Full Year 2022 Vesuvius PLC Earnings Call
2 March 2023 08:30:00

Vesuvius plc;
Patrick Andre, CEO
Richard Sykes, interim CFO
Andrew Douglas; Jefferies LLC, Equity Analyst
Bruno Gjani; BNP Paribas Exane, Research Analyst
Dominic Convey; Numis Securities, Research Analyst
Dominic O'Kane; JPMorgan, Analyst
Harry Philips; Peel Hunt, Analyst
Mark Davies Jones; Stifel, Research Division

Patrick Andre Good morning, ladies and gentlemen. Welcome to Vesuvius 2022 Results Presentation. My name is Patrick Andre, Chief Executive, and to my left with me this morning is Richard Sykes, our interim Chief Financial Officer, pending the arrival of Mark Collis. I will start with some updates on our global performance during the year 2022, then Richard will give you more details on our financials. I will then conclude with some perspectives on the year 2023 before opening the floor for questions.

First, I'm very happy to present to you today our fully audited accounts for the year 2022, less than 1 month after the cyber incident, which forced us to shut down all of our IT system worldwide beginning of February. I'm very proud of the outstanding work of all Vesuvius personnel to defend against this attack over the past few weeks, and I'm happy to confirm today that we've recovered all of our systems worldwide, that all our plants are completely operational. The security of supply of our customers has been fully preserved, and the impact of this incident on our 2023 results will be limited to a one-off cost of GBP 3 million to GBP 5 million corresponding to the cost of restoring our systems with the support of external qualified consultants.

Coming back to our 2022 result, you can see on that slide that we delivered a record set of results last year despite the difficult market situation in the second half and the strong inflationary environment. These are the highest result ever of Vesuvius both in terms of trading profit and in terms of profitability, exceeding the previous pre-pandemic record despite significantly lower volumes.

Our revenue increased 18% on an underlying basis. Our trading profit increased 50% on an underlying basis and 60% on a reported basis due to the average depreciation of the pound during the year. Our return on sales increased by 240 basis points to reach 11.1%. If our sales volume would have been similar to 2018, we would have been relatively close to our midterm objective of 12.5%.

Despite our decision to reinvest in working capital to protect our customers against the risk of supply chain disruption and a record level of gross related capital investment, we could increase our cash conversion ratio to 82%. This strong cash management discipline enabled us to strengthen further our

balance sheet and reduce our debt-to-EBITDA leverage ratio to 0.9x below at the end of the year versus 1.4x last year.

The main reason behind this positive result was our ability to simultaneously fully compensate our cost increases with necessary price increases and gain market share through technological differentiation. I'm very pleased, in particular, with the performance of the Flow Control business unit, which could again gain market share in volume in most key steel producing regions.

More than ever, the success of our business model relies on our technological differentiation and the value that we are creating for our customers. Our new product sales ratio, defined as a percentage of our turnover, realized with products which didn't exist 5 years ago, increased again to 16.2% this year as compared with 15.3% in 2021.

To further increase our technological lead and pave the way for more market share gains in the future, we've decided to increase our research and development spend by 18% in 2022. This amount, which is fully expensed in our accounts will continue to grow in the coming years. Our new material science and robotics excellence center in Belgium was formally inaugurated last year and has already been visited by more than 25 customers delegation from all over the world.

We remain very confident in the long-term growth potential of our steel and foundry end markets beyond their current short-term weakness. We are as a consequence expanding our capacity especially in Flow Control and the Steel Division to serve the growing Asian and Middle Eastern markets. In particular, we will progressively develop over the coming years a new flagship plant for the Steel Division in Vizag, in India.

Let's now look in more details into the performance of the Steel Division last year. As you can see on this slide where the size of the bubbles is proportional to Vesuvius Steel Division sales, the steel production declined in all major regions of the world in 2022 with the only notable exception being India.

This decline accelerated in the second half, and in particular, in the fourth quarter, as you can see on the right side of the slide. The only positive outside China was again India in the fourth quarter. China also slightly improved by a small 2% but from a very low point. We expect the first quarter of 2023 to remain at a very low level, an improvement to only start in Q2, but at a slow pace, which will only accelerate towards the second half of the year.

Our Steel Division continued to gain market share through technological differentiation and our volume progressed more than the underlying market in most regions. In particular, our Flow Control volumes, as you can see on the slide, progressed faster than the steel market in all regions outside China and similar to market in China. Market share gains were particularly pronounced this year in India and in the Americas, North and South.

