EDITED TRANSCRIPT
SSAB.ST - Q1 2018 SSAB AB Earnings Call

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CORPORATE PARTICIPANTS

Håkan Folin SSAB AB (publ) - Executive VP & CFO
Martin Lindqvist SSAB AB (publ) - President, CEO & Director
Per Hillström SSAB AB (publ) - Head of IR

CONFERENCE CALL PARTICIPANTS

Alain Gabriel Morgan Stanley, Research Division - Equity Analyst
Anssi Kiviniemi SEB, Research Division - Analyst
Antti Kansanen DNB Markets, Research Division - Analyst
Carsten Riek UBS Investment Bank, Research Division - Executive Director, Head of European Steel Research and Equity Analyst, European Steel Research
Cedar Ekblom BofA Merrill Lynch, Research Division - Analyst
Johannes Grunselius Handelsbanken Capital Markets AB, Research Division - Research Analyst
Ola Soedermark Kepler Cheuvreux, Research Division - Equity Research Analyst
Seth R. Rosenfeld Jefferies LLC, Research Division - Equity Analyst
Tom Zhang Crédit Suisse AG, Research Division - Research Analyst

PRESENTATION

Per Hillström - SSAB AB (publ) - Head of IR

Ladies and gentlemen, welcome to this presentation by SSAB of the first quarter 2018. A special welcome also to you that follow us via the webcast. My name is Per Hillstrom. I’m Head of Investor Relations at SSAB. And this is the agenda for today. We have our President and CEO, Martin Lindqvist who will take us through the first quarter performance by division. We have our CFO, Hakan Folin, who will talk about the financials. Martin will come back here and talk about the outlook and after that, we will open up for questions. Both here in Stockholm from the floor and also from the phone line.

So by that, please Martin, take the stage.

Martin Lindqvist - SSAB AB (publ) - President, CEO & Director

Thank you, Per. So to start with some kind of summary. I would say that the market is quite okay. I think we generally see good demand in most markets, most segments. We saw that in Q1. We see that going into Q2 as well. Also, think that we saw a good demand and good development in our strategic growth areas. Q&T, automotive and so on. And when we look into Q2, we have a positive outlook when it comes to volumes and prices. We improved earnings, we had internal inabilities, I will come back to that, or operational headwinds.

I will talk a bit about EBIT and I will also mention that we with the AGM decided also to take up dividend again in SSAB, which I think is a sign of strength. But to start with the part that I’m not happy is this picture. We had 2 big disruptions or disturbances during Q1. First of all, we are very dependent on the railway between Luleå and Borlänge to ship slabs. As you know, we have the slab facility or the (inaudible) in Borlänge and then we have 900 kilometers of train transport down to the rolling mills in Borlänge.

This first quarter there was lack of railcars. A lot of the railcars were being broken and being repaired. And then we suffer, we can’t really feed Borlänge with slabs. We tried to mitigate that by shipping by both Oxelösund and then take it up by railway to Borlänge. But when this happens, we lose rolling capacity, we will lose rolling volumes, we will delivery volumes and we have a higher transport cost. That is sorted out. It was during Q1. Now the winter is more or less gone, not completely gone, but the trains are moving again as they should.
The second part where we were incapable or had problems was in Oxelösund. When we are tapping the blast furnace you drill a hole in the tap hole and you need to drill it in the middle and we have a laser pointing out where to drill. We missed and we hit the mantle. So we had to stop the blast furnace for 2 weeks for repair and then we lose production, slab production. And then we had -- I mean when you lose slab production, you also lose rolling. So we lost 2 weeks of slab production or steel making and we lost a bit more than a week of rolling, and that gives lower volumes and higher costs. This is also sorted out now into Q2. But these are -- so if the external factors are with us during the first quarter, we had internal problems or disruptions or disturbances during the first quarter.

Taking a look at the market and the prices on decent levels, we have increased prices in U.S. with the USD 200 per tonne so far this year. And you see this is spot prices. They are on a high level. And if you measure spot prices for plate over spot prices for scrap, we are on margins that we haven’t seen for a while. So I would say that market is good, prices are decent and the inventories in the supply chain are not extremely high. There are on a good or even a low level.

Summing that up for SSAB, we made an EBIT of SEK 916 million in the quarter, higher prices, higher costs of raw material, Hakan will come back to that, production disruptions but still ended up SEK 200 million better than a year ago. We had a decent operating cash flow, Hakan will come back to that as well, SEK 761 million, and we continued to decrease the net debt during the quarter.

