Results Overview

Operator
Ladies and gentlemen, welcome to Solvay Q2 2020 Results Conference Call for analysts and investors. Solvay team, the floor is yours.

Jodi Allen
Good afternoon and welcome to our second quarter 2020 earnings call. My name is Jodi Allen, Head of Investor Relations, and I'm joined virtually by our CEO, Ilham Kadri, and our CFO, Karim Hajjar. Today's call is being recorded and will be made available for replay on the investor relations section of our website. I would like to remind all participants that the presentation includes forward-looking statements which are subject to risk and uncertainties. You may refer to the slides related to today's broadcast which are available on our website.

With that, I'll turn the call over to Ilham.

Ilham Kadri
Thank you, Jodi, and hello everyone. I hope you and your family are staying healthy during this continuing challenging time. At Solvay, health, safety and security of employees remain our number one priority. We continue to have 10,000 employees, or 42% of our human capital working in a virtual capacity, and we will take a cautious and progressive approach to the confinement over the coming month. The recent spike in COVID cases in certain parts of the world have increased our numbers slightly. Today, we have 40 colleagues who are infected with COVID-19 and 176 employees in quarantine. We wish our colleagues a quick and complete recovery and we will continue to take a disciplined approach to managing the safety of our employees.

As I mentioned to you in May, Solvay's businesses began to witness the significant impact from the COVID pandemic in the second quarter following our solid third quarter results. We quickly adapted our organisation to manage through the short-term challenges and focussed our priorities on managing cost while driving cash generation.

I am pleased to inform you that the fruits of our labour are paying off. Slide three summarises the results. We delivered record free cash flow to shareholders of €435 million in the first half 2020 compared to €33 million in the first half last year, as all of our businesses remained unwavering in their focus on cash generation. This marks the 5th consecutive quarter of strong and positive free cash flow. The majority of this improvement, 75%, in fact, was due mainly to the enforcement of working capital discipline. Karim will share more on these financial details in a few minutes.

In addition, we continue to focus on our self-help measures and have made significant progress executing our cost saving programme we shared in November as part of the growth strategy. Since that time, we increased and accelerated our delivery in light of this crisis from €300 million to €410 million. For 2020, I would like to share with you some important breakdown of the cost savings figures.

In the first half of this year, we delivered €170 million in cost savings for the Group. This is a record and it enabled us to mitigate a portion of the steep drop in volume due to COVID impact. Of this €170 million, €80 million are structural cost improvement, and €90 million of the current cost savings relate to conserving measures.

Turning to the top line, first half sales were down 11% to €4.6 billion, and second quarter sales were down 17% to €2.2 billion versus quarter two 2019, with headwinds from aero, auto, oil and gas and construction markets impacting volumes since April. Thanks to our diversified portfolio, Other markets were resilient, such as healthcare, adult food, home and personal care, and electronics. In fact, Solvay has outperformed the general market in certain areas. We welcome these results considering the unprecedented time we are all facing.

In fact, I would like to share with you a bit more about what makes Solvay special, more about why we are regarded as technology leaders by many of our customers. I will start to share more on our performance by region and markets and, of course, our new customer wing, while Karim will explain the performance by segment, business units, and financial details, including cash and cost performance and impairment. I will then close with a short update on our growth strategy, specifically, our portfolio and investment.

Before I dive into each market, I want to share some insights on the regional performance. Our sales in China, in particular, are back to pre-COVID levels and have grown sequentially by more than 20% from quarter one to quarter two, and grew more than 5% in quarter two 2020 versus quarter two 2019. Asia-Pacific region, excluding China, is slightly down versus quarter two last year. All other regions remain down versus last year and versus quarter one.

Let me now dive into some of our key markets, representing about 50% of our sales, and I invite you to turn to slide four.
In auto, market estimates indicate global production was about 45% lower in Q2. As you know, this is an important market for Solvay, representing about 14% of the Group's sales on an annual basis. Our Specialty Polymer business, in particular, supplied many high-performance polymers to these markets and its sales in Q2 were down 26% in comparison, demonstrating the continuing replacement of metal with polymer. We have further evidence of this penetration through new business awards into the demanding under-the-hood application. So, in fact, what I'm saying, despite the fact that there are less vehicles being produced, we have more penetration of Solvay materials in each car produced. This led to our outperformance of the general market and will continue to position us well when growth resumes.