Let's now have a look at the financial results of the Steel Division. The trading profit of the division increased by 69% to GBP 173 million. The division's return on sales increased 280 basis points to 11.5%. The technological differentiation of the division enable it to successfully execute its pricing strategy to fully compensate for all cost increases.

At the same time, this very same technological differentiation also enables the division to gain market share. To maintain this positive momentum in the future, we are increasing further our R&D effort with a 17% increase in 2022 after a previous increase of 10% in 2021. And I would like to mention here that the 2020 base was not particularly low as you will remember that we didn't cut at all our R&D expenses during the pandemic. All R&D costs are fully expensed in Vesuvius account, not capitalized.

Let's now look at Foundry. It's a bit of a complicated side, but if you look at this slide, Foundry markets, further declined in 2022 especially in China and EMEA, as you can see on the left part of the slide. These 2 markets of EMEA and China represent close to 50% of the consolidated Foundry Division sales, and their decline could not be compensated by a better performance in the other regions. To be noted, however, a slight improvement, the beginning of an improvement in the light vehicle market in all regions worldwide last year including in EMEA and China, and we expect this recovery in the light vehicle market to continue and probably to accelerate a bit in 2023.

Despite this persistent weakness in the end markets, of Foundry, the Foundry Division could improve its trading profit in 2022 by close to 35% to GBP 54 million and improved its return on sales by 130 basis points to 9.9%. The division could achieve this performance by successfully increasing prices to compensate for cost inflation, and at the same time, as in the Steel Division, gaining market share in most regions due again to its technological differentiation, same business model as in Steel. Only exception was EMEA where the priority given to necessary price increases translated into a minor loss of market share, which we expect to fully recover in 2023.

As in the Steel Division, we are increasing very significantly our research and development effort in Foundry, 21% in 2022, with the objective to increase further our technological differentiation and support market share gains in the future.

We remain very confident in the long-term growth potential of our Steel and Foundry end markets, especially in Asia, Middle East, Africa and Latin America. As a consequence, we are pursuing our capacity expansion program to fully benefit from this growth potential. Over the 2 years, 2022 and 2023, we will dedicate a total of GBP 110 million to this expansion program, which will represent around 60% of our total CapEx spend over those 2 years.

The major part of this expansion program relates to the Steel Division and especially to Flow Control in India and EMEA. However, we are also expanding our Advanced Refractories capacity in India to serve the fast-growing steel market in this country and in the wider Asian area. We will progressively develop in the coming years, a new flagship greenfield plant in Vizag, in India, manufacturing both Flow Control and Advanced Refractory product. This new state-of-the-art facility will, in 5 to 10 years, become our

most important plant in Asia and will support our long-term development and market share gains in this growing region.

In the Foundry Division, we are expanding our existing plant in China to serve the growing aluminum foundry market in the country. All those investments will be operational by 2024, exactly when we expect the market to recover. These investments have the potential to generate an incremental GBP 40 million incremental EBITDA when at full capacity which we expect to be around 2026, 2027. You will also notice the structurally low level of our sustaining CapEx needs at around GBP 40 million per year. GBP 40 million per year only is what we need to keep all of our plants in good shape worldwide. This illustrates the very low capital intensity of the Vesuvius business model.

You will find on this slide a few illustrations of our ongoing expansion projects. On the top left, you can see our Kolkata Flow Control plant in India, where we are increasing our VISO production capacity by 50%. This expansion was completed a few weeks ago and will already support ourselves this year in 2023.

At the bottom left of the slide, you can see some pictures of the groundbreaking ceremony of our new flagship plant in Vizag, in India last September. The monolitics and flux investments already decided in this location will occupy less than 1/4 of the total land available leaving very significant potential for further expansion and extension of new product lines in the coming years.

Finally, on the right side of the slide, you can see a picture of our Foundry expansion in China, where a new flux line will enable us to accelerate our penetration of the aluminum foundry market, which is growing rapidly in line with the electrification of the light vehicle market in the country.

On this slide, you will find a sample of 2 out of the 15 new products, 15 new products which we launched in 2022. On the left part of the slide, this is an illustration of the new Flow Control product specifically designed for our stainless steel customers. We've developed a special internal liner for our VISO product, which will prevent the penetration of stainless steel into our products. It not only improves the lifetime of our VISO piece but also improves the quality of the finished stainless steel products by minimizing the level of impurities in the steel. And as a consequence, the rejects or downgrades for our customers.

On the right side of the slide, you will see our new Rotoclene Foundry product. This is a new melt treatment for steel foundries, which significantly improves the finished casting quality. With our products, our customers can not only reduce the amount of necessary rework and associated labor cost, but they can also reduce their energy consumption and CO_2 emissions, thanks to a sharp reduction in the number of defective steel castings having to be recycled.

