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KEMIRA.HE - Q2 2019 Kemira Oyj Earnings Call

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PRESENTATION

Olli Turunen - *Kemira Oyj - VP of IR*

All right. Very warm and sunny welcome to Kemira's Second Quarter 2019 Result Presentation. My name is Olli Turunen, and I'm Head of Investor Relations at Kemira.

Kemira published strong results again this quarter, and today, now, we will have a deep dive into the numbers presented by our President and CEO, Jari Rosendal; and our CFO, Petri Castrén. After both presentations, you have a chance to ask questions here in the room and also of course over the webcast, either by typing to the tool or calling over the phone.

Let's begin. Jari, please go ahead.

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Great. Thank you, Olli. Welcome, everyone. Good afternoon. And as the title said, strong earnings improvement continued in Q2.

Some key points on top of daily day in, day out operations. So focus on value over volume and active sales price management continued successfully during the quarter. And this price management, starting from the turn of the raw materials cycle, has obviously been a long road, but we've been doing systematic work the last 4 or 5 quarters on it, and you can see the progress, what we've achieved.

Markets, I would call generally good. We are seeing some softness in some areas of the market compared to earlier really good markets. Now we call it good, but we didn't see that much direct implication to us but some. And our strategic investment projects, we have continued those, obviously, and then they are on track.

Let's look at then the Q2 numbers. Revenue, EUR 664 million. Organic growth was flat, mostly by our own design by driving the volume over -- sorry, the value over volume and then really actively managing our product portfolio on going forward. We continue to see strong year-on-year organic growth in our Oil & Gas business. Successful sales price management and the same time softening raw materials in some areas helped on some input costs.

Operative EBITDA grew EUR 206 million and the margin was 16.0% of revenue. Actually, the improvement on our profitability came from all of our regions for both segments, so every unit was able to contribute to the improvement. Also, operative EBIT grew nicely by 32% and was EUR 60 million. EPS, EUR 0.22 versus EUR 0.14 last year.

Then looking at the segments. Pulp & Paper revenue, EUR 373 million. Organic growth came down slightly due to many of our own planned actions in product mix optimization. As you might remember, we closed down what we call ECOX production last year, and that took down volumes and revenue quite a bit, freeing up the peroxide to the market.

One thing that Petri will elaborate also more, we trade a lot of caustic soda, so buy in and traded forward to the Nordics. And as the caustic soda prices have come down significantly from last year, it's mainly a top line effect, not so much a bottom line effect.

Q2, also, in Pulp & Paper is a shutdown season and shutdowns were slightly longer than last year. This time, we also had some unexpected shutdowns from customers. Still, the operative EBITDA margin improved 14.4% and also the operative EBIT in Pulp & Paper grew by 17%, which is nice to see.

If I look at the longer term market outlook, customers continue to invest into board machines, into tissue machines. And so that indicates that customers sort of, long term, believe in demand growth. A lot of pulp capacity additions also are in planning as we have all heard.

Moving on to Industry & Water, a very strong quarter. Solid water treatment market. EU continues to review the water treatment regulation.

Oil & Gas performance, really good. Like I said, 30% year-on-year organic growth and revenue to EUR 77 million in the quarter. We have and expected to see some moderation of demand in the Oil & Gas application areas, but that hasn't directly hit us at all, basically, in Q2.

Polymer raw material prices have eased off in North America. Let's see how sustainable that is if we think of longer run. Coagulant raw materials are gradually coming up, and we expect them also to come up during the second half of the year, but we're in a better position now to meet that challenge.

In Q2 and Q3, we are delivering to the oil sands in Canada for the tailings and treatment campaign during the summer seasons. This will increase our top line, dilute somewhat of the margin, but will be accretive to our bottom line and delivery weight will be on Q3 during this year. I&W had an exceptionally good quarter with operational EBIT margin of 18.1%.

Then moving on to something that I don't talk that often, but I think it's relevant to also understand. We work hard on keeping people safe and our operations safe. We have over 5,000 people working directly for Kemira and about average 100-odd thousand people as contractors on our sites and laboratory, sometimes even in our offices. We produce roughly 5.3 million tons of product to the customers from 64 sites, and we have over 1,000 shipments going out from our sites every day, and you can imagine how many shipments are coming in every day. So a lot of complexity in our operations and we need to stay safe every day.

