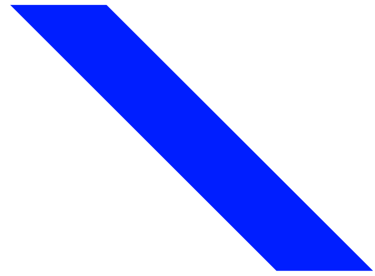
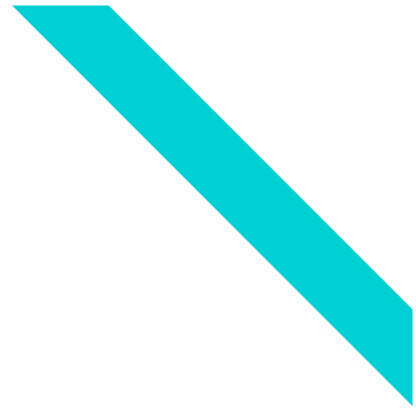


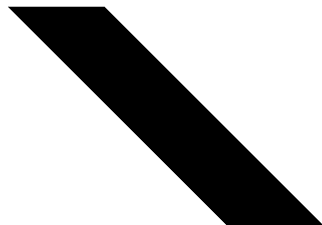
REFINITIV STREETEVENTS

EDITED TRANSCRIPT

HALF YEAR 2024 VESUVIUS PLC EARNINGS CALL



EVENT DATE/TIME: August 01, 2024 / 8:00AM UTC



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- **Mark Collis** *Vesuvius plc - Chief Financial Officer, Executive Director*

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- **Harry Philips** *Peel Hunt LLP - Analyst*
- **Mark Davies-Jones** *Stifel Europe - Analyst*
- **Thomas Elgar** *Deutsche Numis - Analyst*
- **Operator**

PRESENTATION

Patrick André *Vesuvius plc - Chief Executive Officer, Executive Director*

Good morning, ladies and gentlemen. Welcome to Vesuvius half year 2024 results presentation. My name is Patrick André, I'm the Chief Executive. And with me this morning is the Mark Collis, Chief Financial Officer. I will start with some update on our performance during the first six months of the year before Mark gives you more details on our financials. I will then conclude with some perspective on the full year 2024 before opening the floor for questions.

Our results for the first half were in line with our expectations despite weaker market conditions than expected. Our revenues declined 2% on an underlying basis with a positive volume growth in steel, only partially compensating a significant volume decline in foundry. Our trading profit remained robust with a decline limited to 0.9% on an underlying basis. Despite the difficult market conditions, we could slightly increase our return on sales by 10 basis point to 10.4%.

We also continue to make progress in the management of our cash with a further reduction of our working capital intensity of 90 basis points as compared with June last year to 23.2%. Thanks to this focus on cash generation, we could maintain our net debt to EBITDA ratio at a low level of 1.2 times and this despite the high level of our strategic expansion CapEx and the implementation of our share buyback program. This good performance made the board confident to propose an interim dividend of 7.1p per share, representing an increase of 4.4% as compared with last year.

We delivered against all our strategic objectives during the first half. We gained market share in both the steel and foundry divisions. In the steel division, the market share gains were mostly driven by flow control. But advanced refractory, however, also continued to make progress and gain market share in Asia with India now representing 17% of the advanced refractory business unit global turnover with a profitability above group's average.

Both divisions, steel and foundry, also achieved a positive net pricing performance with price evolution more than fully compensating for all cost inflation. We continue to implement at pace our structural cost saving program with GBP6 million in year savings now expected in 2024, a doubling of our previous estimate of GBP3 million. We maintain our previous forecast of a run rate of GBP10

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million to GBP15 million cash cost savings end of 2024. And we are fully confident that we will achieve our objective of GBP30 million cash cost savings by 2026.

Thanks to the good productivity of our R&D organization, we could launch 18 new products during the first half with the new product sales ratio of the group progressing again to 17.9% and even exceeding 20% in flow control. Our expansion CapEx program remains fully on track and should conclude by the end of this year.

Our safety performance was again strong during the first half, confirming the structural improvement achieved over the past five years. We inaugurated in Brazil our first carbon neutral manufacturing plant for flow control and advanced refractories product. And we remain on track to achieve our objectives of 12.5% return on sales and GBP400 million free cash flow generation by 2026.

Let's now have a look in more details at the performance of our Steel Division. You can see on this slide, where the size of the bubbles is proportional to the sales of our division in each region, how the steel market evolved during the first half of the year.

India and EEMEA, the non-EU + UK part of EMEA, were the only two regions to experience significantly positive growth. And in the case of EEMEA, this growth, however, was flattered by the recovery from the earthquake in Turkey last year.

Everywhere else, steel markets remain subdued, especially in the Americas, both North and South. EU + UK remains stable, but at a very low level, 15% below 2021. China's production declined around 1% due to the weakness of domestic demand and despite a significant increase in steel export towards the rest of the world. steel production in the EU + UK and in the Americas today remain significantly below its normal level, and we expect a recovery going forward.

In this difficult environment, our flow control business unit continued to perform very well and gain market share globally and in most major regions. This was particularly the case in EEMEA, where we benefited from the launch of new steel project and from the recovery of the situation in Turkey following last year's earthquake.

The only exception remains as last year, EU + UK, where our sales were negatively impacted by the bankruptcy of an important customer in Italy and where we continue to manage carefully our customer credit risk. The steel division overall could achieve a strong financial performance despite the difficult market conditions. The revenue of the division grew 0.5% on an underlying basis, reflecting a progression of flow control volumes underpinned by market share gains.

