Vesuvius Plc Half Year 2022 Results | LSEG | July 28, 2022

Patrick Andre:

Welcome to Vesuvius half year 2022 results presentation. My name is Patrick Andre, Chief Executive of Vesuvius, and to my right with me this morning is Guy Young, our Chief Financial Officer. I will start with some updates on our global performance in the first half, then Guy will give you more details on our financials. I will then conclude with some perspective on our full year 2022, before opening the floor for questions.

Patrick Andre:

We delivered a strong set of results in the first half of 2022, our strongest ever performance since we started trading as an independent company in 2012. Our revenue increased 21% on an underlying basis. Our trading profits increased 69% and our return on sales increased by 350 basis point to reach 12.5%. Despite the need to reinvest in working capital to follow the growth of our top line and to protect our customers against the risk of supply chain disruption, our focus on cash management enabled us to further decrease our net debt to EBITDA ratio, which hit 1.3 midyear versus 1.4 and of 2021. Based on these positive results, the board felt confident to propose an interim dividend of 6.5 pence per share an increase of 5% versus H1, 2021.

Patrick Andre:

The reasons why we could achieve this positive results are that we were able at the same time to fully compensate all of our cost increases with the necessary price increases, and to continue gaining market share through technological differentiation. Starting with a mitigation of inflationary pressures, all cost inflation incurred in both 2021 and 2022 has now been fully recovered through price increases, in both the steel and the foundry divisions.

Patrick Andre:

Regarding market share gains, the steel division volumes grew 2% in the world, excluding China, when the corresponding steel production was declining 4%. The steel division also gained market share in China. Similarly, the foundry division continued to gain market share in most geographies. This could not prevent however, the deterioration of foundry volumes of around 3%, due to the very difficult persistent situation of the automotive markets in the first half of the year. Thanks to this simultaneous successful mitigation of inflation and market share gains, or return on sales reach 12 and half percent during the first half. This performance achieved, despite a difficult market environment confirms the long term profitability potential of our activity and the relevance of our technology driven business model.

Patrick Andre:

Looking forward, all our key strategic initiatives to support future growth and further profitability improvement are now fully on track. On the M and A front, the integration of Universal is proceeding better than planned, and expected synergies will benefit both the Advanced Refractories and the foundry business unit in 2022 and 2023. We have an appetite for these mid-size bolt-on acquisitions, which have proved very successful for us so far. And we will continue to explore further opportunities in the coming months and years.

Patrick Andre:

Our strategic Capex expansions in flow control in India and in EMEA are proceeding as planned. On top of the previously decided isostatic and slide gate expansions, we have also decided end of June to engage the construction of a new flux production facility in India. This new facility, which will cost £5.8 million will be operational beginning of 2024. This flow control capacity expansions will support our market share gains ambitions in the key growth regions of EEMEA, India and Southeast Asia. In parallel, we observe a growing interest of our steel customers worldwide for our robotic solutions, which provides them safety cost and reliability advantages, as compared with traditional solutions. In flow control, we are planning to double our robotics casting technology installations by 2025. Advanced Refractories is also now successfully developing and rolling out its own robotic solutions.

Patrick Andre:

You will find on this slide, two examples of our innovative robotic solutions. On the left side of the slide, you can see a picture of our new flow control robotic solution for the ladle make-up area. This is the area where steel ladles are being prepared and where slide gate plates are being changed when they reach their end of life. Our robotic solutions improve the ergonomics of the workplace by reducing the number of operators needed and by placing the remaining ones in a remote position, not exposed to the dangers of the hot zone.

Patrick Andre:

At the same time, our robots improve the consistency and productivity of the operations through their ability to perform fast and repeatable operations. Our robots also help to increase the refractory's performance, thanks to smart inspection tools, extending the life of refractories under very safe conditions. On the right side of the slide, you will see a picture of our new Advanced Refractories robotic gunning installation, which coupled with our propriety software interface, enables a fully automated repair gunning of basic oxygen furnaces. This high speed automated gunning equipments can deliver material at up to 200 kilos per minutes, halving the repair time of basic oxygen furnaces with a strong, positive productivity impact on the steel plants, where BOFs are the bottleneck of capacity.

Patrick Andre:

On the sustainability front, based on the very positive result we've been obtaining so far, we've decided to increase further our ambition by doubling our reduction target for 2025 to 20%. And by setting ourself a new intermediary target of reducing our carbon footprint by 50% by 2035. We've built a detailed industrial roadmap to achieve this objective. This will imply process and plant optimization and a progressive move to 100% non CO2 emitting electricity sources, including investment in solar, in most of our plants and facilities worldwide.

