is now the first time when we are reporting according to our new reporting segment structure; so we report our three segments, non-ferrous solutions, ferrous solutions and energy light metals and environmental solutions and the figures of services business are included into these three solutions segments, but we also report the sales volume of our services business separately.

First some update regarding the changes in our Executive Board. Last time in our quarterly reporting we went through the new organisational structure and we highlighted that there are still some vacancies that need to be filled. Now, Mika Saariaho has started as Head of Strategy; Michael Frei is starting as Head of Supply; Vesa-Pekka Takala is leaving the company and to move forward to new duties and the recruitment of new CFO is proceeding well, and we look forward to being able to complete that in the near future. Moving to the summary of our first half of 2010, let us first take a look at the operating environment.

The operating environment has continued to improve and strengthen. The mining and metals industry showed signs of recovery supported by the positive long term outlook for metal demand and in the emerging economies especially. Metal demand continued to grow; inventory levels declined; the prices were in good level, and of course following the recession companies have accumulated needs to invest to their existing operations and they have been revitalising their investment plans that were put on hold when the collapse started. Also, as the production rates are increasing and getting back to normal and increasing levels, the needs for various kinds of services are naturally growing.

Regarding the competitive situation, we have been able to defend our gross margins for new business, thanks to our leadership in technology. The advanced value added solutions that we are providing and our asset light operating model and, as you see from our strong order intake we have been able to, despite of protecting the margins, we have also made tremendously good progress in winning new business.

On the chart, if we look at the demand growth forecast for selected commodities, it looks like that we are really heading forward to a solidly growing market in all the metals.

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If we then look at the order intake and order backlog we of course are very pleased and happy about the strong order intake continuing also in the Second Quarter. All in all in the first half of the year our order intake already exceeds the order intake of last year. The order intake of the first half is three times higher than the order intake in the corresponding period last year and in the Second Quarter the order intake is almost three and a half times higher than in the comparison period, and of course this is very good news. With the order intake being strong our order backlog grew to more than 1.3 billion, which is of course a very good basis now to take the business forward. From this backlog roughly 40% equalling to roughly €530 million, is estimated to be delivered still this year and then the rest in 2011 and beyond.

Regarding the largest orders, what is perhaps good to notice is that our order intake was strong in the Second Quarter, despite of the fact that we actually did not have any super big single orders in the Second Quarter. Of course this means that the underlying demand for product, services, and smaller solutions has increased very nicely and really the basis there is recovering and has recovered on a quick pace.

The new orders in the first half have been around the world; this tells about Outotec being well positioned and being able to well participate in the growth and vivid economical activity in the emerging markets, so really this is what is also highlighted in our strong order intake of almost 770 million in the first half of the year.

Then if we look at the numbers, sales is 410 million for the first half, reflecting naturally the fact that the order intake for the whole of last year in the recession was very low and we started the year with a low order backlog relatively speaking; so the sales is recovering of course later than the order intake is recovering. Gross margin was very strong in the first half, being 25%; this strong gross margin was due to good basic execution, but also especially because of the high share of services business. Services business in the first half was 27% of our revenues, and then the good gross margins of our acquired Larox business, today being the filters business line, that was also positively contributing to our good gross margin level.

From the business operations in the first half, the operating profit was 15 million; and then when we take into account the one time restructuring costs related to our cost structure improving programme, and then the amortisation of the good will according to IFRS, plus re-evaluation of the Ausmelt shares, we arrive to the reported operating profit of -4.6 million for the whole of first half-year, but I want to highlight that from the business operations we were on positive result and really this negative overall operating profit is due to the restructuring measures that we are taking in order to make sure that our cost structure is competitive also in the future.