Advanced refractories continues to progress in Asia and in particular in India, which now represent 17% of this business unit sales and where profitability is above the group's average. Advanced refractories, however, has not yet recovered from the market share losses experienced last year in North America and in Europe, and we expect this situation to improve gradually in the coming months.

The Trading profit of the division increased close to 10% on an underlying basis. And return on sales improved by 100 basis point driven not only by the market share gains previously mentioned, but also by a positive net pricing performance everywhere and by robust cost savings across all business units of the division.

Let's now turn to the foundry division. As you can see on this slide, foundry markets remain very difficult during the first half with no improvement as compared with the second half last year, contrary to our expectations. This was particularly the case in EU + UK, North America, and North Asia, three very important regions for the foundry division together, representing around 60% of the division sales.

Decline of market as compared with first half last year were double digits in North America and in Europe and high single digits in North Asia. And the light vehicle market, which last year had better performed than other industrial markets also showed sign of weakness everywhere but in India during the first half.

Our foundry end markets outside of India remain for the time being stabilized at a very low level. And we expect the timing of the recovery to be more likely in 2025 than in the second half of this year contrary to our initial expectations.

In this difficult market environment, the foundry division made good progress in its strategic initiatives. The division gained market share in all regions, thanks to the differentiated products. It achieved a positive net pricing performance, more than offsetting all its cost factors evolution with price adjustment. It implemented strong cost reduction actions, which will progressively deliver over the coming months and years.

However, these positive achievements were not sufficient short term to compensate the negative impact of the market weakness with revenues declining 8% on an underlying basis as compared with first half last year. Due to this very significant top line decline, the division's trading profit reduced by 27.1% to GBP20.7 million and return on sales decreased 220 basis point to 8.2%.

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Globally overall, the group, we continue to make very good progress in the efficiency of our R&D organization with 18 new products launched during the first half only of this year versus 21 launches for the full year 2023. These new product launches are important for Vesuvius as they help us gain market share over competition and the profitability of new products is generally higher than average.

You can see on this slide a few examples of the new products we've launched during the first half of the year. Of the left part of the slide, you can see a new high performance, high durability, slide gate plates introduced by the flow control business unit for using long steel, stainless steel, and thin-slab casting production. This very versatile plate, covering in an optimal way very diverse end markets will help our steel customers improve both their safety performance and their cost competitiveness.

At the center of the slide, you can see our new fully automated gunning robot for basic oxygen furnaces, introduced by our advanced refractories business unit. It will help our steel customers reduce the downtime associated with their furnace maintenance operations and improve their cost at the same time by reducing the refractories consumption. And finally, on the right side of the slide, you can see the new environmentally friendly inorganic binder introduced by the foundry division, enabling our foundry customers to better protect their employees by sharply reducing the level of hazardous emissions on the shop floor in their plants.

We continue to make good progress with the penetration and adoption by our customers of our innovative robotic solutions for continuous casting. These robotic solutions present important safety advantages for our customers as they allow them to remove workers from some of the most dangerous areas in the steel plant.

At the same time, by reducing the number of human errors, our robotic solutions reduce the downgrade of steel, improve the yield of operations and the overall quality of steel products. We could sign five new contracts in flow control in the first half of this year, the same number as for the full year last year. These new contracts will support an increased level of flow control consumable sales in the coming years.

Our strategic expansion program launched in 2021 remains fully on track and is expected to conclude by the end of this year. In this program, we are expanding the capacity of our flagship flow control business unit worldwide to support our strong market share gains ambitions in the coming years. But we are also expanding both the product range and the capacity of our foundry and advanced refractory business units in Asia, in Asia only, to increase our penetration and benefit from the positive market dynamics in this region.

This very important expansion program will give us, will give Vesuvius, the possibility to benefit fully from the growth expected in India, in Southeast Asia, and in EEMEA over the coming years. And after completion of this program end of the year, we will also be in a position to decrease our overall level of capital spending and increase further our free cash flow generation.

Looking at India, particularly, development in India is a very high priority for Vesuvius. And our objective is to benefit fully from opportunities in the country by growing our sales at a faster pace than the already fast-growing underlying market.

And you can see on the picture here, our new greenfield flow control and advanced refractory plants, which we are currently developing in Vizag in India. On the top left part of the picture, you can see the buildings hosting the flow control flux and the advanced refractories, aluminosilicate monolithics and basic monolithics production lines, which are part of our current expansion program, and which will start in the second half of this year.

However, we expect market growth in India to continue for the many years to come. And you can also see on this picture that a very significant part of our industrial site remains available for future expansion, which will allow us to fully benefit from the growth potential of India in the many years to come.

We continue to make good progress in our safety performance, confirming during the first half, the significant improvement achieved in 2023. And as you can see on this slide, this is not a one-off performance, but the result of a continuous safety improvement program implemented everywhere in the group over the past five years. This safety performance is now more and more recognized and valued by our customers with several of them requesting our support for the improvement of their own manufacturing operations.

We also continued to make good progress in our sustainability journey towards our objective of becoming net zero globally by 2050. We achieved last year, two years ahead of schedule, our first intermediary objective of 20% reduction of our CO_2 emissions as compared with our base year 2019. And we are now progressing towards our second intermediary targets of 50% reduction by 2035.

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In this framework, we inaugurated a few weeks ago, our first carbon neutral manufacturing plant for flow control and advanced refractory products in Brazil. This plant now only uses green electricity and biomethane for refractories production, completely eliminating Scope 1 and Scope 2 CO2 emissions.