And we have many more to come. Thanks to our research and development efforts, we have a full pipeline of exciting -- we find them exciting - new products to be launched this year and in the following years. You will find on this slide representative, but not exhaustive sample of the products

we are planning to launch this year in 2023. I reassure you, I will not detail them all, but I would just like to single out one of them on the top right, our new robotic technology for the ladle make up area of steel plant. This enables -- this will enable our steel customers to significantly improve the safety of their personnel, while at the same time, accelerating the ladle turnaround and improving by doing so, the process efficiency and consistency.

At the same time that we improved our results, we also achieved very good progress in our sustainability agenda in 2022. Our CO2 footprint declined by 19% as compared with our reference year in 2019. And we are now fully on track to reduce by more than 20%, probably significantly more than 20%, by 2025. Furthermore, we have elaborated and have started implementing a detailed plan to reduce our footprint by 50%, 50% before 2035. This plan will be supported by a GBP 60 million investment program over the next 12 years.

Our MSCI ESG rating has again improved in 2022 to AA, and we are now dedicating 73% next close to 3/4 of our research and development efforts to products, which will present enhanced sustainability features as compared with the products they will replace. You can see on this slide the very significant progress achieved over the past 3 years in reducing our CO2 footprint. Our new target of 50% reduction by 2035 which we are very confident we can achieve, positions us among the most ambitious companies in terms of CO2 footprint reduction, not only in the refractory sector, but more globally in the manufacturing sector.

But our contribution to the fight against climate change is not limited to the reduction of our own emissions. We are also supporting our customers' efforts to reduce their own emissions and develop new finished products to support the energy transition. And you will find on this slide 2 examples of how Vesuvius supports its customers reaching their own sustainability objectives.

On the left part of the slide, you will see our new Durasleeve Flow Control VISO product with 20% more product life and significantly more resistant than the previous generation. It allows our customers to reduce the frequency of incidents on the caster line and to reduce by doing so, the CO2 emissions. On the right part of the slide, you will see an example in China, where the use of our SteelEx Pro foundry filters, together with our flow simulation numerical capabilities, helped one of our customers reach the level of quality necessary to enter the wind turbine markets, which, as you know, is developing very rapidly in the country.

I will now hand over to Richard, who will give you more detailed information about our 2022 financials.

Richard Sykes Thanks, Patrick. Good morning, everyone. I'd like to start by looking at our sales and trading profit bridges. 2022 reported revenue of GBP 2 billion is some 25% higher than last year's GBP 1.6 billion. Adjusting 2021 revenue for foreign exchange movement gives our prior year underlying revenue of GBP 1.7 billion, on which we reported an increase of GBP 300 million or 18% to reach this year's GBP 2 billion of revenue.

It's worth noting that despite lower volumes, both in Steel and Foundry divisions, the company managed to gain market share in most regions. The vast majority of the revenue increase in 2022 was due to price increases in reaction to raw material cost increases, general inflation, supply chain friction costs and also some product mix effects.

If I move on to trading profit. So our underlying trading profit after eliminating the effects of foreign exchange and the universal acquisition increased by 50% from GBP 148 million to GBP 221 million. The key constituents of this increase were, firstly, GBP 14 million arising out of 2021 input cost headwind recovery, GBP 11 million reduction from volume due to the depressed markets, partially offset by market share gains and GBP 70 million driven by price increases together with some product mix. Finally, adding back the trading profit of Universal of GBP 6 million to our underlying profit gives our reported trading profit of GBP 227 million. Our return on sales increased by 240 basis points to 11.1%.

If we take a look at the income statement, and in particular, the numbers below trading profit, our share of post-tax joint venture results were in line with 2021, but net finance costs have increased mainly as a result of higher drawdowns in H1 to fund the increase in working capital and higher interest rates. The effective tax rate was 26.5%, in line with guidance, and noncontrolling interest was higher given the higher earnings at our Indian subsidiaries. Headline earnings have increased by 59% and headline EPS came in at 56.5p, 60% higher than last year.

Moving on to cash flow, we achieved our second highest ever adjusted operational free cash flow and cash conversion of 82%. This was despite the increase in net capital expenditure of GBP 86 million, of which GBP 53 million was allocated to expansion projects. The increase in trade working capital over the full year reflects the increase in H1, followed by a reduction in H2 with an overall increase in the year of GBP 35 million. In the coming year 2023, we expect CapEx of GBP 100 million, split 60/40 between growth and stay in business CapEx, and the level of staying business CapEx of approximately 2% of revenue reflects the relatively capital-light nature of our operations.