If we look into the divisions, Special Steels, I would say good demand in most markets or all markets, all segments, globally. Good growth, volume wise and we saw prices moving up in Q1 which we expected. We had higher cost of raw material in Oxelösund and then of course affected by the standstill in Oxelösund in the blast furnace in the rolling mill.

Europe, good demand continued in all segments. EBIT was down compared to Q1. We had higher prices, high raw material costs, transportation issues also leading to lower volumes. Shipments lower than 1 year ago in Europe.

Americas, we saw the trend, the positive trend during the quarter. So March was definitely better than January, and we see that demand continued to improve during the first quarter with prices 1 continued to increase during the first quarter. And as you know spot prices increase, you see the effect in SSAB’s figures, but there will be a delay of course due to contract structure and so on.

The result was up compared to last year, higher prices, higher volumes but last year we had the maintenance outage in Mobile in Q1, Q2, which we didn’t have this year. We also saw higher scrap costs, but we saw margins gradually improve during the first quarter.

Tibnor, for flat products, I would say, decent development what we suffered from was building related products or building related volumes where we had the lower shipments during the quarter compared to 1 year ago or compared to the fourth quarter. And Ruukki Construction affected by the harsher winter than we had a year ago. So if there is a lot of snow, there are no roof repairs and so on. So we definitely felt that during the first quarter and sales were lower than 1 year ago when we had a milder winter. So when we sum up it we see lower volumes and lower margins. But this is, I mean, call it an accelerated seasonality than due to a lot of snow, especially in the Nordic region. Hakan?
On the variable COGS side, we had a negative impact of more than SEK 1.1 billion. If you only take the raw material part of that, it's actually SEK 1.2 billion. So basically offsetting what we have seen so far on the price increase side.

And we had a higher fixed cost in this quarter compared to last year and higher activity level in the downstream operations, also general salary increases. What I think is important to mention, I think I did that last time as well, is that in terms of fixed manning, we are actually at exactly the same level that we were after we have finalized the redundancy programs at the end of 2016. What we have done to manage the increased activity level is that we're using more temporary manning. But fixed manning is exactly on the same level. So we can quicker, if and when the downturn comes, adjust our manning as well.

We saw quite a lot of positive impacts from foreign exchange, SEK 280 million. That's because the Swedish krona strengthened against dollar and we buy, for the Nordic operations the coking coal and iron ore in U.S. dollar, so stronger krona there helps us. On the other hand, the krona has actually weakened against the euro and we have a lot of sales in Euroland and then when we translate that back to Swedish krona, we get the positive impact.

The last part here, other, is mainly due to that in this quarter we have higher -- we are running the facilities at a higher pace. We have lower under absorption compared to last year, but all in all, adding up to a bit more than SEK 200 million. When we look at it sequentially, you can see it's actually quite a small improvement in result, it's only around SEK 75 million. But you should remember that in Q4 last year, we had SEK 265 million in compensation for the breakdown that we had in Oxelösund 1 year ago. So if you would adjust for that, the increase is around SEK 350 million. Higher prices compared to Q4, all 3 steel divisions, Americas, Europe, Special Steels, biggest increase in Americans. Volume moving upwards. Special Steels, Europe moving in the right direction, but Ruukki Construction and Tibnor going down compared to Q4.

And on the variable COGS side, we see actually higher increase than we see on the price side, given that the raw material has, and I'll come back to that, but has increased quite a lot. Somewhat lower fixed cost partly because we had a maintenance outage in Q4. Also here some positive effects for the same reason and then other being around SEK 200 million negative and the biggest portion then being this insurance compensation of SEK 265 million.

If we look at the cash flow then, as Martin mentioned, we had a decent operating cash flow of SEK 800 million. We also had a positive net cash flow of SEK 300 million. And we did this despite having a working capital buildup of around SEK 800 million. And I think this, all in all, is rather okay if you look back at what we did in Q4 where we had a working capital release of SEK 1.7 billion. We typically have a working capital release in Q4 because we sell less towards the end of the year. But this quarter I would say was extraordinarily large and we had an operating cash flow of close to SEK 3 billion in Q4. So given that I think what we achieved this quarter is actually still quite okay.