As a summary, our results remain very resilient during the first half despite the very difficult market conditions, especially in foundry, and we continue to deliver on all our strategic objectives. I will now hand over to Mark who will give you more information about the financial performance during the first half. Mark.

Mark Collis *Vesuvius plc - Chief Financial Officer, Executive Director*

Thank you, Patrick, and good morning. I'll start with the revenue bridge. The key takeaway is that we have largely offset the weaker foundry market with yet another successive period of strong market share gains in flow control and foundry. Revenue in H1 '23 was just under GBP1 billion. And after adjusting for the stronger pound, our restated underlying revenue would be GBP955 million.

For the volume impact, there are two opposing factors at play. Firstly, the impact of the weaker market in foundry. And secondly, our ability to consistently deliver market share gains in flow control and foundry.

Taking the market weakness first. As Patrick has outlined, this was both multi-sector and multi-region. We estimate that our addressable market declined on or around GBP30 million. This equates to more than a 10% decline compared to the same period last year.

On a more positive note, we believe the volumes in our foundry market have been stable between the second half of '23 and the first half of '24. But the confidence and cash flow that comes from lower interest rates will be necessary before the higher volumes return.

Offsetting the weaker foundry market has been a very good performance in market share gains in both flow control and foundry. We estimate this has driven revenue growth of greater than 2%, which is in line with our CMD commitment.

This increase in market share is a direct consequence of the increase in our new product sales ratio, and this is a measure where the trend is also positive. It's our new products that allow us to deliver value to our customers, and it's this value which enables us to increase our market share and deliver positive net pricing performance.

The final part of the bridge is a reduction in revenue, which is due to selling price changes. As raw materials fluctuate, we adapt our prices either positively or negatively to reflect this. And given the advance refractories has benefited from lower raw material costs, we have therefore reduced our gross price.

In the trading profit bridge, however, you will see that net price was still a positive and contributed to our trading profit. So to resummarize, our group revenue has held up very well, despite a 10% estimated decline in the foundry market.

And now turning to trading profit. In summary, we have improved our return on sales despite significantly lower volumes. This clearly demonstrates our ability to deliver consistent returns, which should also give you a sense of the potential upside when the volumes recover.

The H1 currency impact was a headwind of GBP6.8 million and adjusting for this gives a return on sale starting point of 10.3%. You'll note that the drop-through on volume was much larger than we typically expect. And we've included a table to clearly show the component parts.

From this table, you can see that while the increase in steel volumes fell through at a normal level, the impact of the lower foundry volumes fell through a much higher rate. This higher rate is because the volume shortfalls are disproportionately impacting our larger, more mature businesses in Europe, Japan, and North America.

Here, the level of fixed cost as a percentage of revenue are higher than our businesses in India, Southeast Asia, and China. This is clearly an area we are actively addressing as part of our cost reduction program. But again, it also gives you an idea of the potential upside we will see when volumes return in those markets.

Moving to price. Here, you can see the net impact on price. This has contributed GBP5 million to our trading profit and is off the back of successive periods of positive net price performance. And to repeat, this is only possible due to our fully expensed R&D investments, which create products that enable us to value share with our customers.

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And finally, we saw the first benefit from our cost reduction program. While we guided to GBP3 million in-year savings for '24, we've already delivered this in the first six months. And as a result, we are now doubling our in-year target to GBP6 million.

A few moments ago, I told you that we believe that volumes in our foundry market were broadly stable. And I think this graph illustrates the point. You can see the revenues in foundry, while down on H1 '23, are slightly ahead against H2 '23. I also think the graph nicely illustrates the resilience in our overall business model. It shows the consistency of revenue and profit in what can only be described as a challenging set of market conditions.

Looking at the full income statement, I've already covered the trading elements. Beyond trading, I'll address finance costs and minority interests.

For finance costs, there are two areas driving this. Firstly, there is the impact of higher leverage. This is a consequence of our share buyback and the continuation of our expansionary CapEx program. The second element is a reduction in interest income as we have managed to repatriate surplus cash held in Argentina, which was earned in a very high rate at 30%.

For minority interest, the charge increased by 15%, reflecting a profit growth in our majority-owned Indian businesses. Both businesses continue to benefit from their strong position in the Indian market, and the steel business, in particular, benefits from those capacity investments which are beginning to come through and on stream.

Our H1 headline EPS was 21.8p, which is marginally down by 2.9% on an underlying basis. And finally, turning to the interim dividend, the Board has approved a 4.4% increase to 7.1p per share, a clear indicator of the confidence we have in our business and our commitment to returning cash to shareholders.

As we set out in our recent Capital Markets Day, we have an objective to reduce our working capital intensity to 21% by 2026. We are making good progress and have edged down to 23.2%. We should recognize that we have set ourselves a very high bar by measuring ourselves on a 12-month average basis, but it's also worth noting that the 3-month measure shows we are now at 22.4%. This is both a good indicator of the progress but also the immediate opportunity available to us.

The next level of improvement, though, will require us to do things differently. Our approach is to further reduce with three different areas to focus on.

Firstly, we are investing in people, which for us means a stronger supply chain function. Secondly, we are focusing on simplifying our entity structures, which will lead to more efficient invoicing and processes. And finally, we are investing in an improved planning system. This will allow us to better plan and meet cost of demand with a lower level of inventory.