If I look at working capital, the increase in inventories, which was intentionally commenced in 2021 and continued into H1 2022 in reaction to the supply chain challenges we were facing, and as the supply chain challenge reduced in H2 2022, the decision was taken to reduce inventories, and this process remains ongoing. As a result, our working capital to sales ratio has increased to 23.8% at the end of December, but still remains below pre-pandemic levels.

Looking at working capital in more detail, trade receivables reduced from GBP 433 million in H1 to GBP 378 million at December, a reduction of GBP 55 million. Despite this, the 12-month average days receivable remained constant at 78 days outstanding. Days inventories have increased from 76 days at the end of 2021 to 89 days at the end of 2022.

This is despite the reduction of GBP 43 million in H2, which was achieved mainly through raw material inventory reduction. Our focus in H1 2023 is going to be to continue to reduce our inventory levels, in particular, those of semi-finished and finished goods, which will result in reduced production levels for

a period and may require temporary plant shutdowns. This will have the inevitable effect of lower fixed cost absorption.

Moving on to net debt, in terms of our net debt position, the net debt at the end of December 2022 was GBP 255 million, down from GBP 277.1 million at December 2021. Our net debt to EBITDA improved from 1.4x in 2021 on a post-IFRS 16 basis to 0.9x at December 2022. This is well within our comfort zone of 1.25x to 1.75x. We feel, we remain in a strong position from a balance sheet perspective for the challenges of 2023 and have sufficient flexibility to invest in both organic and inorganic growth opportunities.

And I will now hand back to Patrick for the outlook.

Patrick Andre Thank you, Richard. Looking forward, we expect to successfully -- to continue to successfully achieve market share gains through technological differentiation and new product launches. We are also very confident in our ability to continue to cover cost increases with pricing.

Beginning of 2023, Steel and Foundry markets, remain weak, and we anticipate the rate of recovery to be slow and to only improve later in the year. We will also be impacted in the first half by a negative fixed cost absorption effect related to the reduction of our inventory level. We believe we have to reduce inventory levels. They are too high at the end of this -- of last year and we will also be impacted in the first half by the cost, GBP 3 million to GPB 5 million, as I mentioned earlier, of the cyber incident. Despite this, we are very confident that our 2023 results will be in line with our expectations.

Looking beyond 2023, we expect a positive impact of our investment in research and development, long-term growth initiatives and development of our capacity in fast-growing regions will result in accelerated growth and profitability.

Thank you for your attention. I now propose to open the floor for questions.

Dominic Convey Just 3 if I may. Firstly, in terms of the outlook for 2023, I think it's notable that you're looking for a mid-single-digit volume decline this year or that's the working assumption, whereas some of the big steel guys are a little bit more optimistic and hoping for low single-digit growth. I wonder if you could just perhaps bridge that for us as to why specifically you're a little bit more cautious.

Secondly, just in terms of drop-through on the pure volume element, last year looked as though it was about 35%. And I think in the past, you've talked maybe sort of 25%, 30% is the sensible number to assume to get towards that medium-term target? And if you could just maybe, just update us on that.

And then finally, just in terms of what's going on in India, it's clearly a very attractive market for probably the next decade or so. If you could just let us know where your market shares currently are in

certainly Flow Control, but also in the refractories and whether you're seeing any change in the competitive dynamics there given the attraction for other suppliers.

Patrick Andre Thank you very much. I will answer on the '23 perspective and give you some idea of the bridge. I will let Richard comment on the drop through, and I will take the question of India. Regarding the bridge '23, the underlying assumption of our guidance in terms of volumes, in steel, we believe that we will be at a low point in Q1 and that the pace of recovery, starting from Q1, will be on the right side. We probably already are in March on the right side of the V shape.

But it's a small -- it's a slow side of the V shape, the recovery. So taking this into consideration, the fact that the year 2022 was a continuous decline, we are integrating an underlying assumption of on or around 5% volume decline for our own sales in the Steel Division in full year 2023 as compared with full year 2022. That's the underlying assumption. So if you are more optimistic on the steel market than us, we can go a little bit higher. If we are less optimistic, we go a little bit lower.

In our Foundry Division where the shape is not the same, we believe that we are already at the beginning of a recovery, and we are anticipating a modest but positive 2% growth of our volumes in the Foundry Division in 2023 as compared with '22. So we believe that the real acceleration of growth will be more towards the end of the year or '24 than during the full year if you look at the full year '23 on average.

Then if you look at our results, '23 towards '22 to get rough number, if you start from the trading profit of 2022, GBP 227 million, we'll have a negative volume impact on around GBP 25 million, mostly in the Steel Division associated with our assumption of volume decline. We have a negative foreign exchange of on or around GBP 5 million.