So with systematic work year-to-date, our total recordable injury frequency per million working hours is 2.5. Naturally, the target needs to be 0, but we start to reach the industry best class sort of a performance in that. We still have work to do in a number of areas, so we need to stay safe every day, every hour, every minute.

Why I'm bringing this up is that it has also a link to financial performance. If there is an injury, typically, a line or a full plant is stopped. Obviously, the injured person needs to be taken care of, hopefully not a bad injury. And then investigations start and so on. So management, staff, operators are involved in non-production type of things, non-business things. And obviously, that then is away from the business performance. So that's the link that we have to also keep in mind. But people safety, operational safety continues to be on top of our mind every day and getting people home after a good day of work important and has a business link.

Then sort of stepping away from the quarterly focus also and reminding of our longer-term strategy focus. We continue to focus on Pulp & Paper, Oil & Gas and water treatment. We don't intend to wander away from these areas. There's enough market opportunity in these for us. We aim to be the market leader or among leaders in the market in these segments.

On average, for Kemira, these markets provide roughly 2% to 3% annual growth opportunity. We see fiber-based renewable, recyclable trend increasing. And in Oil & Gas, the production is moving more and more to the unconventional side of producing Oil & Gas, and that's where we are active.

Our product portfolio needs to include great products, therefore we are working on our product portfolio constantly. We invest roughly EUR 30 million a year into R&D and application improvements. We are pruning our product portfolio constantly. We have 4 major product groups that bring 80% of our revenue. That's bleaching, that's coagulants, that's polymers and that's sizing chemistries for board and papermaking. And these are the strategic product areas that we also have been and are investing in when we think of our increasing capacity.

Great and experienced people with deep application knowledge, operational knowledge and technical capabilities is a key on top of the products and an excellent end-to-end operations. We drive value through carefully planned investments and continuously improving our operations, and these again drive our top line and especially bottom line.

Our mid- to long-term financial targets remain unchanged. So operative EBITDA target in the range of 15% to 17% from revenue and gearing below 75%.

Returning back onto a bit more short term and the next 6 months plus and our key focuses. So active price management. Notice I'm not saying value over volume anymore, but now we start to be there where we want to really start to be conscious in what's happening in the marketplace, balancing also our utilization rates. They are high, still, but not that we lose volume for the wrong reasons, especially when prices are right.

We continue to work on our product portfolio and our service offering and rightsizing our services so that we don't underserve the customer and the customer is unhappy. But we also don't overserve, which where we don't get the value and we hurt then our bottom line, so we need to rightsize the offering.

We continuously continue to work on our operational excellence. As I explained, operations are quite complex, so there are always opportunities to improve. We'll complete the Rotterdam polymer capacity and the AKD sizing capacity in China and get them up and running by the end of the year. They will not contribute to the bottom line or top line too much this year, but we expect to have a full contribution next year.

And as there are again uncertainties out there, we read the trade wars and so on and so on, it's really important we continue our prudent cost control in all areas.

That concludes my summary for Q2 situation. Next, I'll ask Petri to come and give some more details on the numbers. Petri, please.

Petri Castrén - *Kemira Oyj - CFO, Member of Management Board & President of Americas*

All right. Thank you, Jari. So as you see, profitability improvement continued from strong Q1 and even actually accelerated its pace during Q2. So let's look at some of the drivers that were behind the good strong performance.

So as Jari mentioned, growth moderated to 2% as the focus was more on value over volume. And again, some of the softness in the markets that led to about 4% decline in volumes delivered.

I would say that we have been very successful with our pricing management, and we've combined that with clearly stabilizing raw material environment. This led to this excellent quarterly result.

Perhaps some of the highlights in terms of where the pricing management has been really successful are our North American shale. We've both seen the growth on that one, but it also has come at a very good profitability. And there, we also have differentiating products so it's -- that certainly helps in the pricing management.

Another area where we have done excellent job in terms of the pricing management is the North American Water business. That, in the past, has been quite challenging for us at times and even now as it is facing higher raw material costs continuously, it has actually been very successful in passing those costs to our customer base.