Looking at free cash flow. Despite improving our working capital intensity, we see the impact of two issues at play. Firstly, the impact from the increase of expansionary CapEx, which has contributed to the total CapEx of GBP50 million in the first half. Of this GBP50 million, it's important to note that the stay in business or maintenance element is less than GBP15 million. The balance of GBP35 million is split between expansionary projects of around GBP20 million, together with customer installations and the ongoing rollout costs of our ERP implementation.

As we have previously stated, this current phase of expansionary CapEx will come to an end on or around the end of this year. This, combined with the resulting improvement in trading profit, supports our free cash flow target of GBP400 million over the three years to2026.

The other element is working capital outflow. Consistent with the previous half years, our working capital balances will always be higher in June. And when the standard levels of activity decline in December, this working capital outflow will reverse.

Turning to net debt and leverage. Both have increased in the period in line with expectations. This increase was driven by three main factors. There was the outflow of GBP30 million related to our GBP50 million share buyback program. Based on current run rates, this first phase will be completed in a few months. Secondly, at the current share price, we also took the opportunity to prepurchase the majority of our stock option commitments at a cost of GBP17 million. And finally, we paid the dividend of GBP44 million.

Combined with our free cash flow for the period, our net debt now sits at GBP350 million and our leverage at 1.2 times. The latter remains comfortably at the bottom end of our preferred range of 1 times to 2 times.

So before I hand back to Patrick, I wanted to give you an update on our cost reduction program, which we announced in Capital Markets Day last November. Firstly, we are making progress. As already mentioned, we have doubled our in-year savings target to GBP6 million. We are also -- reconfirming our end-of-year run rate savings at GBP10 million to GBP15 million. And finally, we can

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now confirm that we have fully identified the projects that will generate GBP30 million of annualized cash cost savings within the year 2026.

When it comes to cost and cost saving for Patrick and I, it's almost always about the removal of headcount. To this end, we have already removed 137 people from our headcount since the start of the program.

And to give you a flavor of the types of projects we are focused on, I thought it was helpful to give you some examples. When we think about our ERP implementation, one of the main reasons we are doing this is to reduce the cost of our finance organization. This currently runs at 2% of revenue, and it's the same amount of money we invest in R&D. So in the fullness of time, this needs to be much lower.

In terms of plant footprint, we have already announced the closure of two plants in Europe, Tamworth, our last plant in the UK and a smaller slide gate assembly plant in Germany. In terms of warehouse rationalization, we are investing in the design and build of an ultramodern fully automated centralized warehouse in Poland. This will further result in an external warehouse but also the removal of headcount and will also allow us to hold lower levels of inventory.

In Borken, our flagship foundry plants in Germany, labor and fixed costs are high. Here, we have a clear priority to automate. One current example is the implementation of a robotic solution to improve the batching process for raw materials. And interestingly, this gives us a payback on CapEx of 2.5 years. These are just a few tangible examples that our business is executing.

All of these projects are tracked by a central team. And to date, we have over 100 identified initiatives that we are tracking. And we look forward to demonstrating progress on these in future updates. So with that, thank you, and now back to Patrick for the outlook and closing remarks.

Patrick André *Vesuvius plc - Chief Executive Officer, Executive Director*

Thank you, Mark. So group achieved resilient results in H1 despite difficult market conditions, especially as you've seen in foundry. We no longer expect a significant improvement in our end markets in the second half of this year with recovery most likely only in 2025.

Accordingly, we now expect our full year headline trading profit to be only slightly ahead of last year on a constant currency basis. Beyond 2024, we remain confident in the growth potential of both our steel and foundry markets, and we are very well positioned to benefit from the recovery in these markets once it materializes.

But irrespective of the timing of market recovery, we continue to anticipate clear progress in our result, supported by the growing benefits of our cost reduction program, our continued investment in innovation, and our important capacity investments in India.

We remain confident in the achievement of our 2026 objectives, as communicated during our Capital Market Day last November. Thank you very much for your attention. I now propose to open the floor for question.

QUESTIONS AND ANSWERS

Andrew Douglas *Jefferies - Analyst*

Good morning, gentlemen. It's Andrew Douglas from Jefferies. I've got loads of questions, but I'll ask three and then I'll come back.

In terms of advanced refractories, let's start there, why not. Good progress in terms of market share gains in India and China. Can you just talk about China in particular? Because one would have thought that that's a slightly more competitive market? So the fact that you're winning share there is good.

And how confident are you that the previously lost share in Europe and US actually comes back and why is that? I'll do one at a time.

Patrick André *Vesuvius plc - Chief Executive Officer, Executive Director*

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China is very interesting -- China, we had -- first, we have a very low activity of advanced refractories historically in China. Our development in the steel division in China has been historically 95% centered around flow control. But recently, over the past couple of years, we have identified interesting opportunities to grow profitably in China for advanced refractories, again, starting from a low base.

And it's interesting that over the past two, three years, even over the past two, three years, I would say slowly but surely, we are now increasing our sales of advanced refractory in China in a strong coordination with flow control, most of the time at the same customers, that's customers, which are already customers of flow control business unit. And we have proved that we have been able to do that in profitable and efficient way.

So China, contrary to India will, I don't think, constitute a huge part of the advanced refractory business going forward. But percentage point by percentage point it is growing and is profitably growing, which is quite interesting for us.

In Europe and US, we lost market share, and we continue to see the tail effect of this loss of market share in the first half this year, last year because last year, we are probably the last one to adapt our advanced refractory products prices down. We have been leading to raise prices. We have been lagging to decrease prices with the market. And we were punished for that, if I may, last year, when we lost a certain number of important bids where we usually have a certain number -- level of market share. This still produce lagging effect in 2024, in the first half.

