Company **Outotec Oyj**

Conference **Q2 2019 Interim Report**

Speakers **CEO Markku Teräsvasara**
CFO Jari Ålgars
Vice President – Investor Relations Rita Uotila

Operator Hello and welcome to the Outotec Q2 interim report 2019. Throughout the call, all participants will be in listen-only mode, and afterwards there will be a question and answer session. Today, I'm pleased to present the CEO, Markku Teräsvasara, and the CFO, Jari Ålgars. Please go ahead with your meeting.

Markku Teräsvasara Thank you and good afternoon or good morning depending on where you are. Welcome to Outotec's first half-year and quarter 2 results release. To summarise the presentation, we can say that the market is active, we had strong order intake and our service continues to improve well in line with our strategy. I know that many of you are interested to hear more about the merger with Metso Minerals. I will come back to that a bit later but of course first we look at our numbers.

When it comes to market activity, the market continues to be strong, particularly for minerals processing equipment and projects and also for hydrometallurgical plant solutions. It is still mainly brown field upgrades/modifications/debottlenecking, but during the second quarter we also received two large green field orders: one gold processing plant and one copper processing plant as you have seen. As mentioned, our service developed well both in terms of order intake and order backlog and now when we have seen our supply chain improving nicely, we see the sales developing very rapidly.

Copper and gold continue to be the most active metals and when it comes to so-called battery metals we are involved in most of the lithium cases that are active at the moment. This copper and gold is also well represented in the announced orders with the gold processing plant mentioned in Saudi Arabia, 140 million which is roughly 50/50 between the minerals processing and MEW and then we have this green field copper concentrator and hydrometallurgical plant in Russia where two thirds of that is minerals processing, one third MEW, total value 250, however, during the second quarter order intake we booked 35 million.

Then of course related to the water recycling and circulation, in many ways all tailings management, representing that market which is active at the moment, we have this paste backfilling plant order from Australia.

Looking a bit more in details our segment to segment, MP, mineral processing, continues to improve with a high share of services and of course looking at the chart not only the order intake increased, first half-year 30%, second quarter 39%, we also had nice growth on the service sales and the sales mix was geared towards 50/50 between service and capex but looking at the chart below and particularly looking at the order intake rolling six months, we are already at the levels we had during the mining super cycle without having a super cycle at the moment, so from MP side I think orders and backlog including services are developing well.

In MEW we have an improving workload in several areas because there are a number of large basic engineering projects that are ongoing at the moment and not yet visible in our sales numbers, however, already giving workload for the organisation and as you saw, three major projects that have been received during H1 have also a significant MEW portion. What is common between this and the minerals processing segment is that even in MEW the service base is increasing rapidly.

Looking at service a little bit more in detail, it is a continuous development in all areas in order intake which you can see from the lower left corner, the blue part, which is our order intake is at an all-time high level. We have the backlog continuously increasing and as mentioned through our work we have had supply chain and spare parts/wear parts delivery improving, sales are catching up nicely with a total of 27% in the first half of the year and 41% during the second quarter.

When it comes to the ilmenite project, we have discussions ongoing with the customer, but it is taking a longer time than expected. The ilmenite market, however, is still supporting this investment. It is a big project for both us and the customer, and the negotiation is taking a longer time than expected, however we remain confident that our 110 million provision that we booked at the end of 2018 is sufficient. We will of course announce any substantial news going forward.

It was an active month in our product development. Our R&D activities have continued to deliver valuable benefits to our customers – water has been mentioned many times. Three out of four new product developments are somehow related to water in terms of new types of filter press, water quality and quantity management systems that you can use in your process plant, and then of course the paste thickener, both helping customers to maximise their tailing storage facilities but also helping them to recycle process water in a good way and together with the water quality and quantity management system secure that good quality water is returned to the process in a good way.

In the MEW side, related to Ausmelt, there is Lance motion detection system that actually are more accurate and more precise than conventional manual operation, making sure that our smelters are more productive and with a higher quality. Now I'll hand over to Jari Ålgars who will go through the numbers.

Jari Ålgars

Thank you, Markku. Now I have the pleasure of taking you through the numbers. Order intake has improved 10% so far this year and 18% compared to Q2 last year. Sales was flat for the quarter and we are still behind last year's numbers with 6%, but as we guided earlier, our sales will be filtered towards the end of the year. Despite the low sales, our result clearly improved, supported by solid project execution and high service share.