Regarding variable costs, 2 areas are perhaps worth mentioning. One is the decline in caustic soda that Jari mentioned, and it is a mostly traded product. It means that we are selling it at a fixed margin. So, really, the price of the product does not matter all that much. And then the other area where we have seen declines in the quarter is the cost of electricity. And our cost of electricity is a portfolio of long-term hedges, so we hedge up to 5 years in terms of electricity prices. Also, we sourced some of the electricity from Teollisuuden Voima, TVO, and Pohjolan Voima, PVO, where we actually get electricity at production costs. And then some of it is -- it is sourced at spot rates. So the mix of that is actually was quite favorable during the quarter.

Favorable currency development is something -- is another factor to our EUR 26 million year-on-year EBITDA improvement. Some of you may remember that we were struggling with the explain the negative currency situation a year ago. First half '18 was really difficult for us or caused negative EBITDA variance. This time, we are pretty much recovering what we saw negative on that line a year ago.

And now if I'm sort of looking at what's the remainder for the year if currencies stay at the roughly current levels. We'll see some much smaller numbers from the currency evaluation. Perhaps a slight positive, though.

On the cost side, if one adds up the fixed cost line and right of use leases, you'll see that the costs are up about EUR 8 million year-on-year. That's actually for a very good reason because, with a good performance, we have actually had the chance or had to increase some of our incentive accruals. So most of that increase that you see in those combined lines is actually coming from the increased incentive accruals due to the good performance. So again, other than that, we have been quite been successful in terms of offsetting the inflation by managing our costs.

EBITDA improvement adjusted for the IFRS 16 improvement, that comes to EUR 17.6 million. And that's sort of apples-to-apples comparison and over 20% year-on-year improvement.

And finally, I repeat my comment here from Q1, relating to the IFRS accounting change, make sure that it's understood correctly. IFRS impact on a year-on-year comparison was about EUR 8 million, EUR 8.3 million precisely. And that's in line with the guidance that we gave early in the year, about 1% positive EBITDA impact from the IFRS change, maybe slightly higher now, around 1.2 points.

Moving on to the raw material picture. Key points, I think, were already covered from this chart. On the right, the favorable net impact continued and actually even grew in Q2. Perhaps, sort of a -- I know that people will be asking what do we see in terms of raw materials going forward? So the declines in electricity costs and the caustic soda, those are sort of aberrations. But if one looks at other raw material costs for the rest of the year, we basically see flat to very modestly increasing raw material environment, so that active price management that Jari was talking about still remains a valid strategy.

One area where we have benefited and which obviously has contributed to the Industry & Water good result is that the propylene costs have been at low levels in recent months compared to the -- a bit longer-term recent history. And this clearly had a positive impact to our polymer product profitability. And Oil & Gas and Industry & Water has a higher share of polymers compared to the sister segment, Pulp & Paper.

Cash flow. Improved profitability obviously helps cash flow in Q2 and also, obviously, for the first half. Also, reminder that in Q1, we received a EUR 15 million excess capital return. That is sort of a onetime and is not -- will not be repeated at least in the near term.

Another comment on the seasonality of cash flow. So last year, we generated less than 30% of operating cash flow during first half, and it is indeed a seasonal pattern that we expect to repeat itself this year. It's caused by some of the seasonality in our business. It is caused by -- or amplified by the expected capital expenditure rhythm that we have. And it's also further amplified by the sort of the net working capital rhythm that we have in the business.

That takes me to our CapEx. While the CapEx year-to-date is roughly at the last year's level, we do expect that the CapEx rate will accelerate towards the end of the year. Much of it is actually invested into strategic projects that Jari mentioned, and so that we are expecting to land within our EUR 180 million to EUR 220 million CapEx guidance.

Operative return. ROCE, or return on capital employed, now improved to 10.8%, driven obviously by Industry & Water profit improvement.

Comment on debt. IFRS 16 impact on net debt and reported debt is an increase of EUR 135 million. The net debt ratio as we report is increased to 2.5 turns. And this change and how we report this a bit exaggerates the ratio as we take the last period debt level, which is higher because of the IFRS 16 change, but only 2 quarters with an EBITDA with a positive IFRS 16 impact and then still 2 quarters with pre-IFRS 16 numbers that do not have that. So if one adjusts to that and really takes best way to adjust it is to take pre-IFRS 16 numbers. The net leverage would have been 2.2x, slightly higher than what it was in Q1, but again clearly lower than what it was this time of last year. And the year-on-year -- I'm sorry, increase from March quarter to June is really caused by our dividend payment, which took place in Q2, while it was declared in Q1, but it was paid out in Q2.