But now we have adapted the level of our pricing offering to the normal market. And we are not price leader in the advanced refractory market. We are not the leader in this market. Other companies are. So we are not making the market price. We are following the market price. And we are getting, I would say, better at following the normal market price level. And this, I believe, will translate -- is already starting out to translate into a more normalized level of market share, more in line with our historical market share in EU + UK and in North America.

This being said, we are -- this is happening progressively because we have no intention of gaining market share by undercutting the level of prices -- the normal level of prices in the market. So we let customers make their choices and progressively, our historical normalized market share is and will be coming back.

Andrew Douglas *Jefferies - Analyst*

Thank you. And on foundry, you've clearly taken cost out given the tough market environment. Have you set the cost base now at a level for where we are today? Or have you kind of assumed life gets a bit trickier? And if you've assumed it for current level and life gets trickier, do you have obvious costs to take out and to protect profitability?

Patrick André *Vesuvius plc - Chief Executive Officer, Executive Director*

We are taking a lot of cost out of the foundry division, but we are not reducing by doing so, the production capacity of the foundry division. We are taking out fixed cost, which simultaneously enable us and will enable us when this fixed cost reduction will flow into the P&L of foundry starting end of this year, beginning of next year, to improve the performance of the foundry division, even at current level of volumes.

But at the same time, we maintain the capacity to increase our production volumes further because we believe that the current level of the foundry market is absolutely not representative of the normal, normalized level. We are in EU + UK or in North America or in Japan, we have 15% -- at least 15% lower than what should be a normalized level. So we are not reducing production capacity. We are reducing fixed cost.

So at the same time, we are adapting to the current situation, but also we are maintaining the capacity to reincrease rapidly as soon as the market will recover. Which seen from today, we don't see in the second half, but we clearly see in 2025.

Mark Collis *Vesuvius plc - Chief Financial Officer, Executive Director*

I think a good example is we're transferring production that's labor intensive to Turkey, where, obviously, it's cheaper, but in where we need to retain the production in Borken, we're automating. And that's stuff that just happens throughout the normal business process at Vesuvius.

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Andrew Douglas *Jefferies - Analyst*

And then last one on India. Did you guys see any impact from the presidential election in India like some of your peers? And can you just talk about the competitive landscape? Clearly, India is hot and everywhere else is a little bit on the cold side. So are you seeing increased competition, more challenging pricing, anything like that?

Patrick André *Vesuvius plc - Chief Executive Officer, Executive Director*

No, we are not seeing any negative impact of the presidential election in our India performance, which, by the way, you can follow through our listed Indian subsidiaries.

So our Indian subsidiary. We have two subsidiaries in India, Vesuvius India for the steel division, Foseco India for the foundry division. You can follow the performance of this every quarter because they have to publish their results every quarter. And you will see that we are not seeing any negative impact of presidential election. We are continuing to make good progress in India, and we expect to continue to make good progress in India going forward.

The competitive landscape in India is most terrible in the world because this is the region, which is growing the fastest, which is everybody is making the same analysis. So everybody says, oh, India is a place to be. So everybody wants to be there. So I think it's very difficult to find, if not impossible, to find one of the important players in the refractory world which doesn't have a strategy to grow in India.

But this is where it's interesting because you can see different strategy, producing different results. And this is a battlefield. India is really a battlefield. But for us, it's an interesting battlefield, and we believe that we have, at the same time, first, the right people.

We have very good people in India. And people in our industry makes a difference. We have top people in India and very dynamic, very strong technically, strong commercially, and they are our first assets in India, our people. We have been present in the country for more than 30 years. Manufacturing in the country more than 40 years. We were doing -- Make in India well before Mr. Modi was elected. And we have always manufactured in India, 90%, if not 95% of what we were producing in -- selling in India for 30 years. This has always been our strategy. This gives us a footprint and understanding of the country, which I think is unrivaled today in the -- for foreign players, I mean, in the country.

And we are investing in top of the art manufacturing activity with the best possible equipment. The product that we are proposing on the Indian market are the same highest quality product than the one we are proposing anywhere in the world, in Germany, in Japan, in -- we don't see the Indian customers have been second zone customers.

Our Indian customers are very smart, very well educated, good technology, very demanding in terms of technology and performance, and we are giving them the best we have. And I think this is a winning strategy. We will continue to develop that, to invest in new capacity, invest in people, right. So, it all starts with investing people, invest in new capacity, and we are very, very happy to fight this battle, and we believe that we have good assets to be one of the winners of this battle in India.

Lush Mahendrarajah *JPMorgan - Analyst*

Good morning, guys. It's Lush Mahendrarajah from JPMorgan. I've got a few as well, but I'll take them in turn. I guess the first one is on inventory. So I guess a good work in capital performance in terms of reducing that year on year. But just given the sort of change in outlook, is there a need to sort of underproduce in the second half? Are you sort of happy with where inventory levels are?

Mark Collis *Vesuvius plc - Chief Financial Officer, Executive Director*

Yeah. We'll get an unwind in the second half, but not because we're thinking volumes are going down, per se, but literally in the month of December, things will always be quieter. So you should just get a natural unwind over the course of the second half. And we saw that last year, we saw the peak in June, and I think we'll see a reduction in December, but not really -- not much driven by the change in volumes and outlook, per se, but more just the natural unwind.

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And we should also benefit from the continuation of the reduction in intensity as well, which, as you saw from the three-month measure, is now below 23%. So if we can sustain that, we'll get a natural improvement over the course of the second half.