We also continue to make good progress winning new business in EV and hybrid vehicles. For example, we recently expanded our relationship with a large European OEM, who will use one of our next-generation polymer technologies in battery containers for hybrid vehicles. This all comes after commercialising similar technologies on other auto platforms and the customer is now expanding usage on new hybrid models, further evidence on the continuing penetration of polymers into auto. As a reminder, batteries are a key growth platform for Solvay we launched in quarter two last year.

I am also proud to announce that we are in advanced discussions with Veolia, a global leader in resources management and specialising in the design and provision of auto waste and energy management solutions, which contributes to the sustainable development of communities and industry. Together with Veolia, our plan is to create a circular economy consortium to address the end-of-life of lithium-ion batteries. We look forward to sharing more details with you in the near future.

Moving to Aero, we are performing in line with the market, though we saw significantly lower aircraft production in the second quarter. The civil sector represents about 7% of the Group sales. Our leadership position supplying composites to the sales programme helps us to offset some of that reduction. In response to the aircraft production decline, the Composite business has been rigorously focussed on their cost take-out to align their footprint to the new environment and the team has been executing their plan flawlessly. To date, we are ahead of schedule. 50% of the restructuring plans are completed and we have already closed one of the two intended facilities.

As you know, electronics is a market that includes a diverse group of subsectors, including semiconductors, semiconductor consumables and equipment, displays, and smart devices, and all of these use Solvay's materials. Solvay sales to this market have been resilient through the crisis, as we supply a number of specialty materials from Specialty Polymers and Special Chem businesses. As a reminder, we invested in a plant in China to produce an electronic-grade H_2O_2 to meet the growing demand in the semiconductor industry. We continue to grow with our tier 1 semiconductor customers, and are working on more new business opportunities to support 5G mobile electronics.

Healthcare continues to be a resilient market for Solvay. As a reminder, our specialty polymers are key ingredients for a number of applications, including haemodialysis, pharma packaging and medical devices. We are enjoying good growth in each of these segments. In addition, our technologies are being requested in new markets in response to COVID-19. Our polymers are being used in ventilators, face masks and other protective equipment. Group sales are expected to total €20 million this year. Our recent investment late last year in polyether sulfone technology (or PESU) in Asia (India) is helping to support this growth, and we are thankful that our solutions are helping to protect people during such times. In many respects, Solvay's growth in healthcare has outperformed; reflecting our broad portfolio of technologies and the value we bring to our customers.

Home and Personal Care grew modestly in the first half, reflecting our strength in hygiene and cleaning-related products. We also have an exciting innovation pipeline and continue to invest in being best in this market. This business has been innovating more bio-friendly solutions at the request of our large customers, consumer customers. And indeed, we recently rolled out a bio-polymer that offers hair and personal care manufacturers a full range of conditioning and texturizing features. In addition to that, I am particularly excited about a proprietary patented new technology we have just launched, which offers a 24-hour germ protection and leaves an invisible barrier, which not only kills 99.9% of germs, but continues working after it has dried. This innovation combines superior cleaning performance with long-lasting anti-microbial technology while maintaining a shiny surface, a very unique solution protecting consumers. We had been working on this opportunity long before the start of COVID. But, in fact, we have accelerated our efforts since then. And it could not come at a better time for consumers. We will update you more as we are in the early stages of product launch, but based on strong preliminary interest from top B2B, B2B2C, FMCG companies and customers, we expect this to be a commercial success.

Finally, I will now turn to mining, where we saw the downturn particularly in copper production in line with market dynamics. Many of the copper mines are in places like Panama, Peru, where production temporarily ceased. We expect these headwinds to be short-lived as the fundamentals in this industry remain intact, and Solvay's technology leadership continues to be recognised across the industry. In fact, we just extended our contract for the next 3 years with our number one mining customer. Solvay earned the business despite lower prices offered from competitors. It's a great example of our winning business model, and the hands-on technical support Solvay brings to this multinational. Our technologies, together with our digital tools and software, help them optimise their process and improve yield, creating measurable value.