Our year-to-date operative EBITDA is now ahead of last year by some EUR 36 million on a comparable basis, excluding the impact of the IFRS 16 accounting change. So we are quite well on our way to meet our guidance, which is that our operative EBITDA will increase from the prior level on a comparable basis. Still, for the record, we repeat that guidance in our half year report.

Finally, I'd like to conclude my slide or my turn with the reminder of the key points in our equity story, why people should and would invest in Kemira. First of all, we are targeting profitable growth and we're demonstrating that we are actually improving the profitability with this 35% increase year-to-date in our EBITDA and even higher 40% increase in EBIT year-to-date. And further, we have now reached our mid- to long-term target of 15% to 17% EBITDA margin, both for the quarter and year-to-date.

We do provide an attractive and stable dividend yield to our shareholders. Dividend yield in today's share price is roughly -- is still over 4%, which makes it quite attractive in today's low interest environment.

Sustainability. Jari talked about one aspect of sustainability, by the way, which is safety. So there are multiple aspects of sustainability. It has always been important to us, but now it has become much more relevant as an investment trend. EcoVadis is a highly regarded independent third party, and the gold rating that we -- is their highest rating and the gold rating that we -- they have given to us is really an indication of our broad sustainability focus. And they actually give that gold rating only to 5 -- top 5% of the companies that they rate. So indeed, it's a good validation of our sustainability focus.

With that, I'll stop my remarks, and Jari and I are ready to take your questions. Thank you.

QUESTIONS AND ANSWERS

Olli Turunen - *Kemira Oyj - VP of IR*

Very good. Let's first take questions here in the room and then over the webcast. Do we have questions here? Harri? Please state your name and company by the way.

Harri Taittonen - *Nordea Markets, Research Division - Senior Director & Sector Coordinator*

Harri Taittonen, Nordea. One question about the pricing and the delta with EUR 23 million, if one compares to a year ago. Would it be possible to think about, like, how much of that is, let's say, pricing on a like-for-like basis and how much would be roughly attributed to the mix and your efforts to value over growth, if you split that EUR 23 million, roughly?

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

A good question. We haven't actually gone that way of analyzing where it comes from. We rather work on where we can gain it. So some of it is just taking prices up due to the raw material environment that there is. But a lot comes from working on the product mix. So best-yielding products to the capacity working sometimes even with the customer. So part of the volume that we have intentionally also lost is walking away from deals that are not worth taking. So there are many components in this equation and we really haven't really bottom-up looked at how much comes from where, and that also differs from quarter-to-quarter, so it really doesn't give that much information, as long as that number is there and we can see it coming. The other thing is also that a lot of these things have been negotiated months and months ago, but they kick in. So, typically, you can negotiate a new contract and a new pricing 3, 4 months before it kicks in. So we also know what has been coming going forward. Same goes on the raw material side, sometimes we have fixed deliveries there and we know what's coming in from the raw material side.

Harri Taittonen - *Nordea Markets, Research Division - Senior Director & Sector Coordinator*

Okay. Maybe another question. You have talked about the CapEx projects earlier, but now that the startup is getting closer, would you mind -- I mean, how much can you sort of give -- feel of the, say, the top line impact, combined, just on a very rough basis, and the schedule of the startup curve, like how long it's going to roughly take for the main parts of the CapEx project?

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

The special polymer line in Holland, in Rotterdam, we start the ramp up somewhere in September or something like that, and it will be ramped up by end of the year. That will not have directly so much of a top line effect, more of a bottom line effect next year because we are already delivering those volumes, but we are tolling them out at higher costs. So we are [tolling] manufacturing then with a partner, so we're taking costs down.

Then the customers that we are serving, they will have gradual growth of demand, so that's sort of more organic type of growth, not a step change. The AKD Wax site will basically double our AKD capacity, and that we then deliver all over the world from China and we'll be a clear #1 player in that. We also will be -- which is the most important strategic move also, is we will be backward-integrated to fatty acid chlorination and will be self-sufficient to our existing capacities and our new capacities. So self-sufficiency means that we have security of supply, which has been a struggle. And second, the price point will go to a different price point for us because we are not buying that from outside.

We don't give out the numbers and so on, but I can say that they both have a nice effect to our numbers, above our 15% to 17% EBITDA percentage target rate.