A negative one-off fixed cost absorption impact because we are planning to reduce our finished product inventories in 2023. We believe that the level where we are in terms of working capital intensity end of 2022 is too high, was perfectly justified when the supply chain freight market were not reliable on distorts the reliability is improving. So without any negative impact on the security of supply of our customers as we are managed giving priority to cash management. We believe that the right thing to do is to decline our working capital.

We are planning to decrease our working capital intensity in 2023. The price to pay, if I may, for this priority given to cash management is that this year, we'll have a one-off of on or around GBP 10 million of fixed cost absorption. And we have the cybersecurity incident, GBP 3.5 million, which we are integrating, and we are fully integrating the impact of this in our guidance. This will lead you to what we said that we are in line despite this one-off with our expectations.

Before handing over to Richard to answer your question about the drop through, regarding India, India is a very important growing region. India and Southeast Asia are 2 very important growth regions.

There will probably be the fastest-growing region in the world for steel going forward. And we are -- our ambition is not only to grow in line with the market growth, but to exceed the market growth.

We have, I would say, a very strong market share in Flow Control, that's as anywhere in the world, at least as good as what we are everywhere in the world. Our market share in Advanced Refractory is lower in India. And we see opportunities to increase our market share in Advanced Refractories in India going forward because we have also a very good product in Advanced Refractories.

And we believe that our Advanced Refractory division will grow faster than the underlying market in India. We -- the foundation of this new flagship plant that we are building in Vizag, in India is very important. We believe that the right way to grow in a growing market is to have solid manufacturing foundations with modern, state-of-the-art, very efficient manufacturing facilities. This is exactly what we are building now in Vizag.

And this will support not only our Advanced Refractory expansion, but also our Flow Control expansion because even if we have strong market share already today in Flow Control, we still have the ambition to continue to expand our market share in Flow Control in India and in Southeast Asia. And this plant in Vizag is very well positioned to serve not only India but also the Southeast Asian market.

Richard Sykes In terms of volume, I'm sure as you'll appreciate, I mean, the drop-through depends on many things in terms of whether it's regional, it depends on the product. It depends on the scale of the volume. But yes, I can confirm that the drop-through that you should be taking into account is between 25% and 35%, but that obviously excludes the impact of one-off fixed overhead absorptions.

Andrew Douglas The obligatory 3 questions, if I may. Can we talk about pricing? Clearly, there's lots of ups and downs, raw materials, energy, labor, et cetera. And I know that historically, you've been very honest about prices up and down with your customers. Can you just give us a flavor for where we are in your mind for 2023 at the moment, taking into account the basket?

Secondly, just going on from your growth CapEx plans, clearly, we've got a bit of a couple of years spike. If we think about '24, '25, do you think you need more growth CapEx maybe in different areas, or are you confident that what you're putting in now gives you the right kind of footprint, if you will, for the next kind of 10 years or whether there's more?

And then lastly, M&A pipeline, just wondering what that's looking like. And I know that you're -- you don't want to pay up for things. If you don't do any M&A, we are now below the oldest net debt-to-EBITDA sweet spot. Do we think about buybacks? And what's your view on that? I know that your capital allocation is growth first. But looking beyond that, do we now start to think about buying back stock?

Patrick Andre Thank you, Andy. On the first point regarding pricing, our policy remains exactly the same. And to be early, we have our own pricing policy independent of what other players

of the market could do. And our policy is that we don't reduce prices if our costs do not decline, irrespective of what others may do.

So we have no reason. We are not a commodity player. We have a strong technological differentiation. And our policy has always been remains and will remain that cost input are a pass-through for us. So when our cost inputs increase, we increased our prices in line with that. When our cost input decreased, but we give it back, that's the right thing to do, we believe, to our customers.

And so what is the situation today? Today, we are probably at an inflection point. Last year, where we had growing cost. This year, it's a mixed bag with some costs increasing as labor cost, some costs decreasing as the sea freight. Energy is now starting to decline, but from a very, very low point, very high point middle of this year. So if you look average, over average, things are less obvious.

So for the time being, it's more or less a wash. So when we are looking at our cost base between what increases and what decreases, it's more or less stable. So we have no reason to decrease our prices today. Now if later in the year, the external parameters contributing to our cost base would evolve in a way which will translate into a decrease of our cost base, then we will pass it through to our customers as we have always done. But really, it is the evolution of our cost base which is driving our pricing policy, not what others are doing.