And if you look it at the longer trend how does it look then? Well, this is rolling 12 operating cash flow from the start of 14 up until today. I would say we used to hover around maybe SEK 3 billion here. But now we are actually lifting ourself up to SEK 6 billion. And when I look forward, we believe we can generate better profitability helping cash flow. We will have a CapEx that's clearly lower than depreciation and amortization. We have potential to continue reduce working capital over sales, that ratio. We did that again in Q1. Otherwise, we would basically not have been able to have a positive cash flow. With lower absolute level of our debt and also with increased credit performance, we will have lower interest costs and with a tax rate of around 20%. Adding these factors up, we are rather confident that we can continue and will continue to generate good solid cash flows.

I will not spend too much time on the balance sheet side, but some words about our maturity profile and our net debt situation. We have in the coming 3 years, '18, '19, '20 around SEK 9 billion in maturities. Not so much in '18, quite a lot in '19 and then again quite small amount in '20. And we will during this year start working [with hope to] improve the situation for '19. So we don't enter '19 with that state by looking the same way. We have an overall duration of 5.5 years. So it's actually quite a long duration on the debt portfolio. On the net debt and on the net gearing they both decreased somewhat during the quarter, net gearing from 22% to 21% and net debt is now down at SEK 11.4 billion.

So coming back into the [raw] material, as I talked about in the bridges, we have seen overall purchase prices have increased. We start with the main components for the Nordics operations and iron ore and coking coal. Our purchase prices both increased during the quarter. Iron ore, 18%, coking coal, 23% and for iron ore, part of the increase that we get from purchase prices during Q1 will also impact the result in Q1 and that's mainly
for the operations we have in Luleå where we have -- where we don't basically have any stock of iron ore but we get it on a daily basis from LKAB and then it also quicker hits the P&L. If you compare with Oxelösund and Luleå, we will see the impact of the price increase for us coming more into Q2.

Purchase price for coking coal increased actually in percentage wise more during the second quarter -- sorry, first quarter for us. However, the main purchases for coking coal we do in Q2 and Q3 given the -- that we have the winter stock in Luleå [iron ore] but also that we will see an impact of higher raw material cost in the second quarter.

We move then to the U.S. operations where we use scrap. The upwards trends that we saw in Q4 also continued moving up now in Q1. And our purchase prices they were up 23% in Q1 versus Q4, which obviously then these we turn around rather quickly. It's about around a month of lag from when we buy until it goes into our P&L. So we saw these higher prices already now in the first quarter in the Americas. When we look at spot prices, and this chart is [book] prices, we actually also see that in April scrap prices are continuing moving upwards. And this long trend of increased scrap prices from basically beginning of Q4 and up until today, it's actually quite unusual. Typically when the spring season comes it is easy to collect scrap, prices usually moves down. But we have not seen that so far this year. And the main and the logical reason for that is that, EAF steel producers just like us are running at high capacity utilization then increasing demand for scrap.

Okay, to the outlook, Martin.

Martin Lindqvist - SSAB AB (publ) - President, CEO & Director

Thank you. So when we look into the second quarter, we see that in North America, demand for heavy plate is expected to continue to remain strong. In Europe, the demand for strip and heavy plate is also expected to remain good. Underlying demand for high-strength steel also good and prices realized in the 3 steel divisions will be somewhat higher in the second quarter compared to the first quarter and I would say especially for SSAB Americas. And if you look at the volumes or volume trends, higher volumes in Europe and in Americas, Special Steels, we had a very high level in Q1. So we expect it to be fairly stable or slightly lower in Q2.

So looking externally for demand and prices and so on, it looks quite okay going into Q2. I would like to end with this picture talking a bit about our project HYBRIT, the way we try to figure out how to produce steel without carbon dioxide. We closed to the pre-feasibility study in Q1 2018 and we have found nothing in the pre-feasibility study that makes us believe that this is not possible. I would say quite the opposite. So we have decided to start to build the pilot plant together with LKAB and Vattenfall in a joint venture. We will have the first groundbreaking ceremony during the summer and we will build this during -- take 1.5 year and then we will start to do bigger trials and then we are planning to build a production plant or a demonstration plant from 2025. So, so far so good. And we have also in laboratories and in tests produced first steel according to this method and we will now, as said, start to build the shaft the hydrogen generation and also the hydrogen storage in the pilot scale up in Luleå and [Malmfälten].