For information we have also started to record adjusted EBITDA as of Q2 2019 in light of the forthcoming merger with Metso Minerals. The definition of this can be found in the second footnote below. Looking first at MP which shows continuing improvement. Our order intake in MP was very good, improving 30% from last year and 39% in Q2. Sales was flat as the slow order intake second half of last year has impacted capex sales. Service improved well and made up well as the market was active and we were able to solve some of the delivery issues in our supply chain.

The improved sales mix improved profitability. With MEW service sales increased significantly and MEW had a portion in both large greenfield projects, Ma'aden as well as Udokan.

Our order intake was 297 million, which is a good number as such, but a decline compared to our strong order intake in H1 last year. Book to bill is, however, well over 1, which predicts improving sales going forward. It is imperative that we continue to get good order intake going forward as bigger volumes are required to stabilise the profitability. Despite our low sales we were able to improve our result in MEW due to solid project execution and improve our recovery due to better workload and the actions we took last year improved our flexibility.

Overall, we have seen solid improvement in profitability from H1 2018. If we look at the bridge, we can see that the solid project execution supported by the sales mix clearly offsets the low sales volume. We can also see here that the fixed cost increases due to large projects and related sales and marketing efforts. Coming from here, I'm going to the cashflow. The improved margins supported the cashflow. When we have a look at the cashflow, collection of trade receivables as well as increased advance payments in Q2 had a positive impact on net working capital. This turned our cashflow clearly positive for the half-year, despite that we had a weak Q1, so now we are well on the positive side.

Going to our balance sheet, our balance sheet remains stable. The balance sheet has grown from a year ago due to the implementation of IFRS 16 and also due to the provisions made for the ilmenite project. The IFRS 16 impacts many of the key ratio figures. The effect of the IFRS change can be read in the second footnote here. Net interest-bearing debt would be €46.6 million, gearing 12.5% minus, equity to assets ratio 32% without the IFRS change.

Now over to Markku again. Thank you.

Markku Teräsvasara Thank you, Jari. We will first look at the market outlook and guidance. The market demand drivers are very much the same as we discussed last time. Apart from metal consumption, there is a requirement for efficient technologies because of overall grades, because of challenges in raw materials and impurities that you need to remove. The regulations are playing a role and also as mentioned earlier in this presentation, investment in process water recycling and tailings are a very hot topic at the moment.

New use to electric vehicles creates a long-term demand and the activity at the moment and even expected in the future is very high in copper/gold/battery metals and zinc and of course those are traditionally very strong metals for Outotec as well as some pelletizing plant and sulfuric acid investment that we expect to happen. Yet the major activity will be on brownfield. There are a handful of greenfield investments in the pipeline, but the timing of those investments is sometimes not so easy to estimate.

We have a stable market. Our minerals processing business is improving, and service is increasing and of course smaller orders turning faster into revenue. Together with those facts and the three large projects and the significant MEW portion, we are confident that we will achieve our guided numbers for 2019.

A few words about the combination of Metso Minerals and Outotec: of course, this is in the industry and even generally speaking a unique combination in a way how well the businesses complement each other. We are combining two companies to create a leading company in process technology, equipment and services that will be active in minerals, metals and aggregate industries. When I mentioned the complementarity, it is in many dimensions. First, of course, we are combining product and process excellence from different companies, but also strong R&D and technology development combined with a very large service footprint and consumables business.

On the other axis, we also complement each other well from the value chain, having aggregates on the one hand and on the other hand metals refining, it will give different cyclicality for the value chain investment. Geographically, the companies have a little bit different strength and combining those globally we will have a very good, even split of our revenues from different parts of the world. That is even applicable for commodities where putting the commodities together we will have an even split. Metso was traditionally strong on aggregates and iron ore while Outotec has or had a very strong position in copper and precious metals/battery metals but combining that picture will be given a nice complementarity.

Expected synergies as announced July 4th, we are calculating the pre-tax cost synergies of at least 100 million on the cost side and then 150 million revenue synergies from cross-selling and other opportunities over sales network. These synergies will be fully realised by the end of the third year following completion. Timing: expected closing second quarter next year, of course subject to customary closing conditions, sometime passing two steps, one is the shareholders' meeting that is scheduled to be October 29th for both companies, and then of course receiving regulatory approval from authorities. This is the time schedule that we are looking at, at the moment.

As this was the last slide of our presentation, we open the line now for questions.

Operator Thank you. Ladies and gentlemen, if you have a question for the speakers, please press 01 on your telephone keypad. Our first question comes from the line of Omid Vaziri of Jefferies. Please go ahead, your line is open.