Olli Turunen - *Kemira Oyj - VP of IR*

Thank you. Operator, let's take questions over the phone. And meanwhile, let me remind that you can also type the questions through the webcast, we'll then pick them up here. Operator, please go ahead.

Operator

(Operator Instructions) And the first question comes from the line of Martin Roediger from Kepler Cheuvreux.

Martin Roediger - *Kepler Cheuvreux, Research Division - Equity Research Analyst*

I would like to ask 3 questions, if I may. The first questions are for Petri on financials. In the segment, Pulp & Paper, you reported minus 3% organic sales growth in Q2. Do I understand it correctly that you enjoyed some price increases of, let's say, plus 3%, but the volume decrease was, let's say, minus 6%, therefore clearly more pronounced?

The second question is on your statements about raw material prices. Other raw material prices will be set or modestly increasing you said, but I did not understand the message on the electricity prices and caustic soda, which declined in Q2. How is your view on these items going forward?

And the third question is a strategic question more for Jari, it relates to Industry & Water segment. Your exposure to Asia Pacific in that segment is rather small, only 2%. Thus, the impact from this 36% collapse in sales in Asia in Q2 is also very small. You say that you focus on profitable customers, which is fine, but what I do not understand, the Asia water treatment market has huge catch up potential compared to the Western Hemisphere. So theoretically, it could be a huge business opportunity for Kemira. What does you hold back? Is that a tough competition or anything else?

Petri Castrén - *Kemira Oyj - CFO, Member of Management Board & President of Americas*

Okay. The volume and pricing, I don't think we give by segments, but I'll give you some direction on the minus 3%. Jari talked about the ECOX, which is the sodium bicarbonate business that we closed in Sweden, that was more than half of that 3%. And then the decline in caustic price, not caustic delivered volumes, that probably explains about 1 point of that negative organic growth. So I will say that if you exclude -- if you were to exclude those impacts, we would have roughly flat volume growth. That would be on Pulp & Paper explaining the 3%.

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

And ECOX and the caustic trading, ECOX going out was actually a profitability improvement action. So it's volume -- revenue down, but profits up.

Petri Castrén - *Kemira Oyj - CFO, Member of Management Board & President of Americas*

I'll continue with the second question as well, your question about caustic and energy. Caustic is a huge commodity that is traded globally and we're not really a caustic player, so we don't have a view, much of a view on caustic. And we can afford not to have the view on it because we really primarily trade that and we trade that with fixed fee, fixed margin. So whether the caustic is EUR 500 or EUR 600 or EUR 700 a ton doesn't really impact our profitability. So that's why the caustic -- we're not a caustic -- even as the caustic volumes are quite high, they're actually more than EUR 100 million revenues -- EUR 100 million of revenues for us, we're not really a caustic -- we don't have a caustic exposure of all that much, so I really don't offer much of a view on future caustic prices.

On energy, energy prices, obviously, are much more significant to our business because it's a significant cost in sodium chloride manufacturing process. And there, I would say, long-term trend in energy is up. I mean there's no denying about that. So we have the CO2 emissions and the carbon trading, right, so all are pointing out that the long-term trend is up. Just on the short term, we saw a decline in energy prices. That was perhaps the 2 main contributors to that where good hydro balance in Nordics. Now it's sunny, but most of the springtime it's been raining quite a bit here in Nordics, so the hydro balances improved and then actually it does impact spot electricity prices in Nordics. And the second is, I sort of alluded to that, we actually buy some of our electricity on 5-year contracts. And if you look at the 5-year-ago electricity prices, which are now rolling off, they were at a higher level than what we are currently buying. And so the mix of our basket is sort of -- was quite favorable in Q2. But long term, certainly see that electricity costs will be going up.

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

And I'll follow a bit on the caustic because there's been sort of a technology shift happening beginning of last year. The average prices on caustic in Europe sort of market price has been roughly EUR 450 million a ton before the shift in early 2018. EU banned a mercury-based technology as of January 1, '18. So not a lot of players invested into the membrane-based technology. So we had a sort of a spike going up that caustic went from EUR 450 to EUR 700 and above EUR 700, and now it's coming down again, so that's sort of settling off that technology shift, and that's why I've been talking about this because, as Petri said, we trade over EUR 100 million normally. Then if the price goes up 30%, 40%, obviously, our trading revenue goes up. But now it's coming down, so it's nothing to be alarmed about in a sense, but it's good to understand when we do these bridges.

