Conference Call transcript

18 May 2023

AGM TRADING UPDATE

Operator

Good day, ladies and gentlemen, and welcome to the Vesuvius Plc AGM trading update. At this time, all participants are in listen-only mode. Later, we will conduct a question and answer session through the phone lines, and instructions will follow at that time. I would like to remind all participants that this call is being recorded. I will now hand over to the CEO of Vesuvius Plc, Patrick André, to open the presentation. Please go ahead.

Patrick André

Thank you very much. Good morning, everyone. So, I am Patrick André, the CEO of Vesuvius, and together with me this morning, we have Mark Collis, our Chief Financial Officer. So, we'll give you some updates about our trading performance since the start of the year. The most important message is that we've been performing well since the beginning of the year. Our trading year to date has been positive in both our steel and foundry divisions with both volumes and pricing slightly above our expectations. We are particularly happy with the performance improvement in our foundry division where, thanks to the market recovery and also good performance and good progress of the division, the results are starting to improve as planned. But it's good to see that things are improving as planned.

In the steel division also, we have good performance with volumes more or less in line with general market evolution, which is normal, but resilient pricing in the year to date. Regarding our end market, we are also confirming that we are clearly starting to see the beginning of a recovery since the low point of the Q4 last year. We are now clearly on the right side of the V-shape. This recovery, the pace of the recovery is slow, and the general market volume remains low. In absolute terms, for the steel market, you may have seen the numbers of the World Steel Association, 6.8% below last year in Q1. So, in absolute terms, it remains low. So, there is still a very significant potential for improvement going forward. But the important message is that it's recovering. It's positive, even if it is, for the time being, at a slow pace.

We are quite confident that this recovery of end markets will continue in the months to come. But for the time being, the pace of the recovery is slow. And there is uncertainty about will it remain slow, will it be a slow positive in the coming months, or will it at some point, or when will it accelerate? This of course remains quite uncertain for the time being, but the trend is positive. In this environment, and despite the uncertainty about the pace of the recovery going forward, thanks to the quite good results and quite good beginning of the year, we feel very confident to maintain our expectations for the full year. We'll see when we announce in a few months our results with the half year if it is justified or not to be a bit more optimistic. But at this stage of the year, as always, you know we are always cautious. We believe that the right thing to do, considering the uncertainty going forward, is to maintain our expectations.

In terms of working capital management, we are starting clearly to make some progress. So, we are starting to improve the working capital intensity of our business. We are not there yet in terms of what our objectives are, so we still have some work to do in the coming weeks and months, but we are engaged in the move to reduce the working capital intensity as compared with what we believe are too high levels where we were last year. So, we are progressing well for this objective, but we still have some work to do to go where we want to be in the coming months.

Globally, we remain very confident, and I would say even quite excited by the performance improvement potential that we see in our business when the market recovery will accelerate. And based on this, we are continuing at pace our industry-leading investment in R&D. We are continuing our efforts in R&D. And our gross capital investment program remains fully on track. And as I have mentioned during the presentation of our full year results, our new capacity will be fully on track by the end of the year, meaning that we believe that when the market recovery will accelerate, we'll be fully ready to benefit from it. So, I will stop there, and I propose now to open the floor for questions, and Mark and I will... we are at your disposal to answer your questions.

Operator
Thank you. If you have dialled into the call and would like to ask a question, please press * and then 1 on your telephone keypad. If you wish to withdraw the question, please press * and then 2 to remove yourself from the list. Once again, if you wish to ask a question, you are welcome to press *and then 1. Our first question is from Andrew Douglas of Jefferies. Please go ahead.

Andrew Douglas
Good morning, Patrick. Good morning, team. I have just two quick questions for you, please. When we're talking about the steel market, there's not a huge amount of information in the statement. I understand that the cyber security incident has clouded things a little bit. Do you think you're winning market share anywhere, in particular? Your thoughts on your performance relative to the market across some of the geographies. If you could give us a little bit of a little bit of help there. And then just on R&D, can you just talk about how pleased you are or otherwise with the internal progress on the R&D front, but also the customers' uptake of recent new products? I know that during COVID you couldn't get onto customers' sites, and we've unwound that now. But is there a growing interest in the benefits that you're putting into R&D from a customer perspective?