Omid Vaziri Hi, yes, thanks for taking my question. I have two: firstly, given the large impact that we've seen on the margin recovery from improved sales mix, notably service growth being much higher, would you be able to quantify that impact for us so that we can see what impact on the margin you've had from just generally running the projects better and executing stronger but also having improved your fixed cost absorptions? That's my first question.

Jari Ålgars Yes, sorry, it was a lengthy question, so I'll try to take it in pieces. So, if you start with the service mix impact and then also the improvement from the project execution, I think both have been more or less giving roughly the same amount, so both have had a strong impact, maybe more in Q1 from projects and a little bit more in Q2 from the service side, clearly. But if you look at it on the aggregate it's probably about the same. Then, sorry, you had some other questions as well, was it on--?

Omid Vaziri I wanted to understand the margin impact that the sales mix has had so that I can work out what the remaining impact has been that's come from improved project delivery or improved fixed cost absorption.

Jari Ålgars We have usually not guided for the service margins separately from the capex margins, so obviously we will continue with this. From the service we can say we have more of the spare parts compared to the field service and shut-down service jobs and the impact is even bigger because, as we stated earlier, our parts business is clearly the most high-market business that we have and then modernisations, shut-down service, field service work is more capex-like in its margins.

Omid Vaziri Yes, OK, so would it be fair to say that most of the impact in the margin improvement in the second quarter has come from improved sales mix from service growth and the new equipment sales growth being slower in the second quarter?

Jari Ålgars Yes, absolutely. The volume was down on the capex as you compare it and service was up, so definitely yes in the second quarter there was a much bigger impact from the mix.

Omid Vaziri For those of us who are interested in following your improved fixed cost absorptions and project delivery capabilities, what can you say to help us in quantifying that or at least to some extent qualitatively understanding how those are developing directionally?

Jari Ålgars I said that the first quarter was stronger on the capex side because obviously service was not so significant in the first quarter, now you can see that the service really has stepped up during this second quarter and we had a lot of service volume compared to the previous year, so the majority came from service.

Markku Teräsvasara I get that you want to understand it, but we can say that both the capex project margins increased but also there is a mix impact from having more service revenue.

Omid Vaziri Yes, OK, thanks for the clarification. My second and final question was in relation to your cost-saving initiatives, ones that you kicked off last year. Now in light of the announced combination with Metso Minerals' business, what changes have you already made to these plans? Have you reset the details for it? Where are we with this, given the recent changes anticipated ahead?

Markku Teräsvasara I think most of that simplification project that we had, so most of the benefits have already been achieved. However, of course, knowing that the merger will come we will at the moment of course review possible investments and activities that we do in the company, but as we have not yet passed either the extra shareholders' meeting or got the approval from the anti-trust authorities then of course it's business as usual for Outotec and our people.

Omid Vaziri Yes, absolutely. Great, thanks very much for answering my question.

Operator Thank you. Our next question comes from the line of Magnus Kruber of UBS. Please go ahead, your line is open.

Magnus Kruber Hi Markku, Jari, Magnus here with UBS. A couple from me: first on Metals, Energy and Water, with your current backlog how long can you sustain this level of workload and do you think it can be sustained until year-end on the back of these two recently announced projects?

Jari Ålgars Yes, I think what's important for us is that we have stated that we continue to get good orders. These two orders obviously will help a lot but as one of the orders is more MP because the two thirds of the Russian order is MP, one third is MEW, we also need more orders going forward. So yes, we are in a good situation but yes, we also need more orders to keep that good situation.

Magnus Kruber OK, yes, and following on in Q1 you talked about doing engineering work on a number of projects with a value of more than 100 million euros which might turn into orders later this year. Have you seen any progress on any of these orders?

Jari Ålgars All of them are progressing in their own way but obviously it's behind customer decisions, all of them, so we are really not the driver here, but we are continuing to do engineering on the orders and we're continuing to negotiate for them and when they will be decided remains to be seen. We are obviously optimistic that they will continue to progress and turn into orders at some point.

Magnus Kruber Got it. Finally, in a project like, for example, the Baikal copper concentrator, how long would it take from getting an order until it's fully ramped up in production? Doesn't have to be that specific project but generally a project of that size.

Jari Ålgars It depends a little bit on whether it's a metals, energy, water project or if it's minerals processing, but here as we have both, minerals processing usually turn faster into manufacturing, there are more long-lead items and more equipment where we have to order parts and start to do manufacturing in minerals processing while in metals, energy and water we first have to define the process, so usually the S-curve is a little bit slower starting in MEW generally and then what's positive obviously is that at the end it's stronger, so you always win at some point, but the minerals processing curve is more flat than the metals, energy, water.

