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MANAGEMENT DISCUSSION SECTION

Juha Rouhiainen

Vice President-Investor Relations, Metso Oyj

Good afternoon or good morning, ladies and gentlemen. This is Juha from Metso's Investor Relations. And I want to welcome you all to this conference call, where we discuss our Fourth Quarter and Full Year 2018 Results. Results will be presented by our President and CEO, Pekka Vauramo; and CFO, Eeva Sipilä. And after their presentation, we will have a Q&A session.

Before we begin, a couple of things, first of all, we have the disclaimer on the second page of our presentation, and we'll be discussing and using forward-looking statements during this event. And another thing is that we try to wrap up this conference call in 60 minutes. So, please keep that in mind when asking questions.

With these remarks, we are ready to begin. And I'll be handing over to Pekka. Please go ahead.

Pekka Juhani Vauramo

President and Chief Executive Officer, Metso Oyj

Okay. Thank you, Juha. And good afternoon to all of you. Yes, really happy to present our result for quarter four and for full year 2018. We enjoyed, of course, a healthy strong market activity throughout the year, I would say and that was the case also during the Q4. And this is visible in our numbers, very strong growth in orders, sales and strong improvement in profitability as well. We've also started the acquisitions, and during the Q4, we closed two of them, and in full year, we closed altogether three acquisitions, I think they are listed somewhere there later on.

The full year really was reflected by strong market activity in all our markets and in all our businesses and then that, of course, meant that also the full year numbers improved significantly. We need to also note that the Q4 2017 was especially weak quarter, because of the write downs that we had to do about a year ago. In 2018, we continued to execute and implement our growth strategy and also made investments on improving our delivery capability and invested also in R&D. I'll come back to these once – a bit later on.

Our board will propose a dividend for last year €1.20, which is €0.15 more than a year before, and we will transition into semi-annual payments, where half of the dividend €0.60 would be paid in May and the second €0.60 in November this year.

Then, looking more closely on the numbers during the fourth quarter, orders went up by 32% and in fact we had a small negative currency impact, or with fixed currencies we have 35% growth and organic growth in our orders, which is very, very strong performance during the quarter. Sales went up as well. If you remember, we had delivery issues and problems early in the year, but we are able to open, debottleneck our supply chains for the most part. Still we have some issues, but far less than beginning of the year. Our sales went up by 27% and 30% by fixed currencies and reached almost €900 million during the quarter.

Then, adjusted EBITDA almost €100 million; margin, 10.9%; and that is about 50% improvement in terms of actual millions. Operating profit, similar improvement there and earnings per share, €0.42 and like I said, I mean, the comparison is with the quarter that was very weak. Cash flow, €57 million, somewhat disappointing, but this kind of fast ramp up and improvement in supply capability – price capital into our supply chain and inventories and therefore, the cash flow is €57 million during the quarter.

Then, when we look at our segments, Minerals, strong performance there, 35% orders higher than a year before and 39% with constant currencies, extremely strong quarter in order performance. All business areas contributed to this one as well, which is also good, and I would also add that all market areas also contributed to that one. So, we grew throughout the company, which I think considering our global footprint and many things that are happening around us is good performance.

In mining, we didn't see really big number of major projects or complex projects, as we also call them, but we had lots of small and mid-sized orders, which in mining is, of course, risk wise – in fact, better for us than and complex orders are. We saw strong growth in aggregates equipment orders in U.S., China and Nordics and also many other markets, where we're very active in that field. And service orders, of course, I mean, our customers are very busy at this moment and that is reflected in our service orders and sales as well.

Sales went up 29% and with fixed currencies 33%, and growth is driven by equipment, which means that it does reduce somewhat our margins, meaning that in the services side, we have higher margins, which is no new so I think to all of us here. But we are at the face of cycle, when equipment orders are relatively higher than average and therefore, the margins are somewhat reduced and that is visible also in the graph on the page.

EBITDA margin 10.4% improvement over about 1.5% from last year and volume definitely contributed on this one and the equipment order has reduced, or relatively higher equipment orders pressured the market or the margin down.

On flow side, strong quarter as well. Orders up by 19% or 20% with fixed currencies and good growth in services side as well there. The sales up 18% or 21% with fixed currencies, and this is of course, thanks to good order performance in the previous quarters. Improvement in our margin, in our flow side, 16.4%, adjusted EBITDA versus 15.6% the year before, primarily contributed by the operational performance in our factories and supply chain altogether.

And with these short comments, I'll hand it over to Eeva and then, I'll come back towards the end after the numbers, please Eeva.

Eeva Sipilä

Deputy Chief Executive Officer and Chief Financial Officer, Metso Oyj

Thanks, Pekka. Good morning, good afternoon to everyone on my behalf as well. Looking at the income statement, Pekka already commented on the items included in the operating profit, so I'll comment that our net financial expenses are down in the year, mainly due to the repayment of loans during the second quarter of last year; also satisfied with our tax rate, which ended at just below 29% for the year, and earnings per share of €0.42, really a remarkable improvement from 2017.

Moving on to the next slide, as Pekka mentioned, we closed three acquisitions in 2018. So, we wanted to open a bit more for you our organic and non-organic growth in orders and sales. As you can see from the graphs, the organic growth is really behind our strong growth, 22% in both orders and sales were a full year comparison. All M&A impact is included in the structural changes column, but that was in actual numbers only 1% in the full year comparison.

At this point, it is maybe good to remind you all of the structural change impacting our 2019, namely that we divested our grinding media business in early January. The business had sales of some €60 million, so please remember to update your models with this amount being out of Metso as of Q1 this year.