If we look at the Q2 separately, as said order intake continued very strong and the underlying inflow of smaller to midsize orders strengthened significantly. Sales was 223.8 million with a gross margin of 25.5% from business operations, 11.3 million operating profit, and then after the one-off costs and good will, the amortisations, the reported operating profit was 5.5 million, so turning back to a positive figure. From business operations the operating profit margin was 5.1% and the reported 2.4. When we look at the trend sequentially, we already looked at the trend of order book and order intake showing the swift and quick improvement of course in our business model where we are then delivering our projects and solutions from the backlog; the sales revenue is following with a lag, but we also see here that the sales revenue has already started to pick up; and then we look at the profitability, that is also developing to the right direction and the trend is good. If we then look at the business by business segment in non-ferrous solutions, sales picked up in Second Quarter due to the increased order intake and then due to the impact of the acquired businesses the operating profit from business operations was positive 5.9 million for the first half, but after the restructuring costs the overall reported operating profit was -4.2. However, the operating profit from business operations before these on-off costs was clearly positive, and the trend was improving from the First Quarter to the Second Quarter.

Moving forward to ferrous solutions, here we little bit suffered from the fact that fewer projects were in delivery phase, which resulted in lower sales figures in the beginning of the year. However, this business was also, despite of the strong decrease in the sales, revenue was also positive and in that sense with the increasing order intake we are optimistic that this business is also nicely bouncing back.

Moving forward to energy, light metals and environmental solutions, here sales reduced due to the low order intake in 2009, and therefore fewer projects were in delivery phase in the Second Quarter. The operating profit, however, was good from business operations with 11.11% reported operating margin level. Regarding the services, the services business grew by 53%; the growth came here from the acquired businesses. Here we see especially the impact of the acquired Larox business. Services sales represents 27% of our sales in the first half of the year; and we remain on track to achieve the services business ales target of 250-300 million sales running level by the end of this year.

If we then look at the balance sheet, the capital structure, our capital structure remained very strong. We used our strong balance sheet to do cash acquisitions of companies – Ausmelt, Millteam, Edmeston; we also used our strong balance sheet to restructure the balance sheet of the acquired Larox business, basically take care of the debts there and secure that it has a strong balance sheet, and of course in the equity you see the impact of the acquisitions and the cash flow from business operations was positive due to the increase order intake and with this strong balance sheet we feel very confident going forward in developing our business forward.

Personnel increased to 3,200; this increase came in practice all from the acquisitions; temporary personnel accounted for 8% of the total number of employees, and additionally we had some 250 contractors. What comes to the cost restructuring programme, we made 84 employees redundant in April in Finland and all-in-all we are forecasting to meet our target of 170 persons reduction by the end of the year.

Then regarding the events after the reporting period, there's one event here to be reported; and this is the contract to deliver chrome mine sintering technology to Xstrata in South Africa. This is included in our Second Quarter order intake and backlog.

Then a short update regarding our strategy implementation. The first half of this year is being characterised by acquisitions; so we have now completed the acquisitions of Larox, Millteam, Ausmelt and Edmeston; all these acquisitions are nicely complementing Outotec's technology portfolio, product offering and service offering; and now naturally we are in the phase where we are integrating these business both what comes to the integration of the offering to our customers and of course what comes to the integration of internal operations. In addition to these acquisition moves in the first half, we announced the cost savings programme which is now in execution and implementation. We announced the new operating module and organisation structure in order to support the growth of our business going forward, to act as a growth platform, but then also to improve our flexibility, global operational leverage and productivity.

I would also like to give a short update regarding our strategic priorities: in the earlier web casts I have presented a list of Outotec's priorities 2010 and this is a simple summary in traffic lights form how we ourselves believe we are making progress with these things. Winning new orders has been our number one priority and of course with the very strong order intake in the first half we are clearly on the bright green colour here with this priority and we plan to continue to make good progress in order intake also during the rest of the year.

The second one, of course, is that we keep on delivering to our customers. Here our own assessment is that we are a little bit on the yellow here; this is due to the fact that in some areas the deliveries from the backlog are lacking behind. These are primarily due to customer related delays, so for example if the customer doesn't get the site infrastructure ready so that we could do the final performance tests of the process that Outotec has delivered, we cannot of course complete the project. We have had some of these kinds of delays in some areas; so this is yellow and of course now towards the rest of the year we will be fighting and working hard to turn this towards green.