Patrick Andre:

We will also initiate pilot studies to develop technology, to replace natural gas in ceramics firing. But we are also stepping up our efforts to develop innovative solutions, to support our customers in their drive to reduce their own carbon footprint. And you can see on this slide, a real life recent case study with one of our steel customers. There, the use of our laser technology enables the customer to optimize the useful volume of its steel ladles and to simultaneously increase its steel production output by 1.75%, reduce its refractory consumption and last but not least, decrease its CO2 emissions by 6,500 tons every year.

Patrick Andre:

Let's now look in more details into the performance of the steel division during the first half of the year. As you can see on this slide where the size of the bubbles is proportional to Vesuvius' steel division cells. Steel production declined during the first half of '22 in all main regions in the world, the only notable exception being India. On average, steel production in the world excluding China, declined 4%. It decreased even further 6.5% in China.

Patrick Andre:

In this difficult market environment our steel division continued to gain market share through technological differentiation. And as a result, our volumes progressed more than the underlying steel market, both in China and outside China. And within the steel division, our flow control volumes, which you can see on this slide increased faster than average by more than 5% in the world, excluding China. Our flow control volumes outperformed steel production growth in all key regions of the world, without any exception. Let's now have a look at the financial results of the steel division. We already discussed the continuous and very significant market share gains of flow control, but advanced refractories also regained market share during the first half, with its sales volumes at constant perimeter, meaning excluding the Universal acquisition declining only 1% when the steel market was declining 4% at the same time. This is a reversal of last year's situation when advanced refractories lost market share, you remember, due to the disadvantage of having been the first mover in raising prices to compensate for cost increases. The trading profit of the steel division in the first half improved by 97% on an underlying basis to £101.7 million equivalent to the full year trading profit of the division in 2021. Our return on sales improved very significantly by 500 basis, point to reach 13.7%.

Patrick Andre:

Let's now turn to the foundry division. The division results continue to be negatively impacted by the persistent weakness in the automotive sector. And as you can see on this slide, with the exception of India and to a lesser extent, NAFTA, the evolution of the automotive sector continued to be very negative in the first half as compared with last year. And this was not compensated by the other sectors where activity remained, you can see that on the right part of the slide, more or less stable as compared with first half last year. And as a result, the global volumes of the foundry division during this first half were down around 3% as compared with last year. But despite this decline in volume, the foundry division could grow itself by 13% year-on-year on a underlying basis. This was entirely due to price increases, which could fully compensate all cost increases incurred in both '21 and '22. And as a result, and despite the volume decrease, trading profit increased 9% to £25.7 million.

Patrick Andre:

Return on sales, of course, slightly declined as compared to first half last year to 9.5%. But, and it's an important point, improved significantly by 240 basis points as compared with the second half 2021, thanks to the price increases and to the resolution of operational issues in Germany and the United States. We believe the potential for further improvement in the foundry division is quite significant and will materialize when automotive markets will recover. I will now hand over to Guy, who will give you more details about our financial performance.

Guy Young:

Thanks, Patrick. Good morning, everyone. I'd like to start by looking at our sales and trading profit bridges. 2022 H1 reported revenue of £1 billion is some 26% higher than last year's 808 million. Adding back the 13.7 million impact of foreign exchange gives you a prior period underlying revenue of 821.7 million on which we've reported an increase of 175.8 million or 21% to reach this year's H1 997.6 million of revenue, excluding the effect of the Universal acquisition. It is worth noting that the vast majority of the revenue increase in this year was due to price increases in reaction to raw material cost increases, general inflation and supply chain friction costs.

Guy Young:

So turning to our trading profit, our underlying trading profits after eliminating the effects of foreign exchange and the Universal acquisition increased by 69% from 73.6 million to 124. 5 million. The key constituents of this increase were firstly, 6.1 million from volume and market share gains, some 10.3 million, which is a recovery of the lag to our profits in H1 '21. And lastly, a net price impact of 34.5 million. As mentioned previously, this means that the price lag we experienced last year has now been fully eliminated.

Guy Young:

Finally, adding back the trading profit of Universal of 2.9 million to our underlying profit gives our reported trading profit of 127.4 million. If we take a look at the full income statement, our trading profit of 127.4 and the return on sales of 12.5% being an increase of 340 and 350 basis points on a reported and underlying basis, respectively. Our share of post tax JV results were similarly higher and net finance costs also increased mainly as a result of higher draw downs and interest payable on retirement benefit obligations. The effective tax rate was 27.5% in line with guidance and non-controlling interest was higher given the higher earnings at our Indian subsidiaries. Headline earnings has increased by 75% and headline EPS came in at 31.4P, also 75% higher than last year.