Going back to 2018, so, the foreign exchange rate fluctuation was sizable during last year, as we all know for various reasons. And whilst the impact on Metso was slightly less on the second half than in the first half, it still was at a negative on our headline orders and sales as Pekka mentioned and as well visible on these graphs as well.

Moving to our balance sheet, so really no big changes in the fourth quarter. Comparing the year-end figure, you'll see the CapEx and M&A impact in intangible assets. Inventories ended up €200 million up from a year-ago. And really in order to avoid availability issues with the high growth in demand that we enjoyed, we shifted gears in the beginning of 2018.

And as we then saw results of the ramp-up in our supply chain, we were able to tone down a bit during Q4. But really the sort of negative impact on our cash flow from the inventory build-up, of course, was still significant. Going forward, as said many times during last year, we do need to improve our supply chain efficiency to not have to build up in this way for availability. But the actions in this area are not quick, if we want them to be sustainable.

In a high growth environment, absolute numbers aren't the best indicator, we're really focusing on inventory turns and DIO type of KPIs. The decrease in our liquid funds and in interest bearing liabilities is a result of the previously mentioned debt repayments done last year.

The next slide breaks down capital employed and networking capital a bit more in detail. The decrease in our capital employed, combined with improved profitability contributed to improved return on capital for the year. The graph on the right shows well the inventory increase I just discussed. Despite the strong growth, receivables developed well and we can note the clear improvement in the KPIs on that side, similarly also in payables. Advances were relatively flat as the bulk of our business last year was services, and smaller brownfield driven replacement type of equipment orders.

Then, our cash flow was one of the very few numbers that did not improve in 2018. Net cash from operating activities totaled €177 million. This does include the €21 million additional tax payment done in January 2018 on the ongoing disagreement with the Finnish tax authority on previous year's taxable result. So, like-for-like comparison would show an improvement here despite the negative impact from the change in networking capital of €129 million. The positive future growth related items of CapEx and acquisitions are clearly visible on this slide would €67 million in CapEx and €77 million spent in acquisitions, resulting in a free cash flow then of €146 million for the year.

Finally, on our financial position, our returns improved clearly. And whilst our gearing is up, it continues to be on a very low level at 11.7%. Our interest cover of €13.7 million illustrates that we continue to have a solid financial position that will enable us to develop our business forward.

And with that, I would hand it over back to you, Pekka.

Pekka Juhani Vauramo

President and Chief Executive Officer, Metso Oyj

Thank you, Eeva. And I'll move on to my page 16. And look into what we did during the year. We continued, of course, executing our strategy for profitable growth. We invested in our supply chain, primarily into aggregates equipment, foundry capacity to support – and wear castings and rubber plants to support our consumable business and the high demand on the other side for the aggregates segment of the business. We also took a decision to invest in a greenfield valve plant in Jiaxing in China near Shanghai.

We stepped up our R&D efforts. We still continue to do what need to do, that one going forward. But we did spend €39 million on R&D versus €27 million the year before, €12 million addition to that one. And then if we look further down in digitalization program, where we also invested €12 million during the year. So, altogether, these development activities meant more than €50 million for us and we see that's throw investment into the future and we'll continue to increase those investment as we move on.

And as a result, we launched new products – several new products in different areas, different business areas and we are also – we launched also at the end of the year Metso Metrics, where we want to offer connectivity of equipment delivered to our customers to our performance centers, and will over time, as the connectivity and number of connections grows, will give us possibilities to through Big Data and data analysis to provide value-added services to our customers. We've also developed 3D printing capabilities and we have delivered first valve components, spare parts that are 3D-printed and this of course means totally different supply chain for some of our spare parts in that area.

Moving on to next page, the acquisitions, we announced and we also closed the pyro processing company KFS, Kiln Flame Systems in UK during the year. We closed also a valve company acquisition in India, Rotex and Jonsson och Söner in Sweden, aggregate equipment business during the year. We've signed also agreement to acquire a high service company in Chile, which is a provider of specialized technical services and remote monitoring for mining customers in Chile. This is still pending and we look forward closing that sometime during the first half of the year. We also divested, like Eeva mentioned, the grinding media business and that closed beginning of January, so in this year, and it's worthwhile to remind to update your models for that part.

Then, our board proposes – will propose a dividend of €1.20, which has increased from last year of €0.15, and we will transition at the same time to semi-annual dividend payments, first €0.60 in May and second one in November of this year. The dividend totals €180 million altogether, which is 79% (sic) [78%] (00:18:12) of our earnings per share.

And then, last page, the market outlook. We do see continued growth both in equipment and services businesses, in both of our segments meaning, Minerals and Flow Control. And we have changed the structure how we guide. Now, we were guiding market outlook earlier on, now we talk about market activity. And we will then define the outlook with different wordings, either grow remain at the current level or decline, and we will be guiding the six months as we've done also before, so six months ahead.

And like I said, at this moment, we will see continued growth in both of our segments and both in equipment and services side. And even though, this is not to forecast for our orders, but if you look at our past performance, it has been very strong and we see that one too. Market will support the continuation on that one.

Thank you for my part and I think now it's time for questions.

Juha Rouhiainen

Vice President-Investor Relations, Metso Oyj

Thank you, Pekka and Eeva. And operator, we are ready for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from the line of Klas Bergelind from Citi. Please go ahead. Your line is now open.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Yes. Hi, Pekka and Eeva. It's Klas from Citi. So, a couple of questions from me. So, first on the services, so a very strong growth across all verticals, particularly in mining and in Flow Control, and there were performance contracts and shut down services that came through, which I think surprised some people. To what extent was this a year-end phenomenon, when some shutdowns take place versus actual real underlying improvements, which can see seamless strong growth also in 2019, because selling more mine automation analyzers is becoming a real thing out there. So, I was just wondering if this is a step change and now can continue to generate growth for Minerals going forward? I will stop there.