So to sum it up, generally good demand, most markets, most segments. Good growth in strategic areas, special steel and automotive, positive outlook, volume and price. And we saw in Q1, despite the problems we had, the problems amounted to somewhere between SEK 202 million to SEK 250 million. Those 2 examples that I gave you despite that we saw improved earnings compared to Q4 and Q1 last year.

So with that, Per, I think we open up for questions.

QUESTIONS AND ANSWERS

Per Hillström - SSAB AB (publ) - Head of IR

Yes. And we can start here in Stockholm. Please state your name and company and also to make it more easy if you have several questions please state them one at a times so they can answer in between here. So we start with Ola there maybe.
Ola Södermark - Kepler Cheuvreux, Research Division - Equity Research Analyst

Yes. Ola Södermark, Kepler Cheuvreux. Very good that you quantified a problem you're having in Oxelösund -- you had in Oxelösund with the logistic to Borlänge. Is it possible to split it out, so around SEK 100 million each or [just over].

Johannes Grunselius - Handelsbanken Capital Markets AB, Research Division - Research Analyst

It's Johannes here, Handelsbanken. I have 2 questions. The first one is basically on Q1 and pricing and you indicate the prices are up and at the same time input costs like coal, iron ore is also up. Could you perhaps talk a little bit about those 2 moving parts together? I mean, basically, I am after the EBIT per tonne or margin and so forth.

Håkan Folin - SSAB AB (publ) - Executive VP & CFO

If you talk about Americas, I will start there, we saw increased prices, but [around that] you saw how much the scrap was increased and we saw that the result as such was not fantastic. What we saw during the quarter in Americas was that clearly the longer the quarter went, the more we got our price increases implemented and therefore the result gradually improved during the quarter and that's basically what we are expecting for -- that trend we expect for the next quarter as well. If you take the Nordic operations or the production using iron ore and coking and coal, there was a sharper increase on the iron ore side than we had expected that come -- you can say that came after we had negotiated the Q1 contract. So in that sense, we got bit of a margin squeeze in Europe, especially, I would say, because that was where we get the quicker impact from the higher iron ore costs.

Johannes Grunselius - Handelsbanken Capital Markets AB, Research Division - Research Analyst

But is it fair to say that most of the higher iron ore prices, coal prices are in the books or in the P&L in Q1 and we should see more of an effect, but less effect on a sequential basis in Q2?

Håkan Folin - SSAB AB (publ) - Executive VP & CFO

I would say you will see, if you take iron ore and coke and coal again, you will see higher cost in the Q2 as well but not as much. If you compare Q2 to Q1 what we see right now it shouldn't be as much as it was Q1 to Q4, if you understand.

Johannes Grunselius - Handelsbanken Capital Markets AB, Research Division - Research Analyst

And perhaps also another moving part, FX, you have a very strong euro. You mentioned that also in the earnings bridge as positive, but I also know there is a lagging effect when it comes to FX. We will see more of a head -- sorry, tailwind from FX would you say in the coming quarter?

Håkan Folin - SSAB AB (publ) - Executive VP & CFO

What I would say, if euro stays -- euro/SEK stays the way it is, yes, again, since we sell more in euro than we have cost, that will have a positive impact, yes.

Johannes Grunselius - Handelsbanken Capital Markets AB, Research Division - Research Analyst

I'm also wondering a little bit about the price levels you had on average at least for -- if we look at the average prices for special steel, it actually looks like it's slightly down quarter-over-quarter. Do you agree on that or is it more of a mix effect or what's going on there?
Martin Lindqvist - SSAB AB (publ) - President, CEO & Director

[Mix and] other things, but the prices are not per product moving down in the first quarter. I would say the opposite.

Håkan Folin - SSAB AB (publ) - Executive VP & CFO

No, there are.

Martin Lindqvist - SSAB AB (publ) - President, CEO & Director

There are.

Per Hillström - SSAB AB (publ) - Head of IR

Okay. [We see] no further questions here right now. So I will ask the operator, please to give the instructions for the phone line.

Operator

(Operator Instructions) Our first question comes from Alain Gabriel of Morgan Stanley.

Alain Gabriel - Morgan Stanley, Research Division - Equity Analyst

Two questions from my side. If I may start with the first one on the outlook. If I go back to your comments is it fair to assume that you expect the spread between prices and raw materials to expand further in Q2 for Europe and Special Steels? And for Americas in the same context, are there any contracts that we should take into account while calculating our forecast for Q2 like we had 2 quarters ago when you had fixed contractors, they didn't allow you to capture the full extent of the spread's movement for the spot prices? That's the first question.