Lush Mahendrarajah *JPMorgan - Analyst*

Okay. Thanks. And the second one is on CapEx. I think the guide has been lifted --

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Mark Collis *Vesuvius plc - Chief Financial Officer, Executive Director*

Slightly lifted.

Lush Mahendrarajah *JPMorgan - Analyst*

I guess could we get a bit more color on sort of, I guess, what you're doing there?

Patrick André *Vesuvius plc - Chief Executive Officer, Executive Director*

So CapEx is slightly different because, in fact, we are progressing faster than what we planned in our cost reduction program. And if you remember, for those of you who attended the Capital Market Day, the -- to implement, to realize this GBP30 million of cash cost savings by 2026, we have a cost -- a cash cost of on or around GBP40 million.

This GBP40 million being GBP10 million to GBP15 million restructuring cost, P&L-type cost, typically redundancy, severance payment, and GBP25 million to GBP30 million being CapEx, automation CapEx. And we are running fast, I would say, in the implementation of this automation CapEx, and this is mostly what explains the slightly higher estimate of our CapEx this year.

Lush Mahendrarajah *JPMorgan - Analyst*

Okay. Thank you. And just last one for me, your comments on sort of the ERP implementation that you do, I guess, where are we in that journey? And could you give us sort of rough timeline in terms of rollout?

Mark Collis *Vesuvius plc - Chief Financial Officer, Executive Director*

So it's around about a 3-year program, maybe 3.5, 4 years by the time we get to every single country in the group. We've done -- we've gone live in Poland at the start of the year. That was, I would say, successful. These ERP implementations never roll out without challenge, but practically speaking, business continued. We got invoices out on time. You can see that the working capital levels were still delivered.

We've now gone live in Poland. We've gone live in Spain. We're about to go live next month in Třinec in Czech, and then we'll also complete Italy. So the idea is, by the end of this year, we'll be fully on SAP for Europe EMEA steel, basically. And then we'll move to foundry Europe and thereafter, we'll move to foundry in the US and also steel in the US. And then beyond that, it will be the kind of the smaller regions.

Stephan Klepp *HSBC - Analyst*

Yeah, morning, Stephan Klepp from HSBC. Just one question. If you look at pricing, yeah, I mean, obviously, you did really well. And I think we all understand it's a value add with the new product that you have been delivering and obviously, in flow control, where you have better market power and better pricing power. How should we think about that going down to the second half of the year? Will that continue? Will you be able to see further pricing impact? Because obviously, it's a trading effect and you said the introduction of new products were a little bit lower at the start of this year or the first half of this year.

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Patrick André *Vesuvius plc - Chief Executive Officer, Executive Director*

The introduction of new product was higher at the start of this year because we introduced 18 new products in six months, versus 21 products in 12 months last year. So the pace is accelerating of introduction of new products.

So in terms of pricing, what we -- we always, in our guidance, integrate underlying assumption of neutral net pricing performance. So we do not anticipate in the second half, any positive -- we do not integrate in our guidance any positive or negative impact of net pricing. Net pricing being the delta between the evolution of our price and the evolution of our cost. We don't -- we are not planning any negative or positive impact of net pricing in the second half of the year.

Stephan Klepp *HSBC - Analyst*

But then you can turn the argument around with those high introduction, is that a realistic assumption then?

Patrick André *Vesuvius plc - Chief Executive Officer, Executive Director*

We'll see if it is realistic. I think that -- I am very confident that there will be no negative impact.

Mark Collis *Vesuvius plc - Chief Financial Officer, Executive Director*

I think the thing to think about is we measure new product ratio over a five-year period, and it takes a long time for customers to trial and test and accept and integrate new products.

You obviously got the benefit of the previous products that we've developed and issued, but actually, it's quite a cautious industry. So the pace at which you see the margin doesn't happen overnight, for example.

I think the other thing that with the pricing, we tend to use that as a soft kind of position against volume. So if we see volume risk, then typically, we'll offset it with pricing upside, which is why we really don't build it into our guidance.

Harry Philips *Peel Hunt LLP - Analyst*

It's Harry Philips, Peel Hunt. Just a couple of questions, please. The first is just around foundry and operational gearing, and you sort of touched upon it in the context of Andrew's question. But is it -- looking at that sort of half year chart you put up, is it just a sort of a reasonable working assumption to assume sort of similar type second half, notwithstanding days and all the rest of it.

And then in terms of what drives the pickup and what the operational gearing, you had that chart of minus 57% on the drop-through. And I appreciate the comments around automation, moving expensive labor into Turkey. But what sort of medium-term margin should Foundry do? I mean I've got a view, but I'd be interested in your view.

And then the second is in terms of the additional capacity coming on, just an idea of the sort of revenue streams of that just as a sort of broad brush we look at '24 and '25 from that alone or is there an element of sort of swapping out old capacity in the context of that sort of automation and recheck of labor. That's horrible wordy I'm afraid.

Mark Collis *Vesuvius plc - Chief Financial Officer, Executive Director*

Yeah. So I guess the three questions I heard there was foundry margins in the second half, midterm foundry margins, which I may defer to my esteemed quote to my left on that particular point. And then I guess the -- what was the third question, sorry the?

Harry Philips *Peel Hunt LLP - Analyst*

Sort of operational gearing around the sort -- and the CapEx sort of --

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Mark Collis *Vesuvius plc - Chief Financial Officer, Executive Director*

On the broader expansion program. So on the second half, we don't do genuinely believe we're at the trough point. So 8% is disappointingly low, but we think that will continue into the second half.