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

Yeah. Rather difficult to comment whether it has continued, but overall customers are very busy in their operations and activities at this moment and that is, I would say, what is what is driving the strong service sales growth. It's also typical for this time of the cycle – and this phase of cycle that customers are entering into service agreement and performance agreements with suppliers. And we do see steady growth in that one.

On the other hand, we have to say that if we compare with 2017, we've also discontinued several of our service contracts that did not meet the profitability criteria for ourselves. And in that regard, we were able to prove profitability, of course, at the expense of reduced sales for that part. But overall, the growth was good and strong.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

All right. My second one is for you, Pekka. Now that you've been at Metso since November, you are not communicating anything on targets and I guess it's a bit early to do that. But just to get a sense of your initial impression on the potential to expand the margins, particularly in Minerals.

Metso has worked in a more decentralized way now for a year, which should unleash increased accountability [indiscernible] (00:22:25) a need to increase R&D to make the products more competitive, aftermarket more captive. So, we have on one side increased R&D, that's a margin headwind. But then, possibly increased productivity and better pricing. So, where do you see the productivity improvements and the pricing opportunities here, as we go now into 2019?

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

Naturally, as healthy markets will support the pricing environment, but at the end of the day competitiveness of offering is far more important than cycle in this regard. And therefore, we need to continue and will continue to invest in R&D in future as well. When it comes to communicating our targets and things like that, I think we will come sometime mid this year. Maybe in connection of first half results, we will be communicating our new strategies and new targets, so we'll come back to those closer.

But I have to say that the model that was put together a year ago, more sort of decentralized decision making, and giving lot more authority to seven business areas has really worked for us. I mean, we've been able to focus on real business issues much faster than we could have earlier on business areas that are responsible for the entire supply chain, all the way to customers. They've been able to work on debottlenecking, if they have been any issues. And whenever they have been an issue, they have been with a couple of them an issue.

And we've seen successful debottlenecking during the year and situation is now much better. The way of working is well understood by the organization, which is also important and also which I think is a sign of our sort of reporting capabilities that the numbers are coming together in a fairly stable manner, considering the change that we made only a year ago.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Okay.

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

So, I'm positive about this one and I don't have any changes to make – major changes, or in this one. Of course, we'll fine-tune as we go, if we see things.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.

Q

Just one final, and a quick follow-up to that. Just a question on cost allocation. One big driver behind your productivity improvements at one of your previous employers Sandvik was to improve the cost allocation. Construction in Sandvik, were sitting on direct overheads which should sit with mining. Construction is a decentralized business, shouldn't have these overheads and made it unfair for the construction business to sit on these costs when it tried to improve profitability. Have you found anything unfair cost allocation across the different business areas? I'm just trying to gauge if there's any low hanging fruits that you can see, Pekka, when you've been looking at Metso so far?

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

I haven't come across yet, but of course, this discussion is very familiar to me, and especially this kind of model where we have seven businesses and that on the other hand have the same services. Some of the shared services are same and then of course, the cost to be allocated. But of course, it's for us as business leaders, it's really a crucial question that the allocations are fair and correct ones, so that we can draw right conclusions when it comes to accepting orders, booking orders, doing the pricing and understanding the competitive environment very properly. But I haven't seen it as a major issue yet.

I think we have a great understanding how different truly the distribution systems, for example, and change are for various business areas and for various customer segments. Mining, we tend to do much more directly; aggregates, we have distributors and dealers and there, of course, the cost structure will have to be different. On the other hand, when we look at, in consolidated terms, including the distribution part of it whether it's internal or external, then of course, we come to numbers that are far more comparable and that should be the basis to look at them.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.
Q

Thank you.

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj
A

Not to over allocate on areas where we have then other distribution costs beyond Metso.

Klas H. Bergelind
Analyst, Citigroup Global Markets Ltd.
Q

Thank you, Pekka.

Operator: Thank you. Our next question comes from the line of Max Yates from Credit Suisse. Please go ahead. Your line is now open.

Max Yates
Analyst, Credit Suisse Securities (Europe) Ltd.
Q

Thank you. Just my first question would be around selectivity. You talked a little bit about sort of one thing, you're preferring small to mid-sized orders. So, were there any larger orders in the quarter that you had walked away from? And should we, when we think about the outlook for demand being sort of somewhat higher, could your orders be potentially sequentially flat, because you're more selective in the first half than you were in the second, or is that selectivity already taking place in Q4, i.e. you're actually walking away from some business?

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj
A

Probably, Eeva has background from full year 2018 better than I do. So...

Eeva Sipilä
Deputy Chief Executive Officer and Chief Financial Officer, Metso Oyj
A

Yeah. I think that's not something sort of new now. I think it's – partly, of course, it's a market phenomenon we've discussed with you earlier that the customers are very productivity focused, and hence the bulk of the business out there is really on more brownfield and refurbishment type of business. Then, I think we've obviously made it very clear internally that we're looking for profitable growth in all the businesses and, of course, that has resulted into better price management, better terms management, and for sure, there has been some business out there that has hence not been that attractive to us.

But I wouldn't say this is now anything a specific step change. So, we would be looking at sort of a growth outlook. Then the sort of bigger projects, now they come and go, they will sort, of course, sort of have a big impact on comparability between quarters if and when they come. But those, as you well know, it's very difficult to guide on the timing of such business.

I think our basic message continues to be that the market is more brownfield oriented than greenfield due to really the sort of strong customer preference on productivity and improved returns and that's a market and demand that suits us well as well.