Martin Lindqvist - SSAB AB (publ) - President, CEO & Director

Okay, if I understood you correctly, you were wondering about the spread, how that will move when we go into Q2. And what we guided for was that we expect to see price increases during Q2. What we know right now on the raw material that's being developed during the quarter, I would say that, yes, we do expect some spread increase in Q2 as well.

Alain Gabriel - Morgan Stanley, Research Division - Equity Analyst

And for Americas will you capture the full extent of the spread movement or are there any fixed contracts that we need to take into account, like what happened in Q2?

Martin Lindqvist - SSAB AB (publ) - President, CEO & Director

Yes. We have a structure of the contracts so we have a lag in Americas.

Alain Gabriel - Morgan Stanley, Research Division - Equity Analyst

The usual lag.
Martin Lindqvist - SSAB AB (publ) - President, CEO & Director
So there is a time lag between spot price movement and the P&L effect.

Alain Gabriel - Morgan Stanley, Research Division - Equity Analyst
So the usual 2-month lag basically, right?

Martin Lindqvist - SSAB AB (publ) - President, CEO & Director
Sorry, sorry.

Alain Gabriel - Morgan Stanley, Research Division - Equity Analyst
The usual 2-month lag, right?

Martin Lindqvist - SSAB AB (publ) - President, CEO & Director
The usual lag.

Alain Gabriel - Morgan Stanley, Research Division - Equity Analyst
Okay. Fine. And the second question is on capital allocation and I was just wondering if your -- how your views are evolving on the trade-off between your priorities on deleveraging versus seeking organic growth. Do you mind sharing with us your latest views on that?

Martin Lindqvist - SSAB AB (publ) - President, CEO & Director
I think a steel company needs to have a strong balance sheet and if I think about it for SSAB I think we should be able to do investments in our own facilities, regardless of business cycle and that requires a strong balance sheet. I think we should also be capable of over time paying dividends to our shareholders. And thirdly, I think in an opportunistic way, especially in the downturn, we should be strong enough to do things that will develop SSAB long term regardless of business cycle. So we will continue to focus on working capital efficiency and as Hakan said, we have a very decent chance of continuing generating strong cash flows and that is what we are planning to be, a much stronger company then the next downturn and able of doing things that is longer term the right things to do for SSAB.

Operator
Our next question comes from Tom Zhang of Credit Suisse.

Tom Zhang - Crédit Suisse AG, Research Division - Research Analyst
I've got 3, if I may. The first one just on the U.S. demand-supply dynamic with [S 232]. Could you just give an idea of how much firstly on the demand that you are seeing, how much of that is sort of underlying and how much you think is driven by sentiment restocking? And then on the supply side, what has been the impact of 232 on imports relative to demand? Can you give a sense of utilization prior and post S 232 particularly with the recent exemptions? That's my first question.
Martin Lindqvist - SSAB AB (publ) - President, CEO & Director

[Start with last one]. I think that there are a lot of exemptions for 232. So I can't give you an exact figure of what is underlying demand and what is potential or trade barriers. I think the underlying demand, especially in the segments that costumes heavy plate is moving in the right direction. And for us, I mean 90% of what we sell in U.S. or North America we produce locally in Mobile and Montpelier. Roughly 10% is exported from mainly Sweden and to a small extent from Finland. The large portion of those products are products that are not produced at all in North America. So for us, I mean, EU obviously has an exemption right now. But for us, this is so far at least from an SSAB perspective, not a big deal.

Tom Zhang - Crédit Suisse AG, Research Division - Research Analyst

Okay. And also with the iron ore contract, I see that the LKAB contract is now completed. Is that being renewed and can you share any details on how the pricing is determined both with respect to iron ore and the pellet premium?

Håkan Folin - SSAB AB (publ) - Executive VP & CFO

You're absolutely right. The contract was from 1st of April '17 up until the end of March '18. We are now negotiating with LKAB for a new most likely then same yearly delivery contract again. But those negotiations are not finalized yet.

Tom Zhang - Crédit Suisse AG, Research Division - Research Analyst

Okay, fair enough. And very finally, special steel margins are down this quarter clearly part of that is going to be the production outage. But at the end of Q4, you were talking about value weak mix. I think last year, you've alluded to continued weak mix this quarter. Can you give an idea of how you think that will progress going forward?