So growth CapEx, what we have in the pipe today, should lead to a very -- and will lead to a very significant decline of our CapEx plan in 2024. Because the program, this important program of GBP 110 million, normally these objectives should be achieved by the end of the year because we want to be fully ready for 2024. Maybe as usual, there is -- sometimes our people are too optimistic and they may have -- there may be GBP 10 million or GBP 20 million shifting to 2024 if they are not able to grow as fast as we would like them to grow, but normally, most of it should be spent this year. So we should have a significant decline this year.

And based on our current market share, we would not need new growth CapEx for a few years. Now it remains our ambition to grow market share in both -- in all of our divisions. And in case we would be successful or very successful in growing our market share, then we could have some other growth CapEx in the year to come. I don't see that much in 2024, but in '25, '26, we could have some growth CapEx. But in any case, it will remain relatively limited because we are structurally low capital intensity business.

So to increase capacity in our lines of business because we are not integrated in mining, and we do not want to be integrated in mining, which is structurally more capital intensive, we have chosen to be low capital-intensity business because we are giving priority to free cash flow generation. So even when we want to increase capacity, we are talking a few millions. It's not the end of the world, if I may use this expression. So this doesn't prevent us from remaining structurally positive free cash flow generative every year, including the years where we have strong capital investment as was the case in 2022.

Regarding our M&A pipeline, you know that for us, the priority is organic growth. We have -- we don't need M&A for us. We have an appetite for M&A, but we don't need M&A. For us, M&A is not a must have. It's a nice to have. So this allow us, and I believe that I'm happy to be in this position to be selective, even very selective in what we are interested in. So we are not very interested in relatively low commodity type of players in the market. We are not buying market share. That's not the way we operate.

We are interested in niche players, which could bring us either a particular technology or a particular presence in a market which is of interest for us, where technology differentiation plays an important role. So we have always been and we will remain extremely selective in our M&A interest. So there is an M&A interest, to avoid any ambiguity, but a very selective one. We'll see if some of the targets we have in mind would or will not become available in the year to come. But it's not essential. It's nice to have, but it's not essential to our long-term strategy. Our main strategy is mostly organic growth.

The point we mentioned is very valid. We are very happy to be at 0.9x net debt-to-EBITDA ratio, which is, as you know, a little bit below our comfort zone. Our comfort zone has remained the same, I would say, probably over the past 10 years. And we have no intention of changing our comfort zone. We have a long-term vision of this, which is between 1.25x and 1.75x. It remains so and will remain so in the foreseeable future. So we are a bit under.

We have no reason to believe that we will not continue to be free cash flow generative in the coming years based on our, I would say, normal activity, stand-alone activity. So you're right. We'll see what happens in the coming months, in the coming 6, 12, 18 months. But if there are some attractive M&A opportunities, I'm sure that the Board will look at it. If there are none, we'll probably reach a point in the coming -- I cannot tell you if it's 6, 12 to 18 months, but there will be a time where we will reach a situation where I'm pretty sure that our Board will put on the table the question of how should we get some money back to our shareholders. How do we -- how will we do that the day we reach that point will depend as usual, on where, what are the market circumstances at the time where the question will be on the table.

Dominic O'Kane So you're making quite a big step-up in your R&D and your CapEx. So could you maybe just talk about how that will influence your previous margin target, your medium-term margin targets? Are they still the right margin targets, or can we see potential upside there in the medium term to long term?

And then my second question, just on CapEx, obviously, India, a big investment for you. Can you just maybe talk us through the level of risk to the gross CapEx? Is there a contingency number in that number? Just talk us through the level of confidence you've got on that CapEx guidance for the growth spend next year.

Patrick Andre Thank you. Regarding R&D, so we have -- I'm sure you have noticed, a very, very strong believer of a technology strategy. By the way, it's interesting to note that you've seen

where we are today in terms of R&D spend, GBP 36 million, GBP 37 million, something like that, between GBP 35 million and GBP 40 million, probably soon over GBP 40 million. Our sustaining CapEx, GBP 40 million. So we are now very close to the point where we will every year spend more in R&D than in sustaining CapEx where we will become more of a technology company than a manufacturing company. It's quite interesting because that's exactly what we want to be. So we believe in R&D. And to your question, yes, we believe in R&D because we believe that R&D is good for margin. Otherwise, we will not do it, good for profit and good for margin.

Now I will not today, over promise. First thing we need to deliver 12.5%. Once we've done that, we'll talk about what follows. But I've had the opportunity to discuss that in previous years. I see no reason why once we reach them, this 12.5% should be a ceiling. There is nowhere carved in stone that the 12.5% is a ceiling. I think this technology model is very powerful. If we fuel the engine with good R&D. And first, we try to do our homework and reach our 12.5%, but over the long term, I don't see any reason why this 12.5% should be a limit.