Max Yates
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Okay. Thank you. And just my second question would be around working capital. So, based on your backlog, you are going to have another year of strong sales growth in 2019. So, I just want to understand a little bit about how you think working capital evolves in that environment whether you would be able to keep working capital flat at the current absolute level, or you think that she still would need to grow, maybe not in line with sales, but still grow further and that will be a cash outflow for 2019?

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

Eeva?

Eeva Sipilä
Deputy Chief Executive Officer and Chief Financial Officer, Metso Oyj

A

Yeah. I think it will depend on the growth rate. Definitely, sort of we have – as I said, we sort of lately have toned down a bit to avoid sort of excessive inventories and we have quite a lot now to enable us to deliver and provide availability in the coming sort of – also taking into account the seasonality in some of our businesses.

We definitely need to improve on the turns that we will be working on in the absolute numbers. With these type of growth rates that we're reporting now, obviously, it would be sort of maybe unrealistic to not assume some absolute growth as well. But I think it's really now getting the focus we have a better sort of visibility into our supply chain. Sort of we had had success in the ramp up we kind of know what's in the chain, so I think we have a lot better opportunity to manage the turns than then we had a year back.

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

Yeah. In this kind of business, the acceleration always drives capital.

Max Yates
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Yeah. Is there any sense that customers are becoming more demanding around the payment terms or – sorry, the receivable terms on orders that they're maybe putting some more pressure on the suppliers to hold some working capital.

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

I think when we look up internally what that performance has been, I think we have seen a slight opposite development and in fact that the payment terms have become somewhat more favorable for us not in a big time, but some somewhat improvement over the year.

Max Yates
Analyst, Credit Suisse Securities (Europe) Ltd.

Q

Okay. Thank you very much.

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj
A

Thank you.

Operator: Thank you. Our next question comes from the line of Omid Vaziri from Jefferies International. Please go ahead. Your line is now open.

Omid Vaziri
Analyst, Jefferies International Ltd.
Q

Thanks for taking my questions. I've got two. You've been very clear in your reporting of orders thus far. The demand is very much driven by brownfield replacement rather than greenfield. Now in the mining space, we've seen upstream equipment providers announce order wins from large greenfield mines in Latin America, mainly copper. Does your fourth quarter Minerals order development includes any order wins from the same, or more likely how do you position to win orders for downstream equipment here later on? Also, expected timing would be helpful there. And my second question is on the order margin development, how that's been in the fourth quarter please?

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj
A

Yeah. We have seen orders during the year on greenfields as well as and specifically copper. I mean, it's driven very much by electrification and electric cars and we've seen also greenfield orders in battery, metals lithium just received one repeat order from such project as well, and it's not only brownfields, there are also greenfields. And this, of course – this electrification is one the trends that we are currently experiencing and that might be something that we'll carry into the future as well as there are several proposals out there for greenfield copper projects that I have seen going through us.

The margin development was somewhat slightly disappointing towards end of the year. Then, of course, I mean, when we look at the bottom line margins, they represent some, I would say, typical year end booking of course that we had, but nothing that major what we had a year ago, but the margin development was slightly disappointing towards end of the year, but I don't think there's any trend in that one. That one just happened to be a mix issue, as we delivered so much equipment during the fourth quarter, in relative terms more than services.

Operator: Okay. It looks like the person who's asking the questions actually hung up. So, we move on to the next question. Our next question comes from the line of Markus Almerud from Kepler Cheuvreux. Please go ahead. Your line is now open.

Markus Almerud
Analyst, Kepler Cheuvreux SA (Sweden)
Q

Hi. Good afternoon. Markus from Kepler Cheuvreux. Pekka, I've got a couple of questions. Interesting to hear, I assume that you've spent some of your first couple of months seeing some of your customers, and then it would be interested to hear your – especially on the mining side to hear the first impressions there, if you've seen any hesitation given what's going on in the macro economy. And also, if you've seen how are the discussions regarding the sales funnel on the greenfield area?

And then, finally, just your thoughts on, so everyone knows that copper will be tight fairly soon, and I know from others that the depleting ore sit in among the many of the large mines is a big concern, but still they're holding back on investments. And why do you think that is, and what do you think is needed for that to change? Just your thoughts on that would be interesting. Thank you.

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

Yes. I have met with some of the customers. And I don't really feel that they are slowing down things. Of course, the general uncertainty on things that we all are aware of is probably in back of their minds. But like I said, I mean, we have several big proposals out there, greenfield proposals as well, and they tend to take more and more time nowadays. Nowadays, the permitting is a very slow process, and it's getting slower year-by-year. Throughout the world there are new mining regulations, environmental regulations coming in place, and this preparation seems to be taking longer and longer year-after-year. I think that is something that's in the back of the minds of our customer rather than anything which is more short-term.

And sorry, I forgot parts of your question.

Markus Almerud
Analyst, Kepler Cheuvreux SA (Sweden)

Q

Okay. And do you think it's just – so it's more – more of this – I mean, the procedures are more difficult and that's what's making it take time rather than that they don't run after the mine. So, it's just taking longer time for them to get that, that's the impression yeah?

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

Yes.

Markus Almerud
Analyst, Kepler Cheuvreux SA (Sweden)

Q

Hello?

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

Yes.

Markus Almerud
Analyst, Kepler Cheuvreux SA (Sweden)

Q

Yeah. Okay. Thank you very much.

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

Thank you.

Operator: Thank you. Our next question comes on the line of Andrew Wilson from JPMorgan. Please go ahead. Your line is now open.