Martin Lindqvist - SSAB AB (publ) - President, CEO & Director

It's always hard to predict the mix. The only thing I know is that margins per product is moving up.

Operator

Our next questions come from Seth Rosenfeld of Jefferies.

Seth R. Rosenfeld - Jefferies LLC, Research Division - Equity Analyst

Just starting out on your Europe and Special Steels business, despite operating issues that you flagged in those 2 businesses when I look at your actual reported shipments they came roughly in line with at least our own expectations. Can you just comment on how you are able to bridge that gap between a disappointing production and pretty decent shipment figures? Were there meaningful draw-down of semis inventories in those 2 businesses and if so, should we expect some rebuild inventories in the Q2 or otherwise an impact on your cost base?

Håkan Folin - SSAB AB (publ) - Executive VP & CFO

If you take the shipments -- take one division at a time, and start with special steel their shipments were definitely good and you should remember there is a lag from when we produce in the blast furnace until we actually get the material out and ship it to customer. So the impact wasn't that large in Q1. Also for special steel (inaudible) one site and it's the site that's being managed by Special Steels. But we produce these type of products also in Borlänge, Raahe and Mobile and we sell a lot from stocking special steel. So, therefore, the impact on special steel was not seen in the
shipments as you concluded. On Europe on the other hand, shipments in Europe are down 4% in Q1 this year versus Q1 last year. And that was actually to a large extent due to that we had this rail transportation issues.

Seth R. Rosenfeld - Jefferies LLC, Research Division - Equity Analyst

So in the case of special steel then given the differential byproduct or by production side as well, should we expect any change in your operating cost going into Q2 or will you need to rebuild those inventories looking forward [or often especially if we] assume a full reversal of that SEK 200 million to SEK 250 million cost headwind that you flagged earlier?

Håkan Folin - SSAB AB (publ) - Executive VP & CFO

I don’t think you need to -- you can make it easier and just say that those around SEK 200 million should be coming back in -- or should be adjusted for in Q1 when you check the run rate going into Q2.

Seth R. Rosenfeld - Jefferies LLC, Research Division - Equity Analyst

Okay. And one last question, please, on the U.S. market. We’ve seen from some of your peers, perhaps something of a divergence in pricing expectations. People are expecting something of a sustainability kind of a flat pricing on the flat product side, but perhaps a bit of a catch-up coming through on long products. How would you classify the current pricing environment for plate in the U.S.? Do you think there could be potential for further upside or is it flat that is as good as we can hope for right now?

Håkan Folin - SSAB AB (publ) - Executive VP & CFO

Prices, if you look at spot prices or I would say spot margins, spot prices over spots graph, they are at somewhere around USD 600 per tonne which is historically high. I mean the long-term historical equilibrium is somewhere around or below SEK 500. So in the last couple of years, we have seen margins between SEK 350 and SEK 400. So I think without giving any prognosis of U.S. plate prices, I think the margins -- spot margins are on good levels.

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

Just a couple of follow-up questions from my side. The first one on the net working capital, because you mentioned you had a very -- given the facts where we are in the cycle, very good net working capital or not as much net working capital buildup, let’s put it that way. The operational issues clearly helped here, I would say, as well as the FX. Could that actually have a negative impact going into the next quarters because those effects modestly reverse? That’s the first question.

Håkan Folin - SSAB AB (publ) - Executive VP & CFO

No, not really, not major negative impact, no.
Martin Lindqvist - SSAB AB (publ) - President, CEO & Director

You should expect us to become better and better managing working capital. We are running a project and we measure capital turnover and we see that we are gradually -- slowly and gradually making improvements and we still have a way to go.

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

I was just hinting on the 200,000 tonnes you have to rebuild in your inventories which definitely don’t go unnoticed I would guess in your inventory buildup.

Håkan Folin - SSAB AB (publ) - Executive VP & CFO

But if you take the -- if you take the problems that we have with the rail transportation, we were actually still producing the slabs. We only had problems getting them from Luleå down to Borlänge. It took longer time, they didn’t get them in the right sequence. So we actually had those slabs in the company. It’s just that we couldn’t get them to Borlänge and roll at the time when we wanted to.

Martin Lindqvist - SSAB AB (publ) - President, CEO & Director

[So we will move into] finished goods and then ship material during Q2. But the slabs were produced.