Guy Young:

In terms of cash, our cash conversion in the first half was 26% largely as a result of higher investments in working capital of some 93 million and cash capital expenditure of 37 million, which after adding back depreciation and taking into account other working capital movements resulted in adjusted operating cash flow of 33.1 million. This increase in working capital, which we've touched on was intentional as indicated at the time of our full year results. We'd been building inventory levels in Q4 of last year in reaction to the supply chain issues we were facing and to ensure we minimized any customer disruptions.

Guy Young:

We also stated that this trend would continue into 2022 as we had no evidence of a significant improvement in the global supply chain issues at that stage. As a result, our trade working capital to sales has increased to 22.8% as at June, 2022. Driven as you can see by the graphs on the right, predominantly inventory. The inventory build has been in both raw materials and finished goods. Given the expectation of a slowdown in the second half, we have started to reduce our inventory, which is on a downward trend as at the end of Q2. Our focus in the second half is going to be to continue to reduce our inventory levels, including the extension of shutdowns where necessary and taking the inevitable profit impact of lower fixed cost absorption. Finally, in terms of our net debt position, net debt the half year was 327.7 million, an increase of just over 50 million from the December position with operating cash flow being more than offset by income taxes and dividends paid. Our net debt to EBITDA improved from 1.4 times on a post IFRS 16 basis at December to 1.3 times. Well within our comfort zone of 1.25 to 1.75 times. We feel we remain in a strong position from a balance sheet perspective and expect to further improve this in the second half with the focus, as I mentioned on working capital reduction, which will both improve cash flow and help fund our organic growth. I'll now hand back to Patrick for the outlook. Thank you.

Patrick Andre:

Thank you, Guy. We expect a further deterioration of our market environment in the coming months. Vesuvius is however, well prepared to conform this temporary slowdown thanks to our lean, decentralized and entrepreneurial organization. This together with the very positive result of the first half makes us confident that full year group trading profit will be towards the top end of the range of current analyst expectations. Beyond the current temporary slowdown, we remain fully confident in the longer term growth potential of both our steel and foundry end markets. And we are continuing at pace, the implementation of our expansion capital investments, in particular in Flow control. Thank you for your attention. And I propose to open the floor for questions.

Mark Davis-Jones:

Okay, fine. Thank you very much. Mark Davis-Jones from Stifel. If I can just start on the supply chain issues and logistics, because obviously that's part of the inventory build. Can it be part of the unwind too? Are you seeing any easing of that situation either in terms of cost or reliability of delivery? We are hearing some tentative signs that things are looking a little bit better. What are you seeing?

Patrick Andre:

It's a very good point. As you know, we have increased voluntarily our trading working capital intensity, means the ratio of trading working capital to sales, by a couple of percentage point from 20.9% to 22.8%. Because we wanted to protect our customers against those risk of supply chain description.

Patrick Andre:

We are starting to see, you're right, the beginning of the improvements I would ... But we believe it will take time and that these improvements should materialize progressively over the coming months in terms of reliability, and this is an important point, somewhere between now and mid-year next year. We don't believe that from one month to the next, with a magic wand, everything will become wonderful. We believe that it will take several months before things get back to normal in terms of reliability. Somewhere in the course of '23. And in my opinion, probably not before the middle of 2023.

Patrick Andre:

When this happens, it will enable us obviously to get rid of this buffer that we built over the past few months. And we believe that progressively between now and I would say the second half of 2023, we'll be able to bring back down our working capital intensity a couple of percentage points on or around between 20% and 21%. Which we believe we are now able to sustain in normal supply chain conditions.

Mark Davis-Jones:

Great. Thank you. Can I ask a slightly unfair one? I know it's difficult to see what happens in the next few months, let alone further ahead of that. But obviously there's a very sharp differential implied in guidance between the first half and second half profit. There are some exceptional positive factors in the first half, some exceptional negative factors in the second half as you unwind that inventory. Can you give us a bit of help in the moving parts looking into next year, both in terms of cost and price, but also some of those incremental investments coming on stream, some of those moving parts.

Patrick Andre:

Thank you. The unfair questions are for the CFO.

Guy Young:

Mark, so the H2 you've touched on, we have got positives and negatives in both. But the second half is definitely going to be impacted predominantly by that fixed cost absorption, which I think we've touched on.

Guy Young:

The one thing that we haven't gone into a lot of detail on is one other positive in the first quarter of this year. Which was essentially a number of Middle Eastern customers and North African customers who had preemptively taken a full year's allocation of, in particular, advanced refractory product. And that was done at the time when they were concerned with both price increases and security of supply. So there is an incremental four million in the first quarter or first half that won't be repeating as well.