Patrick André
Thank you very much, Andy. On your first question on cyber security, we are now confirming that the cost of the cyber security incident will be limited to £3.5 million. This £3.5 million is integrated in our trading profit above the line. So, I would not say it's a normal cost, but it's a cost that we have to incur. So, it's completely integrated in our guidance. And we are now fully recovered. We have derived all the lessons of this incident. And I believe now that the level of our protection is even higher than what it used to be before. And we are quite confident that we are equipped to minimise the risk of a repeat. I would never dare to say that we are eliminating the risk, but I think that we are quite solid now in terms of cyber security resilience.

Our performance relative to the market, we are more or less in line with the market evolution at the beginning of the year. It's very difficult at the beginning of the year to have a clear estimate of market share evolution, but roughly speaking, all indications we have at this stage is that our volumes are more or less evolving, roughly speaking, in line with the market evolution. We'll see clearer during the rest of the year, but for the time being, nothing which would indicate a drastic change of trends as compared with the past.

Regarding our R&D, we are quite pleased with the progress and with the response of our customers to the new products that we are introducing into the market, especially in all three divisions, especially in flow control, but also in advanced factories and in foundry. This, I think, indicates the decision we made a couple of years ago not to cut our R&D expenses during the pandemic and to continue to invest in R&D, we are seeing the benefit now. We had quite a positive response from our customers to the new product that we are now introducing to the market.

You know that there is a very important event in Germany at the beginning of June, GIFA Metec, which happens once every four years, where there will be a significant presence of visitors, and where we intend to showcase all our new innovations in front of our customers coming from all over the world. And the first indications makes me very confident in the feedback that we will receive from our customers when they will visit our stands and presentations at GIFA Metec in Düsseldorf beginning of June.

Andrew Douglas
Perfect. Thank you very much.

Operator
The next question is from Moses Ola of JP Morgan. Please go ahead.

Moses Ola
Hello. Thank you very much for taking my question. So, I just wanted to circle back to your guidance and expectations for the year. So, at the H2 call, you talked about your expectations for the year and assumed on a quantitative guidance basis minus 5% sales volume decline in steel and plus 2% volume growth in foundry. So, can I just confirm that, as you mentioned, about maintaining expectations for the year, that those growth assumptions are still intact? And then could you perhaps give us more colour on which regions you're seeing any surprises in?

Patrick André
Thank you. Thank you for the question. At this stage, we are more or less in line with our expectations. I don't see obvious reasons today to change drastically our expectations for the year. We have, I would say, quite a good beginning of the year, confirmation of a good situation in a region like India. Southeast Asia has been a bit quicker for the time being, but we believe that for the part of the market where we are active, things should improve going forward. We see also some improvements in China. The long product sector is suffering in South America, but the flat sector is not that bad, which is important for us. And in the US, it's holding relatively well for the time being. Because we are maintaining what I would call a healthy level of caution, I think that my answer to your question is that we remain in line with our expectations that we expressed during the full year results in early March. We'll see going forward if there are reasons to be or not a little bit more optimistic than that. But for the time being, our base assumption remains the same as the one we communicated on at the time of the full year results.

Moses Ola
Okay, thank you very much.

Operator
The next question is from Bruno Gjani of BNP Paribas Exane. Please go ahead.

Bruno Gjani
Thanks for taking my questions. I just wanted to circle back just on that outlook message. I'd just be interested in the development of trading through the first four months of the year. Were the declines in April shallower than the average of Q1, or is the opposite true? And it's the case that trading has actually been a little bit bumpier through the first four months of the year. Hence, it's another reason why you reserve some of that conservatism in the guidance. Is there any colour that you could perhaps provide in how trading fared through the first four months of the year, just to shape it?