Andrew Wilson
Analyst, JPMorgan Securities Plc

Q

Hi. Hi, everyone and thanks for taking my questions. I just wanted to start with – I guess it's probably a question for Eeva. The 2019 kind of margin dynamics, I just wanted to try and get some I guess, even if it's a qualitative commentary on, we're obviously expecting good volume growth and again – kind of again that we've got the negative mix, but also there's quite a lot I think happening in terms of internal improvements which business has been working through and we probably get a benefit from not coming through, and then obviously, raw materials and cost inflation.

I just wanted to try and get a sense of, I guess, probably particularly in Minerals, but also Flow Control, just how you see those margin development in 2019 and just the key things that we need to think about for our models, please?

Eeva Sipilä
Deputy Chief Executive Officer and Chief Financial Officer, Metso Oyj

A

Sure. Well. I think, you've had a good key list already there. I mean, obviously, the order backlog we start the year with is significantly up, and will give us good sort of volume leverage into the year. Then, of course, the mix is more equipment than services, as you rightly note, and you saw the impact of the mix also in the Q4 numbers, so that is something maybe sort of a somewhat bigger change perhaps in Minerals than in Flow, but I think both price are sort of subject to that.

Then, again, I think sort of challenge right now with the uncertainty around us is really to understand the sort of inflationary pressure. Raw materials, what will really happen there, because obviously they are impacted by many other industries, not just our own. And even if the sort of mining comments seem from everyone to be quite positive, of course, we buy say a similar stuff to some other industries where the comments have been more mixed.

We're still assuming that there will be a cost pressure inflation on for us and sort of expectation is that whilst we continue to work on own pricing that we don't necessarily see, expect sort of a positiveness from there. Let's see where it really ends. This is a – I think it's better for us to be prudent and then we see where things go during the year.

Then, yeah, definitely, I think we made good progress in many areas on the strategy execution that Klas noted earlier. But specifically in the supply chain, we've discussed many times during last year that that is a longer term thing and it should help on the margin side from just having less hassle and sort of logistical issues, but of course, should also then help on the inventory turns. So, I think those are really the key things at this point. We wouldn't really want to go into sort of more specifics on that, but I think those are the ones to watch and which we will then obviously be discussing during as the year unfolds.

Andrew Wilson
Analyst, JPMorgan Securities Plc

Q

That's helpful thanks. And just a couple of questions, just on end market dynamics. If you could just kind of talk about oil and gas in a bit more detail – obviously, some comments in the release, but just in terms of I guess how you've seen that develop through the Q4 and just if there's specific pockets of kind of the oil and gas supply chain, which has been particularly strong?

And secondly, just on aggregates. I feel like for the last two years, we've basically been talking about a pretty positive picture in aggregates. I'm probably surprised on the upside against kind of analysts' expectations. But can you just talked about I guess how concerned are we that we're sort of at already very elevated levels and just get a sense of how you see that develop? That'd be very helpful.

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

In the oil side, of course, the – first of all, the sudden drop in oil price and then that one starting to climb up again and then going a little bit up and down, but it has now stabilized over the past few weeks in terms of Brent on $60 level. And I think that gives us a little bit stability on the oil side and we are not very concerned about that one at this moment at all and we're sort of fairly confident on that, that the business will continue in good and favorable terms there in near future.

Then, the aggregates, there are some interesting developments happening. I mean, all the big economies, I mean, some of them are developed countries, some developing countries, seem to be fairly well in that regard. India, elections ahead, remains to be seen what the impact of that one is. Maybe we'll slow down for a month or two, but overall, I think the infrastructure development there will have to continue and it will continue and it's boosting our aggregates business. China, on the other hand, has river sands, which is the most common construction material. And now river sands cannot be used at all and all sand must be manufactured sand in China and that is supporting the aggregates side to a great extent over there.

At the same time, they are consolidating smaller quarries, smaller quarries will not get operating licenses anymore, and bigger quarries have capabilities to invest on more and more and recognize the equipment. And we are both in India and in China, much better percent now with our local manufacturing and with our joint venture companies and we saw very favorable development both in India and in China.

China, last year – in this one and I have no reasons to assume that it would change considering that now all sand in China needs to be manufactured sand. At the same time, all construction materials need recirculated, for example, the concrete roads, the highway network in China will be converted to asphalt. And there's huge amount of concrete that need to be recirculated and that is business opportunity for us.

U.S. aggregates market goes very well favorably and remains to be seen then what happens in Brazil now in the infrastructure side when the new President is in the office. And anyways people are fairly optimistic about that market as well. So, we see some really good interesting developments in aggregates altogether throughout the world and therefore, we are investing in our factories and capabilities and new products in that area and made also one acquisition last year, a smaller one, a Swedish Jonsson och Söner business that we bought and have now integrated that one.

Andrew Wilson
Analyst, JPMorgan Securities Plc

Q

That's very helpful. Thank you.

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

Thank you.

Operator: Thank you. Our next question comes from the line of Antti Suttelin from Danske Bank. Please go ahead. Your line is now open.

Antti Suttelin
Analyst, Danske Bank A/S (Finland)

Q

Thank you. This is Antti. I would like to come back to Minerals services orders. I think you reported 12% growth last year. I think that number must be much higher than the overall production increase by your customers. So, what drove that growth, is it market share or what is it?

Eeva Sipilä
Deputy Chief Executive Officer and Chief Financial Officer, Metso Oyj

A

Well, I think, Antti, there's many things. The composition of our service business, if you remember, also includes refurbishment type of engineered projects. And that, of course, business was at very low levels just some two years back. And of course, that improvement, which is part of the sort of productivity improvement mission our customers own has been visible in our numbers. And we think, we have a good offering, a lot of competence there really to take the big bulk of that business. I think we've done very well also in the key mining markets and very good work from our teams globally on – also pricing, of course, is a positive impact on the growth. Well, that's been an area where we have also worked very hard. So, I think it is really at the core of the strategy, and hence, due to the size of the business, it's managing it well, shows on the overall bottom line as well.