The third priority has been the implementation of the new operational model and here we launched the new structure as planned in April, and now we are learning how the new structure works. Of course this has been quite a significant change in our operational model when we have formed the new business areas combining or restructuring the old divisions in the new set up and also setting up the global market operations network structure, setting up the global shared support functions. It is quite a big change and it will take some time when we learn to operate with this new model, but I'm very pleased that we haven't been to disturbed with our internal things and we have been able to do a very good job in winning new business and being active on the sales front. Of course, when our goal now is to implement and put in place the common processes and tools globally across Outotec, that will also take some time, but the payback of this is that we can much more in a flexible manner collaborate inside the company, combine the offerings of our different business lines to a joint offering towards the customer, and also improve our overall productivity. So there is work to be done here.

The next priority, integration of the acquired businesses, now technically the acquisitions have been completed and the integrations plans are in place, but of course there is still a lot of work to be done to integrate the offerings to our customers, to do the internal integration, making sure that the people of the acquired businesses feel at home at Outotec, their new home. So we have to continue to pay attention to the integration to make it successful.

Regarding the next priority, achieving the 25 million cost savings; in the first half we achieved 4.6 million savings, which is included in our result and we are on track to meet the 25 million annualised savings as planned; so the light is clearly green.

Last, but not least, the goal of growing the services business to this run rate of 250-300 million, we made very good progress in the first half with 53% year-on-year growth and we are on track to meet this target. This is a simple summary of how we are doing regarding our execution priorities and I already covered the fixed costs savings problem so we are on track to achieve this. In first half we recorded 16.1 million of one-time costs which will be leading to some 10 million sustainable annualised cost savings and of course on top of this we have savings coming from actions and activities which have not required any one-time costs, but are of a different nature and I said realised savings in the first half of 4.6 million.

Let us then move to the market outlook and financial guidance regarding the market outlook; the overall market sentiment is supported by growing metals demand in the emerging economies and also in the recent months clearly the metals demand outside China has also started to show increasingly strong signs of recovery. In addition to this there is a continuous need for modernisation and bottlenecking at mine sites and metals processing plants, as well as building new energy efficient and sustainable plants producing less emissions, consuming less energy, using less water and these kinds of examples. Following the recession there are many active sales projects; industry lead times tend to be long, especially in large investments and this is the normal nature of this market.

If we then look at the market outlook by business area, in the non-ferrous solutions area the activity is picking up, especially gold, copper and zinc projects are becoming active. In ferrous solutions there are also strong signs that the demand for raw material for steel making, iron ore and coking coal will continue at record levels; and this is of course driving the investment activity in this area and also in energy, light metals and environmental solutions the market outlook is pointing to an increased demand. In services as the production capacity utilisation rates increase, naturally the need for various services is increased.

Our financial guidance for this year, we have not changed our financial guidance, so we reiterate the guidance that we have given when entering the year. We believe based on the order intake in the reporting period that the order intake will be significantly higher compared to last year, and that the sales will grow approximately to €1 billion due to acquisitions and that the operating profit - including €10 million purchase price allocation amortisations, will remain on the same level as in 2009, excluding one-time items. We are estimating that the one-time items which are related to restructuring of our cost base will be in the range of 20-25 million. Naturally all this is dependent on exchange rates, product mix, timing of new orders and project completions as normally.

Now, I think it is time to move forward to questions and answers.

Questions and Answers

Question
Sanna Kaje - FIM
Would you consider the last 12 months level of about 25% gross margin to be sustainable going forward?

Well of course this 25% of gross margin has been strongly impacted by the mix, so the services business has been on a high level compared to the, so to speak capex business. That is reflected there and when the amount of large EPC lumps and turnkey projects when those revenues are starting to pick up that will of course have some impact on the gross margin, but all in all we believe that we will be able to at least sustain the normal gross margin levels that we have had.