On your second question regarding gross CapEx, there again, I want to be cautious. We always have surprises with CapEx. This being said, we are relatively well into it now. It's not like the CapEx will start 6 months from now. We are in the middle of the implementation. I don't see today any bad surprises not only happening, but no signs that there would be negative surprises in the coming months. So I am relatively confident in the CapEx numbers. I don't believe that we will have major negative surprises in the months to come regarding our GBP 110 million CapEx program.

Harry Philips Just looking at something slightly different, just the performance of Foundry and where it goes from here. Because if you -- the Steel business compared to, say, 10 years ago, is being transformed, profitability is transformed, margin transformed.

I was just looking back at spreadsheet, Foundry made GBP 70 million, GBP 72 million in 2010. It's got nowhere near that really any time since. It's a very European-centric business or a European cost base. Therefore, what steps Foundry are, what environment do you need? Because I say it has sort of seemingly in terms of returns, marked time for quite a period of time, not just through a cycle, but slightly more structurally? So what do you, Vesuvius, need to do to make that business take a step up to where you probably want it to be?

Patrick Andre Thank you, Harry. It's an excellent question, and your analysis is perfectly right. The strength and the weakness at the same time of the Foundry Division has been historically, it's extremely strong position in Western Europe in the core of the industrial heartland of Western Europe, Germany, Northern Europe, this was really the core of the Foundry. And today, there is an obvious evolution that this industrial heartland of Europe may not be the fastest-growing manufacturing region in the future long term obviously.

So the strategy for the Foundry Division, which we are implementing now over the past 3 years since we have a new BU President whom I selected myself for the Foundry Division is that to grow and

reinforce our presence in the fastest-growing region in the world, India, Southeast Asia, China, Latin America, Turkey, Middle East, and already in 3 years, and we are, I would say, middle of the road in our journey. Already the dependence, the level of dependence of the Foundry Division on its historical stronghold of West Northern Europe has considerably declined.

I think that the GBP 54 million that you've seen we are able to do that today with volumes in this core area, which are more than 20% lower than where they were 4 years ago. So this -- probably nobody would have thought we would be able to do that 4 years ago, the 20% lower volumes in what used to be historically the heart of the Foundry Division. And we are growing very fast in what are now the fastest-growing regions.

So we are redeploying and especially the Foundry Division is doing an excellent job to grow in India, in Southeast Asia, in Latin America, in Turkey. So we are deploying our assets there. You've seen that in our CapEx program, we have -- one of the CapEx is to grow the Foundry Division in China to benefit from the growing aluminum foundry markets growing in line with light vehicle electrification, which is growing very fast in China.

So we are redeploying our assets including our people, including our human resources assets at accelerated speed. I'm quite happy with what the management of Foundry is doing with the speed at which they are managing this cultural change within the Foundry Division. The evolution of Western Europe, Northern Europe is what it is. I don't think it will -- we should not dream that it will come back to where it was 5, 10 years ago.

So the future of the Foundry Division is in the emerging markets. So this is where we are really accelerating our presence. And today, we are on track to succeed. We are really growing a strong leadership presence now in this emerging market, and I see a clear positive momentum, which makes me quite confident that we will soon be at or above the level of results that we had in 2010.

Mark Davies Jones Just following on from that, but also across the Steel business. If we are seeing an accelerating shift in heavier, more energy-intensive manufacturing out of Europe over coming years, does that require further restructuring of your footprint within that EMEA market? Or do you think you've already bitten the bullet on that?

Patrick Andre The answer is no, it doesn't. Because I would not say we saw it coming, but we have been very careful to position our assets when we made the big restructuring in the year 2017 to 2020, we have been very careful to position our assets in a way where we could serve per -- continue to serve over the mature areas where we were traditionally strong, but also be very well positioned to serve the growing markets.

The 2 examples in EMEA. We have positioned our assets, our main important asset, our flagship assets are in Eastern Europe. Very low cost base, very competitive cost base. Today, our labor costs are lower in Poland than in China. And this is a very cost-efficient base to serve, of course, Western Europe as

long as there are customers, are very long in Western Europe, but we are very well positioned to serve the Turkey, Middle East, North African market, which is the fast-growing part of EMEA.

So our existing assets are very well positioned to serve the growth, the growing part of EMEA. In North America, the majority of our key assets are in Mexico. And so inside the USMCA, but very well positioned from a cost base and to serve the market. So today, we do not see any trend, which could justify in the foreseeable future, in the many years to come, any additional restructuring for the -- to adapt the localization of our assets.