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

[Even in absolute term] I’m just trying to actually [tighten up] you said it’s a 2-week outage in the blast furnace which you can’t produce material, but you still managed to produce material. I’m just getting a bit...

Martin Lindqvist - SSAB AB (publ) - President, CEO & Director

No, no, no. We are talking about the -- Hakan was referring to the problems with the transport. It’s railway transport in Europe. In Special Steels, yes we lost production and we need to catch that up, yes.

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

Okay, good. Then I understood it correctly. On the financials, if I look at the improvement year-over-year it looks like the most positive effect came out of FX because if I take out FX, there was not as much improvement. Do you expect that this is actually going forward to look a little bit better that underlying the operational results get stronger?

Martin Lindqvist - SSAB AB (publ) - President, CEO & Director

Yes.

Operator

Our next question comes from Anssi Kiviniemi of SEB.
Anssi Kiviniemi - SEB, Research Division - Analyst

It’s Anssi. Couple of left. First of all, on U.S. plate prices we are seeing a tremendous rise. Are there any factors that would support the trend, meaning that we wouldn’t see the normal seasonality with plate prices coming down during the summer? What’s the situation in the market? Everybody is raising prices. How are inventories and what are customers saying?

Martin Lindqvist - SSAB AB (publ) - President, CEO & Director

Inventories are on fairly normal to decent levels. So there is no big inventories as we can see in the statistics in the supply chain or in these service centers. When we talk to customers like yellow goods producer, agriculture and so on, they have a positive outlook. So they are positive. So – I mean we are not expecting – the demand – underlying demand in Q2 will continue to be good. Then what happens with prices is always hard to predict. We are fairly certain of the – I mean we have visibility in Q2, what will happen after summer we don’t have full visibility.

Anssi Kiviniemi - SEB, Research Division - Analyst

Okay. Then a little bit on the capital allocation. You have highlighted HYBRIT project quite meaningfully during the past few quarters. And just thinking about the future investments, looking at 2, 3 years onwards, what kind of CapEx are we talking about when we think about HYBRIT? And will that -- those CapEx figures offset your so-called normal business or how should we look at the investments?

Martin Lindqvist - SSAB AB (publ) - President, CEO & Director

Over time you should look at the investments within SSAB that we are moving from coke oven batteries and blast furnaces over time into electric arc furnaces being fed by hybrids, DRI or what you call it as sponge iron. From a pure SSAB perspective, that will mean 2 things, that will mean lower investment levels because we don’t have to reinvest or rebuild blast furnaces and coke oven batteries which is typically very expensive. And secondly, this will mean better flexibility, because as you know blast furnaces are built for running 24/7 without any stoppages for 15 years. And then you do a realigning and then you continue for another 15 years. If you exaggerate a lot you can say that an electric arc furnace is a red and a green bottom. So when you run, you push the green one, and when you once run, you push the red one. So from a pure SSAB perspective, over time, lower investment costs and better flexibility. On top of that also with the prognoses for emission rights and so on, I would say also a better cost position compared to continue over time running blast furnaces and coke oven batteries.

Operator

Our next question comes from Cedar Ekblom of Bank of America.

Cedar Ekblom - BofA Merrill Lynch, Research Division - Analyst

2 questions from my side, gentlemen. The first one is quite simple. Can you just talk about Ruukki Construction? Obviously losing money at EBITDA, I appreciate that there were some seasonality effects there, because of the harsh winter. But is there more that you can do on the cost side there to improve profitability? And how do we think about potential exit of the asset? I know that it has been earmarked as non-core for a while. Is there any update there? That’s the first question. And the second question relates to spreads in your European business. If we assume that we add back the costs associated with the issues on production and logistics in the first quarter and we normalize for currency, I’m only getting about a $10 per tonne improvement in your margin in that business year-on-year. And steel prices year-on-year on average were flattish in Q1 of 2017 and in Q1 of 2018. But you had quite a big tailwind from lower raw material prices, both iron ore and coke and coal if I look at the year-on-year difference. So I’m just trying to understand is there something in the business that we should be aware of as it relates to your sensitivity to steel and raw material prices on a spot basis where your reported improvement in profitability seems to fall a bit short of sort of spot improvement in profitability? And also on the downside, when we saw the downturn in 2015, reported margins held up better than where spot margins traded to. I’m just trying to
understand the operational sensitivity or leverage to the price trends that we are actually seeing in the spot market and how optimistic we should actually be on the potential for those improved margin to come through in steel companies’ bottom line?