Magnus Kruber Could it be two years or three years from orders until it's wrapped up?

Jari Ålgars You mean by wrapped up that it's ready at the site?

Magnus Kruber Yes, or producing output essentially.

Jari Ålgars Usually in these big projects it can be even longer than that. We talk about maybe two years to get it mechanically ready, half a year to do the commissioning and then up to the third year you start to really run and operate it, so from two and a half years onwards.

Magnus Kruber Perfect. Thank you so much.

Operator Thank you. Our next question comes from the line of Erkki Vesola of Inderes. Please go ahead, your line is now open.

Erkki Vesola Hi, good afternoon, it's Erkki from Inderes. Coming back to MEW, of course the services sales are growing nicely, and their share was up ten percentage points in the year but still the division was in the red. With your current structure, where would you see that the break-even sales level in MEW lies, approximately?

Jari Ålgars I think in general if you look at the numbers now, obviously the margins were good but we also expect them to be good going forward, maybe in general you can say when there are more bigger projects usually the margins in the bigger projects are somewhat lower, so I think using the numbers you see now may be assuming that the additional volume is coming in with a somewhat lower average gross margin, I think from that you can calculate it. There is nothing here in these numbers now that would be very different but maybe when it comes to getting it from smaller orders maybe the margins are a little bit on average, so I would say using that then you should be pretty safe.

Erkki Vesola OK. Also, do you still think it's possible to reach the MEW 2015 margin level of 6-7% any time soon or actually when annual sales exceed, say, 600 billion?

Jari Ålgars It's just a question of volume. I think the machinery is ready. We only need the orders. We can definitely, through the resources we have available, push more volume at the moment, so out of those handful of orders it would be quite good to get orders in the metals, energy and water side, I think it can be quite clear now that in minerals processing we have a quite good workload but in Metals, Energy and Water we definitely can do more and want to do more than what we have at the moment and that could definitely lead to those numbers you're saying.

Erkki Vesola OK, so the break-even point would probably be somewhere between 550-600 billion in MEW?

Jari Ålgars You're saying that's not high, but we are not guiding for that.

Markku Teräsvasara Of course sales mix plays a role as well. What kind of orders are in the portfolio. We are not satisfied with the profitability of MEW and we will do activities to improve it.

Jari Ålgars So it will be quite important now that we get new orders and continue to work on the profitability.

Erkki Vesola OK, thank you so much.

Operator Thank you. Our next question comes from the line of Tomi Railo of DNB. Please go ahead, your line is open.

Tomi Railo Yes hi, this is Tomi from DNB. Coming back to this recent question, can you say anything about the second half profitability or profits in MEW given that the workload is improving, and do you think that you can reach break-even for the full year?

Jari Ålgars As you know, we are not guiding for the segments separately. I think we still need more orders in metals, energy and water to come up to volume levels where we would be well in the profitable area, but it's a good start what we've seen in the ordering take so far this year, so we are quite content with the order intake that we have but we definitely would need to see this continuing and rather on an increasing trend than a decreasing trend from the numbers we saw in the first half of the year, but with those volumes we should already be in the safe zone.

Tomi Railo Then if you can help a little bit on the 250 million Russian copper order, how much of that could be booked in the third and fourth quarter this year?

Jari Ålgars Our plan is that we would be able to book it all.

Tomi Railo OK, and then if I may, you have had a couple of good quarters with the shut-down and modernisation orders and you also write in the report that the enquiries increased. Should we read this as that there should be further good modernisation and shut-down orders in the coming quarters?

Jari Ålgars Yes, we believe we will see that also going forward. It's been a good year so far and we have no reason to believe it should not continue in the same way.

Tomi Railo Thank you, and finally fixed costs are up in the quarter. Is this level of increase also something representative for the second half and the full year?

Jari Ålgars I think it was a little bit because we had quite big orders that we were quoting for and provided there are a number of those I would say we are not guiding for the fixed costs separately, but our aim is still to keep the fixed costs flat as we've been stating year on year. This is part of our strategy and it's something we are working hard on. We don't want to see it starts to increase.

Tomi Railo That was the reason I was asking! Thank you very much.

Operator Thank you. Our next question comes from the line of Omid Vaziri of Jefferies. Please go ahead, your line is open.

Omid Vaziri Hi, thanks for taking additional questions from me. How has the market demand for the output product of this ilmenite project changed since the issues came to light last year?

Markku Teräsvasara No, it has not changed dramatically. Of course, as we discussed earlier there is a demand for this production, the capacity is needed as much today as it was needed some months ago so no change in that area.