Antti Suttelin
Analyst, Danske Bank A/S (Finland)

Q

Okay.

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

I would say that services, especially, enjoys the new organization and more focused on that particular part of the business and its bringing results.

Antti Suttelin
Analyst, Danske Bank A/S (Finland)

Q

Yeah. And would you expect this kind of refurbishment activity to continue also in 2019?

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

I think where the markets currently are, everyone is doing the same what we did, debottlenecking their processes and equipment and that is really something whatever refers to this Engineer-to-Order type of activity, ETO as we call that one. There's a lot of opportunities out there in that field.

Antti Suttelin
Analyst, Danske Bank A/S (Finland)

Q

Okay. And then, I think you said, Pekka, something about potentially giving out new targets. Could you repeat that statement? When and what targets could this mean?

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

Yeah. Of course, I mean, we are reviewing our strategy, it's normally many companies – the activity that companies do during the first half of the year and we are doing that one now, just recently initiated it. And of course, we will look into all activities that we do and we have a process in place and most likely we'll communicate the outcomes of that one after the first half of the year.

Antti Suttelin
Analyst, Danske Bank A/S (Finland)

Q

Okay, thanks. And finally, could you explain to me, why you have Minerals business and why you have Flow Control business, how these two businesses act together?

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

Okay. A question that has been answered many, many times before my time. I think, after all, of course, the composition of company tells a lot about its history and its roots. And we have good solid Minerals business, very profitable Flow side of the business and of course, one might speculate that something could be done about it. But then on the other hand, our balance sheet is very strong at this moment and we need to look at the total picture, how to develop this company going forward. So, I don't think there's any other reasoning for that one that this is the DNA of current Metso and we'll continue with the portfolio that we have in hand.

Antti Suttelin
Analyst, Danske Bank A/S (Finland)

Q

Okay. That is all from me. Thank you.

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

Thanks.

Operator: Thank you. Our next question comes from the line of Robert Davies from Morgan Stanley. Please go ahead. Your line is now open.

Robert J. Davies
Analyst, Morgan Stanley & Co. International Plc

Q

Yes. Good morning. Thanks for taking my questions. The first one, which is really, what's changed in your opinion between sort of 3Q and 4Q in your decision to kind of change the guidance between the mining aftermarket and [indiscernible] (00:51:14) aftermarket on Flow. You've obviously kind of come up with some more positive demand outlook kind of comments for those markets. I just wondered between 3Q and 4Q, ultimately what is the change there? And the second was just around the Flow Control business, given the movement in oil prices, you mentioned the sort of stability of Brent around $60. But is there any sort of potential lag effect there from the kind of 40% move in oil over the fourth quarter that we should expect in 1Q, or how should we kind of think typically between the sort of movements in oil prices, how directly correlated are you? Thanks.

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

If I take the oil price first. Of course, it's not the direct, because we are not in upstream oil, which is far more sensitive to oil price changes. But, of course, stability overall, it's normally a positive sign also to the downstream site, because I mean the refining fees and those tend to be far more stable in those conditions than when the oil prices are fluctuating. So, therefore, it's more stable environment I would say for our customers to operate and that should be favorable.

Then, of course services in sort of a Flow side and oil and gas, that's driven quite a lot by the shutdown activity that the refineries have and the petrochemical plants have there. And we don't see any sort of major change in that regard, meaning that there will be shutdowns. Again, there are always the service opportunities for us in near term as well.

The services, the second part of question was...

Eeva Sipilä
Deputy Chief Executive Officer and Chief Financial Officer, Metso Oyj
A

On the outlook.

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj
A

Yeah. We do see a strong demand for services and we also – that's the reason why we ended up acquiring the high service business in Chile, which really hasn't closed yet, but that will start to contribute to our service business, hopefully during the second half. Of course, that is not all the growth that we see and that is from a fairly small footprint, but we can see that the value-added services that they provide and remote monitoring, we could expand to other parts of the world. And as the nature of services business, we'll be changing with the far better connectivity and the Big Data and data and analysis on top of that one. So, those are some of the drivers that we do see happening there right now.

Robert J. Davies
Analyst, Morgan Stanley & Co. International Plc
Q

Okay. And then...

Eeva Sipilä
Deputy Chief Executive Officer and Chief Financial Officer, Metso Oyj
A

And maybe Robert, just to – if you're...

Robert J. Davies
Analyst, Morgan Stanley & Co. International Plc
Q

Maybe just one follow-up, which is around the service activity itself that you mentioned to strengthen it. Could you sort of disaggregate a little bit between how much is kind of projects in refurbishment and how much is sort of the underlying typical day-to-day service business that you would normally see. You mentioned a kind of higher contribution in project, so we're just trying to get some idea if you could quantify how much of an impact that's been in the quarter? Thanks.

Eeva Sipilä
Deputy Chief Executive Officer and Chief Financial Officer, Metso Oyj
A

Yeah. I don't think we necessarily want to break it down to the detail, but if one thing of the sort of engineered side, this refurbishment side, we've seen higher growth rate partly, of course, due to a lower starting point, whereas this sort of field service spare parts business started to improve in late 2016 already. So, in those businesses, that's also partly that we have high – they've all grown, but then sort of comps obviously were tougher for them.

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj
A

I think we have added resources to this type of activity, engineering resources, and then of course, our supply capabilities are also boosting our service side, because we are to great extent in the same supply chain for that part of the service, as we are with equipment.