Patrick André
If I understand your question, I think it's fair to say that the trading since beginning of the year has been better than what we were expecting. Now, the fact that we maintain our expectation doesn’t mean that we have any bad news for the rest of the year. It means that at this stage, and because there is a lot of uncertainty in the market, we are cautious. And so, clearly the beginning of the year is for us a bit better than what we were expecting. But at the same time, there is a lot of uncertainty. We all read the same newspapers. And so, there is a lot of uncertainty going forward for the general economy. And I don't think it is a time now to drastically change our expectations for the full year. But obviously, it's better to start a bit above expectation than below. But I don't think we should be carried away. It's too soon to be carried away. It's a positive start. Let's wait to see if it is confirmed or not.

Bruno Gjani Sure. So, while expectations for the year are unchanged, is it fair to assume that the weight of profitability say of H1 over H2 has changed though? So, by that I mean because Q1 is stronger than expected, there's less of a H2 leaning towards your financial performance this year than you would have expected at the start of the year? So perhaps less risk associated around the guidance that was communicated.

Patrick André
I see your point. I think that our expectations, the fact that we maintain our expectations for the year, you are fully right, implies that the balance between H1 and H2 is probably more balanced. It would imply that the balance between H1 and H2 is more balanced than what we saw a few months ago. Yes, you're right. I would not want you to derive that there is a negative perception about H2. There is a strong feeling that we should be cautious.

Bruno Gjani
And I just wanted to ask around pricing, I was wondering if you could share some colour around how it's developed. I was interested in the year-over-year impact in the trading period and how it's also developed sequentially, so the first three months of the year relative to Q4.

Patrick André
For the time being our pricing has been quite solid, quite resilient, and I would say more or less in line with the end of the year. At the same time, we have always said our policy is that raw material prices are for us pass-through. And so, we increase our prices when raw materials go up. We are fair with our customers when raw materials go down. At some point in time, the decline in raw materials will start to materialise in our cost structure. And when it does, we will continue to behave in a fair way vis-à-vis our customers by passing it back through, at least the part of it which we translate in our cost structure, passing it back through to our customers. It's a progressive move because we are not at all… for those raw materials that are important for us, which are different from materials which are important for some of our competitors, for the raw materials which are important for us, there is an erosion in price. There is no huge decline in prices, but when this erosion will translate into our cost structure, then as a matter of fairness for our customers, we will of course. That is true. But for the time being our pricing is relatively resilient.

Bruno Gjani
Understood. And given where spot prices are for raw materials that you purchase and freight, if these spot prices hold, what is your expectation in terms of how much prices will have to come down to or how much you pass on from today's current price level? Are we talking around 5% or is it slightly more than that? What is your expectation? I appreciate it's difficult.

Patrick André
It is difficult at this stage to give you a global percentage because in fact the evolution of raw material prices is very, very different from one type of raw material to the other. The raw materials which are probably where we see the biggest, most pronounced decline is more or less everything related with magnesia type of products. So, magnesia based products, obviously the market prices are declining because for some time now the price of those for magnesia based raw materials has been declining quite significantly. And as is normally the case and always the case, you have an adaptation of the [break in audio].

Bruno Gjani Got it. That's very, very clear. Thank you very much. I'll leave it there.

Patrick André
Magnesia is more an advanced factory type of raw material, not at all a flow control one. For those products that we are manufacturing where magnesia is not used, then the movement of raw material is significantly more limited. So, we do not have the same pricing situation for all of our operations. And the decline in prices is concentrated mostly on those magnesia-based products, which for us is a minority.

Operator
The next question is from Harry Philips of Peel Hunt. Please go ahead.

Harry Philips
Good morning, everyone. Just a couple of questions, please. The first is capital allocation. I mean obviously, Mark, you're now well in situ. Thinking particularly around M&A where there's been quite a lot of activity and obviously [unclear] as well as trade being quite busy and thinking particularly around foundry and what you might need to do there. Given the fragmented nature of foundry, are you seeing more opportunities appear on

your radar screen at this point in time? Then just coming back to China, clearly China has had a very good start to the year. There is some expectation that it tails off in the second half. Just wondering how your Chinese exposure, particularly in flow controls, sits around that, please.