About APAC and the water treatment. Also there, we have been applying value over volume. So we have discontinued some of our not-so-profitable or even 0-profit contract with our customers unless we get the prices through. We do not manufacture inorganic coagulants in APAC, that's too low-entry barrier. So we only focus on the specialties, which are polymers.

At the moment, we also bring the polymers in mainly from Europe. So we have the time delay on delivery and we have then the additional cost. You might remember that we have a minority on a South Korean polymer JV, and that JV is building a polymer line into South Korea, and we'll be offtaking all of that capacity. Once that line is up and running in 2021, then we have for the first time also local supply and then we can start working more on the water opportunities. But we'll be always a niche player and not going to the big mass players in Asia Pacific, but staying on the high-end side of things.

We supply 2 of the Shanghai 4 water treatment plants, for instance, in China with polymers. We supply in Singapore and these type of things. So that's our main focus and some industrial players and so on. It is a growing market, so we'll play along with it, but only specialty because we can't compete by deliveries from here in Europe.

Operator

Our next question comes from the line of Anssi Kiviniemi from SEB.

Anssi Kiviniemi - *SEB, Research Division - Analyst*

It's Anssi from SEB. First question -- I have a couple of them, so I will take them one by one. First question is basically a follow-up on Harri's question. You highlighted the ramp up in chemically enhanced oil recovery plant in Netherlands and on AKD capacity in China. Could you elaborate a little bit on the cost effect during second half of 2019? Kind of what kind of increase we should expect in euro terms in fixed cost and kind of what will be the effects on EBITDA? That would be really helpful if you can provide that.

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Okay. Yes, the last one, I'll say it will be nice and it will be not just EUR 1 million or EUR 2 million, but a bit more on the bottom line next year. The cost base, actually, is in our cost already. So at the moment, in China, we have the staff there, we are preparing for a startup. We are training the staff. It's actually roughly 250 people that are -- will run that plant 24/7, so 5 shifts and 50 people, roughly, a shift. So we are carrying that cost already and not getting any revenue or margin for it. So costs won't go up more, but then we'll start covering that cost when we get it up and running.

The same is for Rotterdam or our Botlek site. That cost is mostly in. There might be some ramp up costs. Few first batches might be that they're off-spec and so on and so on, but those are not significant in that sense. So we talk about maybe if there are quality issues with the first batches, we'll talk about 100,000 or 200,000 or those type of ranges, so really don't move the needle. So the question is really that how fast, how reliably can we get it up and running those both sites.

Petri Castrén - *Kemira Oyj - CFO, Member of Management Board & President of Americas*

Just maybe to sort of clarify and give a bit more detail on the China site. So because the site already can manufacture AKD, although the chlorination facility is not yet completed, we have decided to start amortization and depreciation of the asset already. So that -- and that is an impact that actually dilutes pulp and paper EBIT margin and EBIT because we take something like EUR 1 million a month, EUR 2 million a quarter of depreciation and amortization on that site, while it's not really delivering any margin, so that is one explanation. But because we have already started it, that will not sort of -- that -- sometimes often -- typically, you start depreciating when the site is in commercial use. We actually -- technically, it's in commercial use, but it's not delivering yet, so that's why the depreciation is already in the books.

Anssi Kiviniemi - *SEB, Research Division - Analyst*

That's clear. Then a second question relates to pulp markets and perhaps in wider terms, Pulp & Paper division and your demand there. Or kind of have you seen an impact on slowing production, especially in the forms of extended maintenance breaks from your customers? Because we have seen a couple of announcements that directly impacted you. But how do you see you where delivery is going forward? Will we see negative volume development on that site in Pulp & Paper? And if you would give us something on that, that would be helpful.

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Yes. So we all read from the media on what the development has on the pulp development. If we go to South America and hardwood pulp, those companies that have higher inventories, they're not our customers. So if they are curtailing us -- they say they are curtailing production, has no impact on us. So we're looking at the number of customers that we are serving. And in South America, no meaningful things beyond a few shutdowns, so nothing that has really moved the needle. The surprise shutdowns for mechanical problems and so on have been more of an impact than a shutdown. But as I said, across the board, our customers have had longer shutdowns this season than last year as last year they were running pipes hot -- red hot, and this year not so much. But not a big impact yet, so we are obviously following the situation.