Guy Young:

I can only reiterate your own adjective, I think this is an unfair question because as we've sought to try and underline the uncertainty that we're feeling about the second half, it only extrapolates into 2023.

Guy Young:

But if we take a look at our second half as it stands, we by definition are looking at a volume reduction. That volume reduction, if we assume is a similar scenario for next year, we would add back some of our fixed cost absorption issues which we expect to see in the second half. And that along with any incremental volume means that we should be looking at a slightly stronger like for like first half of next year versus the second half of this.

Guy Young:

So for us, whilst '23 is inevitably going to be lower than 2022. It's very difficult for us to give you any kind of exact parameters. We do feel that we've organized ourselves from a cost perspective to be ready for the upturn. And where consensus stands at the moment on '23, we're not suggesting we should go up or down, we don't really have a sufficiently well thought through or evidence based perspective on '23 to give you much more I'm afraid.

Mark Davis-Jones:

Thanks very much.

Andrew Douglas:

Good morning, gentlemen. It's Andrew Douglas from Jefferies. I have five questions. They will all be quick hopefully. Let's start from the top. Can you give us an update on where you believe your customers' inventories are? I'm under the impression that they might still be a touch high, which is one of the reasons you are a bit cautious on the second half as well as the macro backdrop.

Andrew Douglas:

Second question. Or I can do it one at a time if you want. I don't mind.

Patrick Andre:

I can start with this one. Yes, I think you're right. We believe that our customers' inventories, in steel in particular, are too high. And that coupled with the fact that as you know steel prices are going down creates a strong incentive for decreasing inventories in the coming months. Which is an effect which we are factoring in our guidance. It's one of the reason we are integrating significantly lower volumes in H2 for apparent consumption, as compared with H1. And I think it's relatively sound that probably mostly in Q3, we see some reduction of steel inventories which needs to happen.

Andrew Douglas:

The second question relates to the RCT installations. I seem to have been talking about robotics for quite a while now. Looks like you are targeting a doubling by 2025. Is that a bit backend loaded? And what's driving that? Is this new products that have come to market which the customers can't do without? Or they've been waiting for a couple of years to do it and now they feel they should? I'm interested as to what's changed for that doubling to come through.

Patrick Andre:

We have around 25 of such RCT installations up and running today worldwide. We think that we should hit on over 50 by 2025. And think it's a very classical phenomenon in the steel industry. The steel industry is relatively, for good reasons, a conservative industry, adoption takes time. So you have some acceleration of the adoption curve. I think that many steel customers when they see that our robotics installation, which are really new and innovative as compared with historical practice, when they see that it's working, and we are of course organizing visits and proposing visits to the aspiring customers to visit, and existing customers to see that it really works.

Patrick Andre:

Because Vesuvius sells robots that work, not robots that you will install and which will work 2% of the time. So they really work all the time. We maintain our robots and we propose to our customer to maintain and guarantee the operating rate of our robots during their lifetime.

Patrick Andre:

And then it creates confidence. It's a virtuous circle. It creates more and more confidence for our steel customers to adopt those solutions. So it's a welcome, but relatively predictable pattern toward this kind of acceleration of adoption of new solutions.

Andrew Douglas:

Thank you. Secondly, on India, we've got additional capacity being put in there. I seem to remember a debate about India three or four years ago as to how strong India might be on a 10 year view. If you listen to the Indian steel makers, they're going to take over the world. Are we getting a bit more optimistic about the Indian market on a 5, 10 year view? Or is this how well you guys are doing relative to the market?

Patrick Andre:

It's both. We are fairly optimistic in terms of the steel production evolution in this part of the world. And it's not only India, it's India and Southeast Asia and Vietnam in particular. We believe that this India plus South East Asia region will be in the 20 years to come by far the fastest growing region in the world in terms of steel production evolution. And very logically, we are reinforcing our steel production base in this part of the world in a very selective way.

Patrick Andre:

We are reinforcing mostly in flow control or in advanced refractory in very specific product lines where we believe we have a technological differentiation. We don't go in the commodity part of the advanced refactories market where everybody wants to go and which we believe will be a blood bath for value producers. So we go where we have differentiation. And thanks to that, we are progressing quite well, not only of top line, but our profitability in this part of the world.

Andrew Douglas:

Nearly done. ESG targets, clearly quite punchy. Can you talk to us about the costs associated with that. My understanding again is it's reasonably sensible. And from a P&L perspective, we might actually see some benefits rather than cost. Is that a fair comment?