Robert J. Davies
Analyst, Morgan Stanley & Co. International Plc
Q

That's great. Thank you.

Operator: Thank you. Our next question comes from the line of Tanuj Agrawal from Barclays. Please go ahead. Your line is now open.

Tanuj Agrawal
Analyst, Barclays Capital Securities Ltd.
Q

Hi, there. This is Tanuj Agrawal from Barclays. I have one question on your outlook actually, specifically on Minerals. So, when you say Minerals are expected to grow, and I heard your comment on aggregates. So, is it like more strong growth in aggregates and a more modest growth in mining? I say that also, because we are hearing players exposed in the mining industry, they have been pointing out more modest view at least for 2019 in mining, and in particular in copper. I mean, I totally get the view of the secular growth story there, but at the same time if we look at projects, I mean in the last two years there have been over 2 million ton of copper projects which have been approved. So, I mean, how do you see the project pipeline going ahead, because I don't see many projects, ready-to-go projects there. So, what's the visibility of that 2019 pipeline specifically? So, is it that 2019 would be slow before 2020 gets kind of strong again? That's my first question.

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj
A

Yeah. Of course, when we look at these projects from our perspective and then that might be a somewhat different view than what people do get, because our view starts, of course, from the feasibility study and approval and go ahead the distance of the entire project. But then, when we go into the inside the project, the view starts to change a little bit. So, even though we may not see greenfield projects right now that many, but there have been greenfields that were greenfield some time ago and are now getting more active for us in near-term. I would say that and, of course, I mean, I cannot but your view is – insight into these projects.

But we do have through our offering and proposals activity somewhat different view. And it's not happening at the same time when the big projects' assets are announced by our customers. And on mining, of course, copper is clear that will go ahead. And I commented earlier on the permitting, which is getting more complicated and I would say, there is a clear difference between now and let's say, 2006-2007 when the supercycle started. And a lot of regulation has changed since those days and all over the world it has become more difficult to open new mines and that is something that we are we are going through here. And this is probably visible in terms of copper.

At the same time, yes, some of the projects maybe our clients are looking more closely at the risks, because copper specifically is going underground. It's been going underground for quite some time. At the same time, the grades are lower and the ores, when they come from deeper mines are harder. So, those are the risk factors that our clients have. On the other hand, if at all rock gets hotter, there's more opportunities for us. If there is less copper on the ore, it means that more rock, more ore needs to be crossed and milled. So, once again, more opportunities for us, but like I said, I mean, these are in big picture, the moves and changes that are happening.

The aggregates business is – I would say, there are few really major countries in the world where the infrastructure development more or less decides where the aggregates goes, even though that business is global. But I commented earlier on China, India and a little bit USA and a few words about Brazil and we see positive things there and we should not ignore Europe either in the aggregate sides, it's – Northern Europe specifically has been a good market for us and we see that to continue and for the time being, we see the aggregates business really prospering in all these main markets as well.

Tanuj Agrawal
Analyst, Barclays Capital Securities Ltd.

Q

Okay. Thanks. Just one very small one actually, on Quellaveco, it's a €5 billion large project. When you booked it in Q3, it was somewhere around – it was booked as a mid-size project. Given that it was such a large project, are you expecting any more significant orders around Quellaveco going ahead. I mean, I'm not looking into a couple of tens of millions going ahead in future, but some significant orders.

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

I haven't – I'm not that aware on detail of Quellaveco. I've of course heard the name of the project and are aware of the order, but what the follow-ups on that one is, I would have to check that one from our people. And on the other hand, we will not comment to details on individual project either.

Tanuj Agrawal
Analyst, Barclays Capital Securities Ltd.

Q

Sure. Thanks. Thank you.

Operator: Thank you. Our next question comes from the line of Manu Rimpelä from Nordea. Please go ahead. Your line is now open.

Manu M. Rimpelä
Analyst, Nordea Markets Division

Q

Thank you. My first question would be on the cost inflation, a clarification on the comments you made. So, did I understand you correct that you are aiming for offsetting cost inflation with price increases, but you are uncertain whether you will be able to do that and the net pricing could be a headwind in 2019?

Eeva Sipilä
Deputy Chief Executive Officer and Chief Financial Officer, Metso Oyj

A

Sorry, then I was unclear. Yes, we are targeting to offset net cost impact with pricing. I'm pretty comfortable that that is achievable, but I'm not necessarily assuming that we can improve the margin, which was a question from Andrew earlier with pricing.

Manu M. Rimpelä
Analyst, Nordea Markets Division

Q

Okay. Thank you. And then, another question in terms of the Minerals EBITDA and the operating leverage. So, we have seen sequential improvement in the fourth quarter, but the overall operating leverage still remains just around 15%, 16% in the fourth quarter. So, I mean, where do you see now that you're starting to solve these supply chain issues and potentially gaining traction on pricing and delivery should continue to kind of remain strong. So, where do you see that the operating leverage capabilities of those business unit is? Can you give us some light on that?

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

Yeah. I would say that looking back and what I have understood of last year is that we really struggled with our supply chain and those ramp up efforts that we did have, there were some major cost element in all of them. And as we are now in a much more balanced situation, though still in a growth, rapid growth mode, we could expect somewhat improved leverage as we move on. We do have some structural issues that we need to take a position later on in order to make sure that we have smooth internal supply chains inside the company and we are addressing those things with numerous actions as we speak. So, we need to continue to develop that one, but I think we know where the issues are and we are acting on them.

Manu M. Rimpelä
Analyst, Nordea Markets Division

Q

Okay. So, you would feel comfortable in targeting your higher operating leverage in the 2019 than you had in the fourth quarter?