Jarl Kaila Nordea

I have got a housekeeping question on the PA amortisations; will they come to an end this year or how do they continue?

They will not come to an end this year; they will continue, but of course at a decreasing rate.

But for how long?

V-P, would you like to give a more detailed…we will definitely continue also next year, but the rate is going down.

V-P Takala
The first year it is the hardest, then it will go significantly down; then depending on to which fixed assets category, those allocations belong to … they have different degree amortisation times, but anyway the one time impact is fairly large this year and then it goes down and becomes more ‘business as usual’ and I think all of that will no longer in 2011 and going forward report those separately; but for this year’s analysis purposes it is a relevant issue.

Pertti Korhonen
And of course potential new acquisitions will then need to be looked at separately.

I am going to ask another question about this; you have already touched the slow revenue recognition and said that it was reasons beyond your control and customers and so forth. Was there any bottle necks within your own side that could have speeded up the ..?

No we have not had any such kind of bottle necks; it really has been attributed to be enable to complete certain milestones to finalise the acceptance of certain performance characters because in some other areas there has been delayed, not related to Outotec’s delivery.

Nico Dil – JP Morgan

Good afternoon. I would like to ask three questions please: first of all a very simple one - perhaps for VP - the 4.6 million in savings, how much of that filters through to the cost of goods sold line versus the SCNA line? The second question is really around the market outlook. I just want to get a bit of flavour of what you think about the base orders here. When I refer to the base orders I effectively strip out the large orders that you announced during the Quarter. When speaking to your customers do you get the impression that we can increase further from here, or that there has been some type of a restocking or a one-off positive effect in these orders? The third question is around the services; from the comments that you have made, I get the impression that they are bound to improve; I just wanted to make sure that my understanding here is correct.

VP, would you take the first question.

Thanks Nico, the matter is that basically all of the savings came from fixed costs of goods sold and traditional fixed costs were roughly flat if not even on comparable FX rates, slightly higher than the previous year with comparablestructure; that was a result of significantly higher selling and marketing costs which are to be seen as an investment for the future. We are investing in tendering and bidding processes now in order to win new business, so that is basically a good thing, but this is the analysis Nico.

Pertti Korhonen
Of course that investment also started to become visible in the Second Quarter in the form of the very large order intake. The second question … Nico could you please remind me what was the second question.

If I look at the base orders they seem ultimately at a very high level if I even compare it on a historical basis, they seem to be at an all-time high. I wonder where we go from here; has there been some type of a on- off or is there effectively more room to improve from here?

Of course there has been bent up demand and things in the sales pipeline, which have been blocked there during the financial and economical crisis and of course now that is starting to move forward, there is a lot ketchup coming out of the bottle all of sudden. However, we believe that with the promising trend in the marketplace, the inflow of smaller to mid-sized orders will also continue to develop positively. That is at least at the moment our feeling of the pulse.

What about the services; the comments that you have made effectively imply that services are bound to go up from here as people increase their production rate, or the miners increase their production rate. Is that a fair conclusion?

We believe that we will continue to grow our services business, and then as said we are forecasting that we are on track to meet this target of 250–300 million services business annual run rate by the end of this year and of course when we can tick the box in achieving that target we have to set ourselves a new target for the services growth and that's probably something that we will be discussing in the capital markets day.

Thank you, that's very helpful; I'd like to also thank VP, and wish you all the best in your future career.

Rupesh Madlani – Barclays Capital, London

A few questions from me please: firstly the appointment of your Chief Strategy Officer. Is that largely to implement your existing strategy, or do you anticipate further changes to either your operating model or your business structure? Second, the number of acquisitions you've made so far this year and last year seems to have progressed quite well. Do you still have appetite for further acquisitions if the opportunities are around, and is so what size? Third, if you would comment on - it certainly looks like activity levels in terms of order intake has picked up; do you think that; that could extend to potential for additional licence fee income for this year? Then lastly, as VP is moving on after a number of years service, perhaps he could comment on the timing around a new CFO appointment; do you believe that will be completed in time for the next Quarter's reporting?