Patrick André
Thank you very much, Harry, for the good question. As always, of course, we are looking very closely at M&A opportunities. You know that our priority is organic growth. We are concentrating on that. But at the same time, we have a very solid balance sheet. We continue to have a good cash generation, so we are continuing, and we will continue to maintain a very solid balance sheet and low leverage on our balance sheet, which means also that we have the financial means in case there will be attractive opportunities to look at M&A. So, we are looking at some opportunities.

However, we are extremely selective regarding what we are looking at. And we have two criteria which are always the same. The first one, any acquisition needs to be a complement to our portfolio in terms of technology and needs to bring us something in terms of technology. And the second point is that the price should be reasonable. So, we are looking at potential acquisition both on the steel side and also, you're right, there may be some opportunities on the foundry side. However, for the time being, we need the two conditions to be met. And we do not have yet on the foundry side an opportunity which meets the two conditions at the same time. We are continuing to look at it and discuss.

Harry Philips
Lovely. Thank you.

Patrick André
The second part regarding China, your second question regarding China. Yeah, I was in China last week, and it was the first time I had the opportunity to go back there over the past three years. So, I had a very positive trip in China. We have a fantastic team in China who has been making very good progress over the past three years, despite their isolation. And the market is clearly getting better, both in steel and in foundry. And I think that the China performance is one of the elements, China performance resilience at the beginning of the year and in all likelihood for the rest of the year is one the elements which makes me confident for the evolution of our overall results for the year going forward. So yeah, it's a rather positive situation in China when I was there last week.

Harry Phillips
Great stuff. Many thanks indeed.

Operator
The next question is from Sanjay Jha of Panmure Gordon. Please go ahead.

Sanjay Jha
Yes, thank you for taking my question. I wanted to get my head around your working capital statement. You mentioned that the volumes were probably better than you had expected. So, I'm trying to understand why you have not seen a much better improvement in your inventory levels. And could you just remind us, what is your target for inventory days for this year or next year? Thank you.

Patrick André
I will pass on to Mark to give you more details about the number of days. But to first answer [unclear], first, we are seeing some improvement. My job as CEO is to be never satisfied, so I'm not happy with the improvements by definition, but we are seeing some improvements. And I would like my team to grow even stronger and even faster, because again, my job is never to be satisfied. But I sometimes have to recognise that they are making some progress. But one of the important points to remind is that, yes, volumes are a bit better than our expectations, but they are very low. They remain very low in absolute terms as compared with anything normal.

And we need to get better. I will not hide that. I think that I'm not completely satisfied with the pace at which we are making progress, but at least we are making progress. And we intend to accelerate that progress going forward. The cyber security incident beginning of the year has not helped because we have been managing without dashboards for quite some time, for many weeks, which never helps. But I think even with this cyber security incident, we've been making some progress. I believe that now this progress will accelerate in the coming weeks and months. But I will hand over to Mark, who will give you some more flavour about what our objectives are in terms of days.

Mark Collis
Thanks, Patrick. So, I guess first thing is we tend to look at a high level up. We'll look at working capital as a percentage of revenue. So, we're aiming at actually improve by about 0.8%. In terms of absolute terms, inventory, it's broadly in line with December. We expect it to be relatively flat over the course of the entire year. We see most improvement in debtors and creditors, and we've already experienced that so far in the first quarter. So, inventory has ticked up a bit but it's not to the point of being material, to be honest. It’s just not quite as much as an improvement that we would have liked. I would say in terms of days, I would expect it to be broadly consistent because in absolute terms it's going to be consistent, and we're not expecting a huge pickup in revenue. And I think Patrick's already made the point, really, that the improvement in Q1 is really being driven by price, not by volume. And that's why we've not really seen the reduction that you are proposing in terms of inventory values.

Sanjay Jha
Okay. Thank you very much.

Operator
There are no further questions on the conference line. I will now hand over to Patrick for closing remarks.

Patrick André
Thank you very much to all of you for attending our call this morning. Don't hesitate to contact Mark, Rachel, and me if you have further questions. So, I wish you all a very good day. And we'll meet again when we announce our half year results in July. Thank you very much and have a good day.

Operator
Ladies and gentlemen, that concludes today's conference. Thank you for joining us. You may now disconnect your lines.

END OF TRANSCRIPT