Martin Lindqvist - SSAB AB (publ) - President, CEO & Director

Okay. If I try to answer the first question, of course, there is always more to do within cost effectiveness in all areas and that includes Ruukki Construction. So I think what we saw in Q1 was a strong seasonality, quarters like that with a lot of snowing in the Nordic region and so on. I expect to see a normal seasonal pattern when the spring and the summer comes. But having said that, of course, we’re working with costs and we’re working a lot with continuous improvements in Ruukki Construction. Then when it comes to keeping the whole or parts of Ruukki Construction, there is no update. We will come back if and when we decide to do something.

Håkan Folin - SSAB AB (publ) - Executive VP & CFO

And on the second question on the spreads in SSAB Europe, I think there are two things to consider there. One is that if you only look at spot, I would assume maybe you look at fines for iron ore and we are a 100% pellet producer using pellets. And actually the pellet prices have moved in a different direction than the iron ore fines. So pellet premium have increased quite a lot and that will also have an impact on our spreads. That is one thing when you compare Q1 to Q1 in Europe. The second one, I would say is that when -- for Q1 2017, we negotiated the quarterly and half-year contract around November time 2016 and that was actually when the coke and coal was at the highest price and also iron ore was fairly high. So -- and then we set the contract for the first half year and then raw material prices went down. So at that time, we were a little bit lucky in terms of timing of raw material versus our sales prices. And if you compare Q1 this year then actually raw material prices started to increase in the beginning of the quarter when we had already settled the contract during potentially around November-December down 2017. But I don’t think there is any other things that are fishy or should be difficult to understand, except for those 2 factors.

Operator

(Operator Instructions) The next question is from Antti Kansanen of DNB.

Antti Kansanen - DNB Markets, Research Division - Analyst

Just one question from me, please. Still coming back to the mix issues in Special Steels, could you comment a little bit about that? Is there a -- is it due to seasonality? Is it due to certain end-use segments having better demand than others? So what is causing this negative mix for 2 quarters in a row?

Martin Lindqvist - SSAB AB (publ) - President, CEO & Director

I would say that the strongest profitability or the best margins we have are on the most advanced products and they are typically produced in Oxelösund. So, I mean if you take [out of 600 or 500 of] those products and figure out, we have the best possible or call it the best margins on those products and then it differs. I mean Special steels are responsible of selling hot rolled above 700 megapascal. So obviously the (inaudible) has much higher prices and better margins compared to a 700 megapascal strength (inaudible). So there is a spread there. So I wouldn’t say that there is seasonality. It’s more what customers buy and what we are able to produce. So I wouldn’t say that customer segments demanding higher margin products or doing worse than other segments, I would rather say maybe the opposite because it’s yellow goods, its mining and some other areas that typically take those volumes that are also doing fairly well.
And you wouldn't say that the problems that you were experiencing in Oxelösund a year ago that prevented a little bit of price increases that they don't have any spillover effects that are causing this negative mix or anything like that?

As I said before, I think we were having problems increasing prices in the right pace during 2017. And I think, we lost maybe a quarter or 2. And of course, there is always a bit of a challenge for our sales organization to discuss price increases with customers more or less that upset because of the lack of volumes. So I think we were not really on our toes when it comes to that -- it came to that in 2017. We could have done better.

As there are no further questions, I'll hand back to our speakers for the closing comments.

I am curious what's your view here on U.S. plate and supply? I have seen in the news flow that there is apparently an investment in Texas that will come out in the market, maybe '19 or '20 or something like that. But what's your view on your own capacity? I remember a few years ago there was thoughts about expanding in the U.S. and tweaking out more volumes? How do you see that now?

I think we will always have due to continuous improvement the capacity equipped. I mean, the U.S. plate market is structurally under supplied. We are not planning to build a new mill or something like that, but we are of course due to continuous improvements and debottlenecking gradually increasing capacity, but we will not build another mill. And then the mill that I mean that already exist in Texas, what they are talking about is that being [host down] capacity and they have probably been like Oregon dependent on imported slabs. And that becomes a bit more problematic now with the Section 232 and also with the tariffs. So the U.S. plate market is structurally under supplied. So there -- I mean I don't see any big differences in that the coming years at least.

Okay, thank you. Thank you, Martin and Hakan and thank you for the intention. And by that, we close this conference and wish you a nice weekend.

Thank you.