Now and you really have seen that in our expansion program. It's about going even further, debottlenecking even further our assets in the fast-growing area. And today, the point where we are debottlenecking very fast is India, South East Asia because there it's growing strongly. And interestingly, we are debottlenecking in Eastern Europe, in Poland, not for Western Europe, obviously, but because the market in Turkey, North Africa, Middle East are growing extremely fast.

Bruno Gjani I was just wondering if you could shed some color as to how sales progressed through the half. So how did Q4 look like relative to Q3?

Patrick Andre The sales Q3 '22 -- Q4... ?

Bruno Gjani '22 over Q3 '22, did you see further weakening in your markets...

Patrick Andre Definitely. Q4 '22 was significantly lower than Q3 '22. So we have a significant decline between Q3 and Q2. And Q1 will probably be at or even a bit lower than Q4. So we are now Q1 '23 is probably the lowest point in terms of sales with clear signs now in Asia and in EMEA. That as from Q2, decisions have been announced already and will be implemented probably now from March, April, May, to restart. So the low point is probably Q1 '23, even more than Q4 '22.

Bruno Gjani Right, okay. So sales down sequentially H1 '23 over H2 '22. And at the same time, you have the underproduction that you have to face, the cybersecurity impact. So it sounds as if the H1 margin could land at 8% or slightly lower than 8%, so therefore, a big implied step-up in H2 to perhaps around 11% to come out to the full year margin of 9%. Is that the right shape as you see it next year?

Patrick Andre At this stage of the year, I will not comment the numbers. Previously, we told you no, no, it's 9.16, but the shape is right. Your shape is right, qualitatively your pretty right, the way we see the year 2023 today is a lower first half than second half.

Bruno Gjani Right, okay. And just finally, just on India. So it sounds as if it's a very exciting growth opportunity. But I was wondering if you could give us some color around the capacity that's being added to the market, not only by yourselves, but also peers. Is it the case that everybody is chasing after this growth? And if we look, I don't know, over the next 3 to 5 years, is there a risk of

perhaps overcapacity being built in this market? Or is the growth outlook just that strong that you don't see this risk really materializing?

Patrick Andre It's a very good reasoning, and yes, I think there is not a single refractory producer in the world who is not investing in China -- in India. Everybody wants to go in India. It's an interesting battlefield where everybody wants to invest in India at the same time. So of course, when generally, these kind of things happen, it's an interesting market in terms of competition. That's exactly the reason why we are very selective about what we do. And we are not interested at all to go in the most commoditized part of the market where the main deciding factor for customer is price because then even if you go, go, go at some point, you have some -- always somebody else coming and trying to eat your cake.

So we are positioning ourselves voluntarily in the part of the refractory market where technological differentiation matters where the customers and customers in India are sophisticated customers, same as Brazil. Brazil and India are emerging countries, but emerging countries, where the steel industry is a sophisticated steel industry with producers not producing low quality steel, but high quality steel having strong ambition in terms of quality of their steel and really making a difference, paying attention and making a difference between those suppliers who have a certain technology level than the others.

So our strategy, we believe that the right strategy to grow in India is technological differentiation. It's not market share, not market share. If you grow market share in the commoditized part of the market. There is always somebody else coming because the barriers to entry are low. We want to go where barriers to entry are high and the real barrier to entry is technology. And that's the reason why we are choosing the path of investing in the greenfield plant in India where we will also build our own manufacturing capabilities, state-of-the-art, able to produce the most elaborated product that we have in our portfolio because our strategy in India has always been to propose to our Indian customers the highest end of the product that we produce everywhere in the world.

We are not proposing low-end product. Only high-end product in India. And we produce in India. Our strategy has always been to produce in India. We produce in India today, and we've been for years. 90% of what we said in India. We don't import in India. We have high-quality manufacturing people in India.

We have a strong people base in India, people who are as dedicated as any of our other operation managers everywhere in the world who are able to operate the most sophisticated equipment that we have in the world. That's the reason why we invest in this quality manufacturing base in India. We believe that this is a winning strategy to grow in India.

Any further questions from the floor? Is there any further questions from the floor? May I ask if there are some questions online?

Patrick Andre Any -- no questions online?

Operator There are no questions on the conference line. So ladies and gentlemen, that concludes today's question and answer session. I'll hand back to Patrick Andre for his concluding remarks.

Patrick Andre Thank you very much for your attention today, and I wish you a very nice day. And as always, with Richard, we'll be available for any further questions you may have in the coming weeks. Goodbye.