First of all the appointment of the new Head of Strategy; of course creating strategy is teamwork and this new person is going to lead our strategy activities. We have a very, very strong shared view with the Board and in the management that Outotec's strategic direction, is very good. We are addressing very attractive markets with nice growth opportunities there. We believe our strategic direction is right as we speak, and we are now currently working in order to update our strategy and we will be preparing and then communicating the updated strategy the in the Capitals Markets Day. You don't need to expect any changes in the direction, but of course we want to look where do we set the bar going forward and where do we put the focus and how we develop our strategy forward. But it is certainly going to be on the same track where we are right now, because we feel very good about this track.

Regarding the appetite for the further acquisitions, yes so we have now made four acquisitions and we need some time to digest those. We need to make sure that we do a good job in the integration. It's proceeding well, but we have to pay attention to this. We certainly have appetite also for some new acquisitions, especially for bolt-on type of technology acquisitions where we can find companies who have technologies which would nicely complement Outotec's already very strong technology portfolio. We are also looking for smaller services companies that we could acquire to continue to increase our services capabilities. We're also looking for opportunities in the new verticals of energy and water processing, whether we could find some suitable companies there. Yes we have appetite, but we want to manage this carefully. We will not do acquisitions just to buy revenue; we will carefully choose acquisitions that we will make in order to make sure we acquire such kinds of things that really fit our strategy and portfolio well.

Regarding the order intake and the licensing, so of course in certain cases and in certain technology areas, we also have licensing fees, but there is no reason to expect any fundamental change in this area, so we will continue on a normal track. Then your last question about the CFO appointment, we are really very far in the process and very near to completing the process. We look forward to being able to announce it in the not so distant future and the new CFO will then start in the job in the Autumn time.

Just a couple of follow ups, with respect to additional acquisitions, will you apply a similar criteria that you have used for existing acquisitions that VP has outlined in the past. Second with respect to licence fee income, do you anticipate there is a better likelihood of recording licence fee income this year than where you started maybe two quarters ago?

First regarding the acquisition criteria, I don’t think that there is any fundamental reason to change the general criteria. Of course we have to look every case as a separate case and look at the overall picture, but the general criteria, I do not see any need to change those. Then regarding the licence fees, of course our desire is, as a technology company, also be able in our business model to include licensing fees, so that certainly is our desire and appetite, lets see how successful we will be and able to implement that going forward. Certainly the market is improving, so perhaps the times will not be as tough as they were still last year.

Sasu Ristimäki – Carnegie, Helsinki

It is Sasu from Carnegie, Helsinki. I have got two related questions and maybe I can ask them in turn. First, in terms of the cost structure, how do you see the development of your fixed cost on the Opex side, but also the fixed costs on the cogs side, meaning in manufacturing, now as the volumes are clearly ramping up. How much spare capacity do you have still, and at what point do we see the cost ramp picking up a serious pace?

First of all regarding the Opex, if you look at how our Opex has been developing in the first half of this year, it is worth to take into account that the fixed cost improvements they are happening in two areas. Part of that is in the fixed costs of cogs, the costs related to our engineering production, fixed costs. Then the rest is in the SGNA. In the first half of this year currency fluctuation has had quite a big impact on these cost levels, as a very significant part of our costs actually are not in Euro basis as we are operating globally. That is one thing that has been impacting and may also be impacting in the future. Really this cost structure improvement program of 25 million; that will be touching both the fixed cogs and then the SGNA areas. Your second part of the question, whether we will see inflation of the cogs, if I understand your question correctly, we still have some unused capacity. We are not that much having manufacturing plants, but if we look at our engineering capacity we still have some reserved capacity.

However, Outotec’s business model is very much relying on networking with our partners, both in the engineering and then in the physical supply chain area. I believe that as the company was showing before the start of the crisis that we were able to grow roughly 35% a year, and scale up our operation, I believe that we can also in the future continue to scale our operation, because we can then leverage the resources and capacities our partners in the value network have. Naturally when we are a growth company, we don't want to freeze our fixed costs to a current level for the forward-going future, so we will also then redeploy some of the savings to those areas which we believe are needed in order to feed the growth going forward.