Omid Vaziri Thank you, and how best would you characterise the strength of that demand need?

Markku Teräsvasara There are not so many ilmenite smelters. If you look at the combined, depending on whether you are counting the number of bigger size furnaces or if it's the number of smelters, as such. We talk about 10 or even less than 10 depending on how you calculate them, and with an annual production maybe up to 7 million tonnes and if 500,000 tonnes are missing then of course it's a big piece of that.

Omid Vaziri Yes, I understand, thanks very much. That's all from me.

Operator Thank you. Our next question comes from the line of Tom Skogman of Carnegie. Please go ahead, your line is open.

Tom Skogman Yes, this is Tom Skogman from Carnegie. I remember you said earlier in the year that if you get good orders this year for metals, energy and water you can still reach the 2020 10% EBITDA margin. Can you still stand behind this or is it too late now?

Jari Ålgars We obviously have our targets where we have them and we are working hard for that. As we said earlier it requires a certain amount of volume for us. As Markku pointed out already, we are at quite good levels in minerals processing and starting to reach super cycle levels. Obviously, metals, energy, water we are definitely very far from super cycle levels still, so we would need a significant order still in MEW. That paired with some additional ways to improve our profitability, I think we still have a good chance of reaching good numbers in 2020 and obviously our target is, as we have pointed out, 10%, so we have not made any changes to that. That's our official target.

Tom Skogman Then I wonder about these legacy projects, apart from the Saudi Arabian project. These were supposed to be finalised a long time ago, so I hope you could be a bit more open about this now that the deal with Metso has been announced. What is really the challenge or the problem with these ones? Is it that your technologies are not working or that the customers have problems with financing? What's really going on and is there any work being done on these ones at the moment?

Jari Ålgars There is work being done with these ones at the moment. Many of them are already quite close to finalising, maybe there are still some discussions with the customer on how to really close it out. There are a number of them that are there and then there are a couple of ones, of which Crystal is one, where we still have work to do. We are not expecting any material impacts from any of these, but it is very much like with Crystal, you hope things would move faster than it eventually does. Still, we are working very hard on the other ones, so they would be finalised in this year or at least at a point where we can say the same thing as with the other projects -- that we have reached the point where we see that there is really nothing to be done any more, but we have not closed out with the client.

Tom Skogman OK, so is it that they are not performing according to the promised efficiency levels? What are these problems really?

Jari Ålgars Obviously it's usually not only one thing so there are many things to optimise in such a plant. It can be on the customer's side, it can be on our side. It's just something we are working to finalise but usually there are always some technological things as well, so it's always a number of things affecting it before we then reach the level where we can say that the plant is running as it should.

Tom Skogman Do you have any new timetable now when it's a clear delay, to start the rebuild of the ilmenite plant is now clearly delayed. Do you have any new timetable?

Markku Teräsvasara No, I think what I said already earlier is that we have negotiations ongoing with the customer at the moment. It's taking more time than anticipated so maybe it would be wrong to set a deadline for those but of course we are doing it together, we also know that ilmenite plant capacity is needed on the marketplace and we also know that when it comes to that project but also when it comes to other projects we are provided for the risk that we see.

Tom Skogman Talking to investors, there are a lot of investors that have no patience with the MEW business and think it should just be divested in the new entity together with Metso, but I realise there's a lot of good value there in copper smelting, et cetera. But could you give a good argument for those parts in MEW that you think have the biggest value apart from the copper smelters? Have there been any orders taken the last five years that have created a massive headache for you or is it all about these old orders?

Markku Teräsvasara I think we should talk about these so-called high-impact products. We've said it many times that they are all from 2015 or earlier, so in that sense, the recent orders we are comfortable with the portfolio we have, and we are also comfortable with the provision level that we have against them. When it comes to MEW business as such, I think of course it's not one single business, it's a number of different types of businesses and also the outlook for them or cycle is not exactly the same. Hydrometallurgical plants solutions they have been very fast-growing, and also, I think can be compared to the MP business as such. We have the smelting competence, we have sulfuric acid plants, pelletising, there are a lot of businesses, however they have different market situations and different cyclicality and we continuously need to wait and see how we can push them forward.

Tom Skogman OK, thank you.

Operator Thank you. Just to remind everyone, if you would like to ask a question, please press 01 on your telephone keypad. There are no further questions at this time. Please go-ahead speakers.

Rita Uotila Thank you, operator, and thank you to everyone for participating and the good questions and discussion. We will close the briefing as of today and just as a reminder there will be a recording on our website for later on-demand listening. Thank you everyone and have a good weekend.