You do have to weigh up some of the typical seasonal impact you have in the second half, but we are, as you've seen, pushing for market share gains and pushing on further costs. Those costs are probably more kind of short term in nature.

And then in terms of the structural costs, that is really about the medium term. So the things that we talk about in terms of shifting production to Turkey and automating Borken, those aren't things that you do in two to three months, they're more kind of 6 to 12 months. So it's those things will get us back to the medium-term margin absent any kind of volume changes. Patrick, do you want to comment on the --?

Patrick André *Vesuvius plc - Chief Executive Officer, Executive Director*

I think there is no reason to change our objective of midterm profitability for the foundry division, or the profitability of the foundry division should normally be at least 15% before central cost. So let's say, 13%. The profitability of the foundry division should be higher than our group objective of 12.5%.

And I see no reason to believe that they will not reach that. Today, volumes are very bad. They are what they are and they will recover. So there is a question mark about the timing, but I have zero question mark about the fact that volume will recover in foundry. They're are absolutely abnormally low today. And our cost-cutting program in foundry are progressing very well, very well.

Foundry is probably the division making the most progress, I think the fastest progress in terms of cost cutting. There are structural cost cutting. And when you close a plant -- our plant of Tamworth in the UK will only close end of this year. The closure of the plants on the ground will only happen end of this year. The ramp-up in Turkey will be in the course of next year.

So the full impact of the cost restructuring currently happening, and which is very deep in foundry will start to be felt in '25 and will take its full potential in 2026. And by that time, I have reasonable expectations that volumes will have recovered to a more normal level.

We don't need volume to be extraordinary, just to recover at a more normal level. Again, I am unable to say if the recovery in foundry will happen in October '24 or in February '25 at this level of prediction. I am perfectly -- I'm not a magician. I have no clue.

But to -- the assumption that by '25, '26, the foundry market will have recovered to a more normalized level, I think it's a reasonable assumption. And when this will have happened, both the recovery normal volumes, again, we are not -- we don't need extraordinary volumes. We just need normal volumes.

And the full impact of the very good job, which is currently being done in foundry to cut cost and automatize and reduce fixed costs without decreasing the overall production capacity and the ability to follow market growth. Then I think that we will be positively surprised by the result of the foundry division, and the foundry division should be at a level of profitability, which should be significantly higher than the 12.5% of the group.

Mark Collis *Vesuvius plc - Chief Financial Officer, Executive Director*

And I think just to add, I mean, 10% volume declines in the market are extreme. But if you look at European PMIs, they're obviously at a very low level. You look at things like the casting association in Germany, which is a big part of our European business, those casting volumes are down 10%.

Japan's ferrous castings are down 8%, all driven by issues in the light vehicle market, but also just generally in the construction market. So you're seeing things like the high interest rates biting things like farmers who can't afford to buy tractors at the moment. And that's where all of our cost in parts end up going into, it's these kind of heavy vehicles, construction equipment, mining equipment, etc.

So you can see why we would be down by 10%. But if you believe that eventually, there's going to be a recovery in those sectors, which I think everyone does, you should see that kind of bounce back quite quickly.

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I think the last question was just on CapEx expansion and the level of revenue. So I go back to the previous guidance where we said of that GBP100 million of CapEx over that three years, it would generate roughly GBP30 million or GBP35 million of EBITDA. So I would work backwards and say, well, drop-through typically is 30%, not withstanding the previous comment. So that gives you around GBP120 million.

And we've always said that, that would deliver over the course of the kind of three-year period up to the period of 2026. So clearly, we're starting to see some early signs of that CapEx now, but I would spread it pretty much straight line over to 2026.

Patrick André *Vesuvius plc - Chief Executive Officer, Executive Director*

The drop-through in foundry in particular of a recovery of volumes in those area where we have high fixed cost is higher than that.

Harry Philips *Peel Hunt LLP - Analyst*

Yeah, which is?

Mark Collis *Vesuvius plc - Chief Financial Officer, Executive Director*

Yeah, 50%, as you've seen from the chart.

Mark Davies Jones *Stifel Europe - Analyst*

Thank you. It's Mark Davies Jones at Stifel. Really following on from that. Can we talk about the regional picture in foundry? And this goes back to Mark's chart about where your costs are and where your revenues are. Yes, volumes coming back at some point, does it come back in the same places? You're quite heavily indexed to UK and EU. Is the risk that some of that production is shifting to other regions, how local do you need to be to serve that marketplace?

Patrick André *Vesuvius plc - Chief Executive Officer, Executive Director*

It's an excellent question. No, the volume will not come back exactly at the same place. If I take the most important regions, in EMEA, you have a gradual substitution of Northern Europe, Germany and surrounding country Western Europe by the growing -- the fast-growing country is Turkey.

But EMEA as a whole is not that bad. There are similarities we still, by the way. So the Foundry market is growing fast in Turkey on a structural basis. When you look at the evolution of castings in Turkey over the past 10 years and you look at the evolution of castings in Germany over the past 10 years, you are interesting -- it makes an interesting picture.

So we are increasing our efforts to invest in people and also develop our manufacturing capabilities in Turkey in this part of EMEA to be in a better position to serve this growing part of the market. The production capacity of the Tamworth plan that we are closing end of this year in UK is being transferred mostly to Turkey. And we are transferring the most labor-intensive production from Germany, from the Borken plant in Germany, to Turkey. So we are growing our Turkish manufacturing footprint and people commercial footprint at the same time that we are adapting our footprint in the slowest growing part of EMEA.