Anssi Kiviniemi - *SEB, Research Division - Analyst*

Okay. Then continuing in Pulp & Paper. It's a typical seasonality that Q3 is the strongest quarter of the year. Are there any factors why this should not be the case in 2019?

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Last couple of years, the profitability development has been tail-weighted to the second half. And this year, the profile won't be that way so much because of we had last year the currency issues and the raw material swings, which we then started to catch up and so on, so not as much as tail-weighted. But yes, historically, our Q3 has the strongest delivery. Let's see what happens now this Q3.

Anssi Kiviniemi - *SEB, Research Division - Analyst*

Okay. Then the last question, it's about Industry & Water. To what extent the earnings growth has been driven by Oil & Gas, not to which extent by the Water Treatment business that you have? If you could give some kind of split or indication that will be really good.

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Well, we always, in our quarterly report, give the revenue of Oil & Gas, and now it was EUR 77 million, and that was up organically by 30% and I believe reported was up 36%, so you can do the math from there. Our water business is more steady business with low single percentage growth. And now we have also been optimizing value over volume, so we've been giving up also contracts that eat our volume, but give us no bottom line. So if we haven't gotten, for instance, in polymers, the pricing through, we might have walked away from some of the volumes. So quite a bit of that comes from Oil & Gas.

Operator

Our next question comes from the line of Panu Laitinmäki from Danske Bank.

Panu Laitinmäki - *Danske Bank Markets Equity Research - Senior Analyst*

Firstly, I'd like to ask about this margin expansion driven by the higher pricing. Q2 was a rare quarter when you had higher pricing but lower variable costs, and sounds like you are expecting lower inflation going forward than before. The question is that how did you see this impacting your pricing? Are you seeing that it would get a bit more difficult to increase or keep the pricing, for example, in the oil and gas chemicals given that kind of decline in the propylene price? And overall, how did you kind of -- can you comment how do you see the margin expansion proceeding in the second half compared to the first half? And maybe finally on this topic, you mentioned that the profitability in Industry & Water was exceptional. What do you mean by that? Does it mean that Q2 was the peak or 2019 overall will be kind of higher than what's achievable longer term?

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Thanks, Panu. Well, like I said, price management, so we need to be sensitive now what's happening in the marketplace. And when we're talking about the whole basket of products, not so easy to answer. But on polymers, price increases, unless we have contracts that are totally out of date, in general, price increases are pretty much here and let's see where the raw material goes. So we'll be sensitive about that.

As I said, in coagulants volumes, there continues to be a creep up on acids and ferrous and aluminum hydride. So, there, we need to continue that. So it really is dependent on which product, which pocket, which market are we talking about, so not a clear answer. Well, exceptional is the best ever, so you could sort of say that, that's exceptional. Then, obviously, I've asked Antti to keep the asset going, but let's see how the market goes. We've guided that both segments need to be in the 15 to 17. Well I'm not going to ask Antti to drop it to 17, but let's see how the competitive environment goes forward. So we are over the range at the moment.

Petri Castrén - *Kemira Oyj - CFO, Member of Management Board & President of Americas*

Just to elaborate -- Panu, if you want me to elaborate a little bit on the cost side. I tried to sort of talk about the electricity and caustic just for the reason of sort of give you background to your question, meaning, that the EUR 5 million raw material decrease that we saw was primarily caused by these and those are sort of temporary or not benefiting us. So, overall, we see that we still are at flat to moderately growing environments. So the sign on that [road] may well change. It may still be the same next quarter, but it may as well change. But I think the general direction still continues to be fairly favorable for the short term.

Panu Laitinmäki - *Danske Bank Markets Equity Research - Senior Analyst*

Okay. And then, secondly, on Pulp & Paper, you mentioned kind of short-term demand softness in the market. What do you mean by that? Do you refer to these longer maintenance shutdowns that you saw or is this something that you kind of expect to happen? And maybe also on Pulp & Paper, last year, you kind of said that the longer contracts in that business, where you're postponing price hikes and then you would kind of catch up this year, is the kind of margin expansion in (inaudible) is ongoing according to your plan that you had when the year started?

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Actually, it is going pretty much to our plans. Obviously, last year, when we started price hikes, the raw materials continued even after the price hikes to increase, so we needed to go for a second round, but we are there. Then the other side is the product mix and optimizing the volumes and what we manufacture and where we deliver that.