Still on the gross margin subject, just to try and further get to grips with this. You have a certain margin inbuilt into the backlog, at least in terms of your growing assumptions. Do you see this as very dependent on a certain cost build up plan, and secondly that as you get further more short cycle revenue from the services side, shouldn't this actually be improving the gross margin quite significantly compared to the project business that you have in the backlog?

The first part of your question, so of course when we are building our proposals to our customers, we try to secure that we take into account the forward-looking cost developments and try to make sure that we will do deals which have a healthy gross margin structure. It can be assumed that the new orders that we have in the backlog have a normal healthy gross margin structure. Then what comes to the sustainability of the gross margin, there are of course factors that point to north, and there are factors that point to south. The increased level of services business of course is augmenting the gross margin, but then on the other hand when the delivery of the bigger EPC, or lump sum turnkey projects are picking up; that will then dilute the gross margin percentage but of course it will increase the absolute gross profit. There are these two factors there which need to be taken into account.

Finally just a very quick question – I may have missed the answer before – are you very concerned about having imbalances in utilisation across your three divisions or do you see that all of them will be pretty well-loaded going forward?

There are some imbalances currently, but in our new operational model, we are now developing our capability to cross-use the resources better and then also in short term we are positive regarding our expectations for the order intake, and that will mean that our capacity utilisation will be improving. Actually I would say we are not concerned at all, regarding the spare capacity that we might have in some pockets.

Tomi Railo – SEB Enskilda, Helsinki

I will start with the question, if you can give a figure on sales and orders from acquisitions in the second quarter.

V-P, Jari, could help with this. I don't have the figure out of my head.

V-P Takala
Those are now embedded in the new structure as part of the business lines within divisions. We have not gone there to analyse that. Naturally we follow up very carefully the synergy benefit realisation from the acquisitions, but not sales and EBITs separately. I think Pertti already mentioned that those acquisitions actually have contributed positively to the financial results of the first half.

On orders?

Yes on orders, on gross margins, and actually to add especially the acquisitions on Larox has gone very well, so the sales of filters have accelerated both in the products and then in the services. We also have been able to already gain some nice synergy benefits on the top line area, so we have been able to win some new projects because we have been able to combine in a very nice manner the offering of what Outotec used to have and now what Larox filters brought in. We announced today an order from Australia which is a prime example of what we now have been able to do, when we have been able to combine the offerings of both companies together, so very good progress there.

Second question still actually on the order you announced today. Should we expect still some announcements of orders which actually belong to the second quarter, as big as this order today?

Not really.

Sasu Ristimäki

Just forward looking, if we now think that you have order run rate averaging about 400 million per Quarter. Should we start thinking of the company again as a 1.5 billion revenue animal? More importantly, are you yourself preparing to be a 1.5 billion for 2012?

Of course I don't want to start to give any guidance for next year, not speak even about 2012. Of course we believe that the order intake will continue on a healthy and strong level. There will be fluctuations as we have had in the past, so the quarters will not be sisters. There will be fluctuations, but of course our goal is to go back to the growth track and naturally the first phase there would be to bounce back to the levels where we were before the recession started. If you take the combined revenues of Outotec and Larox, lets then see when that year could come, how rapidly the market is recovering, but that is certainly is our first milestone going forward.

But do you have a problem delivering 1.5 billion of revenues in 2012? Do you see that you would have supply chain or internal constraints if the demand was there?

If we again lets remove the note on the year, and let's speak in general that could Outotec grow to 1.5 billion, I wouldn't see no reason why we couldn't do that. What comes to our capability to supply? We just need to keep on winning the new orders and win new business. I am sure that we can deliver.

Closing Comments

Thank you. I think we have taken all the questions from Helsinki. Thank you very much, Pertti, for answering all the questions and thank you from us.