Patrick Andre:

Yeah, it's a fair comment. I think to give you an order of magnitude, our assessment is that to reach this 50% reduction of carbon footprint in 2035, as compared with 2019, we will need between today and 2035 to invest an incremental £60 million as compared with our normal run rate of capital investment. We mean a little bit less between £4 million and £5 million every year. It's significant, but it's not that significant to achieve such an ambitious target of 50% reduction.

Patrick Andre:

And on top of that, we believe, fervently believe, we are quite confident, because based on these studies that not all but a significant number of these incremental investment will have a profitability associated with it, because they will improve our energy efficiency. And all in all, this will have a positive impact on our P&L over the coming 12 years, because we are clearly when we dig, and we are not the only one, but when we dig, we discover that probably there are some low hanging fruits in terms of potential for energy efficiency improvement. Which is the right thing to do.

Andrew Douglas:

Okay. And then last, but by no means least. If we think about the sequential evolution of the end markets in the second half, we can pick our number for organic declines. Are you guys still pretty happy with a 30%, 35% drop through? And how does it need to evolve before you start taking some cost action in terms of structural costs or temporary costs? Just how are you thinking about that?

Guy Young:

So Andy, the 30% to 35% we think still stands. Again, just to underline it though, on top of that 30% to 35% is the fixed cost absorptions we've chatted through. In terms of further cost reduction. At this stage, we're looking at an H2 that is projecting significant volume declines. As we sit here at the end of Q2, we've seen certain weakness in order books and off take in comparison to forecasts, but not significant enough that we can read through whether that is simply seasonality or the start of something else.

Guy Young:

I don't think we should be looking, at this point in time, for any significant cost reductions over and above the normal drop through. Until such time as we have got A, confirmation that the decline is there, and B, that it's going to last longer than we might expect. Because we remain fundamentally convinced that our end market growth is going to be there. There are two markets that continue to grow and we believe should be invested in.

Guy Young:

So we shouldn't be taking too much cost out at this point in time. Our belief is that we are right sized for volume increases, so we would need to be convinced it's something more than temporary before we took much further action.

Andrew Douglas:

Okay. That's really kind. Thanks guys.

Guy Young:

If there's no-

Patrick Andre:

No further questions?

Guy Young:

We can go on online.

Patrick Andre:

Some questions online, maybe?

Operator:

We don't have any questions on the phone lines.

Andrew Douglas:

Andy Douglas, again. Can you give us some idea of your M&A pipeline? You've talked about the desire to do some bolt on acquisitions, just what's that looking like? And are price expectations sensible? Or do we have to meet in the middle somewhere?

Patrick Andre:

Thank you. So no, I cannot give you some ideas, as you can imagine, of the M&A pipeline. But I can say something about our M&A pipeline. Together with Guy, about four years ago, we have screen the landscape and we have identified on or around 20 potentially attractive M&A opportunities. We've been able, over the past few years, to materialize two of them, CCPI and Universal, out of the around 20 attractive targets we had identified with Guy. The vast majority of them, more than 80%, are midsize bolt ons acquisitions. So it means that there are some remaining on a list beyond the two that we have already implemented.

Patrick Andre:

And we are continuing to adopt a proactive approach in this regard, so we have ongoing contact with a certain number of companies on that list. But there is absolutely no certainties that any of those would materialize in the coming months. As you know, there is always uncertainty. But clearly we have an appetite, because we like these bolt ons, they are easy to integrate. The level of synergy is generally high, they fit very well with our strategy. So we have clearly a strong appetite to continue beyond Universal and CCPI these bolt on strategy acquisitions.

Andrew Douglas:

Does that extend into the market? You moved into... well, you bought an aluminum business four years ago, five years ago. Does that strategy still stand?

Patrick Andre:

You're right. When we bought CCPI, there was one of the subsidiaries of CPPI, which we bought at the same time. It's called Permatech. Which is a very good company, active only on the aluminum sector. So it's a metal flow engineering, but in the aluminum sector. First, this acquisition has had quite a positive impact on our organic growth, because in advanced refractories we have been transferring the technology. And we are in the process of transferring the technology of these Permatech subsidiary to all of our operations worldwide, which allow us to reach new aluminum customers everywhere in the world. And yes, among the several companies that we would be potentially interested in, some of them are active in the aluminum sector.

Patrick Andre:

If there are no further questions online? No, so doesn't seem to have any further questions online. Thank you very much to all of you for attending today, both in the room and online. I wish you a very nice day. And, as usual, you can reach Guy and I in between calls for any questions you may have. Thank you very much for your attention.