On the pulp side, I'd like to also point out that when our customers have shutdowns, we can sell that product and take it, so sodium chloride travels quite well. And for a number of sites, we produce dry products. So if a customer is down, we can also think of taking some spot business from Asia or somewhere else because it can't be shipped around the world. From our Uruguay site, we for instance ship to Asia Pacific, we ship to South America, to India. So it doesn't really mean that we are not delivering when someone is having a maintenance shutdown. We take the opportunities to deliver it somewhere else.

Panu Laitinmäki - *Danske Bank Markets Equity Research - Senior Analyst*

And can I just ask about a comment on the softness -- demand softness? So were you referring to what you saw in Q2 or kind of what are you expecting in the second half?

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

More of what we saw in Q2 and mainly through the shutdowns and then maybe more of the market noise, so softness in the market that didn't necessarily hit us. For instance, the huge inventories in the hardwood pulp in South America doesn't hit us in a sense, but is something that impacts the ecosystem and then that was more of a comment that way. So that's why I said that there was softness in the markets, spot prices have come down, but it really, really didn't hit us on our demand.

Panu Laitinmäki - *Danske Bank Markets Equity Research - Senior Analyst*

So without giving any numbers, would you expect the organic growth to be better in the second half then than kind of flat, excluding the issues that you mentioned seen in Q2?

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Well, ECOX, so caustic soda and so on, that's what we're pushing for, but it's a complex, complex thing. But the underlying growth there is still okay.

Operator

(Operator Instructions) Our next question comes from the line of Ben Gorman from UBS.

Ben Gorman - *UBS Investment Bank, Research Division - Associate Analyst*

Just a quick 2 for me. One would be on the dividend, obviously, a long time we've seen growth in that, and this year looking toward, if we annualize things, then closer to sort of 2x coverage. So just wondering at what point you would be comfortable to see growth in the dividend again. And then in terms of the market, in particular, it's sort of related to some of the questions earlier, but what are you seeing from competitors in terms of pricing? Is it a particularly tight market and that's why you are able to have such a big differential versus variable costs at the moment or really we should start to see this normalizing as others try to take share in this sort of environment?

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

First one, on the dividend, so I don't start to speculate what the Board of Directors will discuss on that. But if you look at our track record, our payout ratio has been really high over the previous years compared to our net profits. So even if we are improving and would keep it on this level, which I'm not speculating, still, we have CapEx ongoing. So maybe that gives you the environment Petri talked about, EUR 180 million to EUR 220 million CapEx sort of range for this year. So maybe we can get some net debt down, even then, but not speculating on the dividend. And then market, on the prices and so on, so as I said, we need to look at case-by-case competitiveness and situation. So it's not a general market situation. But then, it's also what your other competitive advantages are. For instance, in the shale side, we do have differentiated products. And so even if we see some general softness in that market, we haven't felt it yet because our products are in nice demand.

Olli Turunen - *Kemira Oyj - VP of IR*

Thank you, Ben.

Then there's a question here over the webcast from [Andrew Nile]. He is asking 2 questions. Could you please comment on some of the technology and market gaps you see in your portfolio that you would like to fill either organically or inorganically? And then the second question is what sort of growth rates are you getting in food and beverage as Ecolab has made very positive commentary about this market recently?

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Okay. Food and beverage is really not our target market so we are not present there, except through our customers from food and beverage packaging that goes into that market. But that's a bit far away from us in the value chain. So no presence in that area, maybe some adjacent spot business, but I don't even know the value going there. We have ongoing R&D projects and joint projects with customers and partners where we are filling some gaps. For instance, in barriers, we're at the moment, launching some new barrier products that are non-plastic barriers and that sort of thing. We can strengthen ourselves in some areas. It's not that we're present there, but maybe our product mix could be higher for instance. That's why we are investing into these 4 categories of bleaching, coagulant, not so much coagulants, but then polymers and sizing, so there, we are adding and developing things. Don't see sort of huge gaps at the moment, but some small ones are always there. That would be nice.

Olli Turunen - *Kemira Oyj - VP of IR*

Thank you.

Okay. There are no further questions, so this concludes the Q2 results presentation. Thank you very much for your participation and have a very sunny weekend.

Jari Rosendal - *Kemira Oyj - Chairman of Mgmt. Board, President & CEO*

Thank you.

Petri Castrén - *Kemira Oyj - CFO, Member of Management Board & President of Americas*

Thank you.