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

Well, that needs to be seen what we are able to deliver, but we have actions in place where we are addressing these issues.

Manu M. Rimpelä
Analyst, Nordea Markets Division

Q

Thank you.

Operator: Thank you. Our next question comes from the line of Jonathan Hanks from Goldman Sachs. Please go ahead. Your line is now open.

Jonathan Hanks
Analyst, Goldman Sachs International

Q

Hi, there. Thanks for taking my question. Obviously, you talked a lot in the past about increasing R&D and you managed to increase it by about €12 million in 2018. I'm just wondering, is that about the level of increase we should expect again in 2019, or do you hope to ramp up the increase a bit more aggressively now? Thank you.

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

That I would say is roughly on the level of what we'll do this year. Then, it of course, depends also on how we – what sort of projects we do approve during this year a little bit, but of course, the key in R&D activity is to have the right people, right resource, right skills in place and that is normally the bottleneck when ramping up the R&D. So, therefore, I would say that we continue in a big picture with the same pace. We also need to look into the digitalization, because some part of that could be also regarded as an R&D and there we are ramping up also our activities.

Jonathan Hanks
Analyst, Goldman Sachs International

Q

Okay. Great. Very clear. And then just a quick one on Flow Control, obviously, very impressive margins this year on sales, which are still some way below prior peaks. I mean, could you maybe remind us a little bit why the margin has been so strong this year and is there any tailwinds this year, which could reverse next year or really should we just take this as the new base and just think about normal operating leverage from this level?

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

Well, I mean, if you look at what we have done over the years in our valve side, first of all, I mean we have solid products – I would say, solid product lines there. The sentiment is good, we have good solid service business. Then, in relative terms, we are manufacturing more and more in lower cost environments and we'll continue with that shift since we've acquired the business in India, we just had groundbreaking inside China at a lower cost environment and where we operate currently. And yes, we can expect that our sort of operations come become more cost efficient in future as well. Then, the other side, the revenue side and the pricing side of it that depends on how the market is developing in the long run, but we are taking lot of actions in our supply chain side to reduce the cost.

Jonathan Hanks
Analyst, Goldman Sachs International

Q

Okay. Thanks very much. Very clear.

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

Magnus Kruber
Analyst, UBS Europe SE

Q

Hi. Magnus with UBS. Just a couple one for me. First, returning to the growth rate in the aggregates business, would you say that the growth rate you saw in the second half of 2018 was slower than the one you saw in the second half of 2017? That's my first one.

Eeva Sipilä
Deputy Chief Executive Officer and Chief Financial Officer, Metso Oyj

A

No. It was actually, we saw higher growth rate. Seasonally, typically, aggregates growth is higher in the first half compared to the second half. But if you're comparing 2017 and 2018, so the growth increased.

Magnus Kruber
Analyst, UBS Europe SE

Q

Okay. Okay. But if you look at the full year, did the full year grow faster in 2018 and you saw the growth rate in 2017?

Eeva Sipilä
Deputy Chief Executive Officer and Chief Financial Officer, Metso Oyj

A

Yes. Yes.

Magnus Kruber
Analyst, UBS Europe SE

Q

Okay. Got it. Perfect. Secondly, on the mining equipment, you have said in the past that the equipment has not had a positive contribution to profitability for some time. Could you give some flavor on how that developed in the quarter?

Eeva Sipilä
Deputy Chief Executive Officer and Chief Financial Officer, Metso Oyj

A

Well, we ended up the year in with a slightly positive numbers and also in that area. Obviously, it's an area where a lot of the improvement also was – we went into increased R&D, because that's one of the areas where we were more focused on. So, it's not – I think it's maybe a tough – it's not a fully comparable comparison, but anyway it was it was in the black even with the R&D cost, so that was of course important milestone.

Magnus Kruber
Analyst, UBS Europe SE

Q

Very good. Thanks a lot. And just also in the past, you have given assessment on want you will be able to invoice from backlog in the next year. Do you have such a number for 2019?

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

The big chunk of the order backlog is planned to be delivered in 2029 due to the composition of the order backlog being very much services and aggregates valves equipment type. As we discussed earlier, there's sort of amount of big mining projects is less and those were typically are multi-year. And of course, there's some of those from in that, but really the sort of vast majority is in 2019.

Magnus Kruber
Analyst, UBS Europe SE

Q

Got it. Thank you so much. I had just one bookkeeping, tax rates for 2019, what really should we see there?

Pekka Juhani Vauramo
President and Chief Executive Officer, Metso Oyj

A

Well, we were working hard to improve structure we have and even took some one-off costs for that in the fourth quarter. So, the target is to move in the right direction from the shareholders' point of view, but nothing – I'm not expecting anything dramatic, so you can of course for prudence's sake also use 2018 rates as a starting point.

Magnus Kruber
Analyst, UBS Europe SE

Q

Brilliant. Thank you so much. That's all for me.

Eeva Sipilä
Deputy Chief Executive Officer and Chief Financial Officer, Metso Oyj

A

Thanks.

Operator: Thank you. And that was our last registered question. So, I'll now hand the call back to you speakers for your final comments.

Juha Rouhiainen

Vice President-Investor Relations, Metso Oyj

All right. Thank you. We have run a little bit past 60 minutes, so it's good time to conclude this conference call for fourth quarter and full year 2018results. Our next call is scheduled for April 25, 2019, when we start reporting 2019 with the first quarter numbers. So, we'll speak to you then at the latest then and now we say thank you and goodbye.

Operator: This now concludes our conference call. Thank you all for attending. You may now disconnect your lines.