And we will keep in Borken those manufacturing line, which by nature can be very highly automatized. And then for those, it makes sense to keep them in Germany because then the product can travel, the production cost will be extremely low, labor costs do not playing a role anymore. And the product can travel, we can serve Turkey from -- for this product from Germany.

So this is the way we are adapting to the shift in EMEA. The also big regions where you have achieved is North America, where you have a shift towards Mexico. Mexico is like Turkey in EMEA, one of the fastest growing place for foundry production. Not only foundry relocating from North American, so US, Canada to Mexico, but also interestingly, many Chinese foundries, getting many Chinese companies getting established in Mexico to produce castings in Mexico, especially nonferrous castings to serve -- to be inside the USMCA, to serve the USMCA market because the rules of the USMCA are being tightened by the day.

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And so the days where you could simply import reliable product and pretend that it's made in USMCA, these days are gone, obviously. And so you see a lot of investment in Mexico, both in steel and foundry, by the way, it's not only foundry, to make import still in Mexico or to produce castings, real production in Mexico, but some in the foundry industry.

Many of these castings, several of these castings have Chinese shareholders. And our North American region is working very closely with our Chinese region to collaborate for how to serve these Chinese foundries getting established.

We will now have with by -- in a couple of months from now, we will have a Chinese-speaking commercial people in Mexico. So we are adapting to the evolution of our customer base because inside the USMCA, Mexico is the growing part.

And in the rest of the world, we are growing in China. We are continuing to grow in China also in foundry. China is, in foundry, a very competitive market, but we have a good team there. And we are, year after year, making progress in the progression of our foundry division in China, and of course, India, but India is an easy part of the story, as always.

Mark Davies Jones *Stifel Europe - Analyst*

Thank you for the answer. And on steel, can I just ask, are you seeing any moderation in the exports out of China as tariffs kick in progressively?

Patrick André *Vesuvius plc - Chief Executive Officer, Executive Director*

Short answer is no. We don't really see short term in the second half and maybe a bit more than that, any obvious reduction, any obvious signs, which could make us believe that there will be a reduction in Chinese steel export. This being said, this steel export are a bit unpredictable. So if they reduce, I would be very, very, very happy to be wrong. And because it's not the best parameter in our industry today. But I'm not counting on it, I would say. So we are not integrated in our guidance.

Any relief from a decrease in Chinese steel export in the second half. After that, we'll see. But for timing, we are not taking that into account.

Thomas Elgar *Deutsche Numis - Analyst*

Hi guys, Thomas Elgar, Deutsche Numis. Firstly, just on autos. Obviously, you noticed -- commented on the weakness there. Maybe potentially a little bit more color around how that shaped through the period and thinking about an exit rate there? And what you're sort of assuming for the year, given sort of Q2 has been widely underwhelming across the industry? Are you assuming stable to slightly up in industrial and auto slightly down? Just a bit of color on how the sort of two bits of foundry going to come out for the second half?

Patrick André *Vesuvius plc - Chief Executive Officer, Executive Director*

So light vehicle represents on or around 22% of the final end market for our foundry division. And we are assuming a continued weakness, as you mentioned, of the light vehicle market, again, with the exception of India. But we are assuming a continued weakness of the light vehicle market in the second half with very, very minor improvement of the other markets, but it's -- qualitatively, I agree with your comments.

Thomas Elgar *Deutsche Numis - Analyst*

And then just secondly, obviously, given the weakness we've all touched on in foundry, does that present any strategic opportunities for you given obviously the strength of the steel business in terms of profitability that perhaps some of your competitors don't have that backing? is there anything that potentially could come out from sort of the prolonged market weakness you've commented now on the interest rates and competitors, et cetera?

Patrick André *Vesuvius plc - Chief Executive Officer, Executive Director*

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You mean opportunities?

Thomas Elgar *Deutsche Numis - Analyst*

Strategically for yourselves in that foundry business.

Patrick André *Vesuvius plc - Chief Executive Officer, Executive Director*

For M&A, you mean, for acquisitions?

Thomas Elgar *Deutsche Numis - Analyst*

Yeah, that's what I'm alluding to, yes.

Patrick André *Vesuvius plc - Chief Executive Officer, Executive Director*

We are both for steel and foundry regularly looking at opportunities for acquisitions. I don't see us -- there are not huge opportunities in foundry. There could be a few opportunities in foundry in the nonferrous foundry sector to support our strategy to expand our presence in the nonferrous foundry, aluminum castings, typically, sector. So there could be in this sector a few attractive opportunities.

But as always, you need to be two to tango. We will be -- we will look at interest at some acquisition opportunities in the -- to serve the nonferrous casting sector in case there will be opportunities. But for the time being, there is none.

Any further question in the room? If there are no further questions in the room, I will propose to open the floor for questions to those attending online.

Operator

(Operator Instructions)

Patrick André *Vesuvius plc - Chief Executive Officer, Executive Director*

No questions online?

Mark Collis *Vesuvius plc - Chief Financial Officer, Executive Director*

Okay 50 people are waiting.

Patrick André *Vesuvius plc - Chief Executive Officer, Executive Director*

If there is no question online, I would like to thank you all for your attention today. Wish you a nice summer. And as usual, with Mark and Rachel will remain at your disposal any time should you have further questions. Thank you very much and have a good day.

Mark Collis *Vesuvius plc - Chief Financial Officer, Executive Director*

Thank you.

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