So these are just a few examples of why Solvay is recognised in many markets we serve for having the right technologies and innovation capabilities. This is why customers call us first when they have a problem to solve. To take this advantage one step further, we have recently launched a group-wide initiative of our front-line, redesigning the way we work with and service our customers. This includes the appointment of executive account managers for the group's 20 top accounts, new sales incentives programmes to drive supply and growth, leveraging CRM, digital tools and investing in our people to a new Solvay Sales Academy with a full virtual and off-line curriculum which we will launch in September. I am confident that reinventing the front-line competencies and processes, together with our market leadership position, will differentiate us even more against the competition while improving our future profitability.

To wrap up the quarterly overview, the significant volume decline led to EBITDA of 29.5% in the second quarter. While we cannot define the full magnitude of the demand shift that began in April, we quickly and efficiently mitigated part of the impact with the cost measures and prices trends during this volatile period. A testament to this is our ability to sustain solid EBITDA margins of 21.7% in the first half of 2020.

With that, I will turn it over to Karim. Karim?

Karim Hajjar

Thanks Ilham. Good morning; good afternoon as well actually everybody. I'll start with an overview of the three business segments and I will refer to figures as usual on an organic basis, meaning constant scope and currency.

I'll start with materials, as you can see on slide number five, where net sales in the first half of the year were down 11% driven by volume declines that began in April. In the second quarter, specifically, sales were down 19% in that segment as a result of lower demand mainly related to Aero and Auto.

Starting with Composites, it's widely understood and accepted that the crisis is significantly impacting air travel, and this impacts production rates for several aircraft in the near term. As Ilham indicated, the business was quick to develop a plan to permanently close two manufacturing facilities and shift production to other, more efficient operations. Also, as Ilham mentioned, we fast-tracked that plan. We brought forward the closure of our plant in Manchester in the UK and only closed that a couple of weeks ago and we're focused on expediting the closure of the second site in Tulsa in Oklahoma in the US by the first quarter of next year. As a result, we are on track to deliver €22 million of cost savings this year, and we will be achieving the full run rate of €60 million that we announced by the first quarter of 2021.

Turning to the defence sector, a historic strength of ours as you'll recall, sales were stable in the quarter and we continue to work with our customers on new defence programmes. We're confident that this sector will continue to grow across the short and the medium term and this will bring resilience and will help to offset some of the midterm civil programme headwinds.

Turning to Speciality Polymers, sales fell only 9% in Q2. Why do I say only? Because essentially, as Ilham already outlined, we outperformed on certain markets despite the softer demand mainly in auto and construction. The business was able to maintain its high EBITDA margin, and this was driven by the combination of our leadership position in key markets, new wins and specifically, disciplined cost focus. For the first half, EBITDA in that segment declined 16%, and in the second quarter it was down 28% due to the volume reduction, whereas pricing remained stable overall. And this helped to preserve our EBITDA margins at 25% in the second quarter.

Moving to the Chemical segment on slide number six. First half sales were down 11%, second quarter sales were down 19%, primarily related to volume and offset partly by price. Starting with soda ash, sales down 17% in the second quarter. As you know, the largest market for soda ash are glass used in construction, glass for containers, and these were impacted by the closures of restaurants and hotels, just to cite one example. Despite these demand challenges, soda ash pricing was resilient thanks to our annual contract structures and our strong customer relationships. Yet the bicarbonate products continued to grow solidly for healthcare and for food applications. Soda ash continues to deliver on the demanding, challenging, ambitious cost programmes supporting strong delivery of the cash targets for the year, which, as you know, is a key metric for every business in that segment.

Switching gears to Peroxides, sales down 13% in Q2 mainly related to lower demand for HPPO in auto and in construction markets. This decline was partially offset by growing demand and supportive pricing for H202 and sodium percarbonate use in disinfectants and in detergents which are sold to the homecare markets. The business has been successful with its cost-containment programme, and it helped to elevate the effects of lower volumes. Overall, the chemical segment EBITDA declined 30% in the second quarter, due mainly to the lower volumes of which nearly half actually occurred in our Coatis and Silica businesses. Every business in that segment worked resolutely on fixed costs containment and reductions, and this offset a large part of the impact and helped to protect segment margins of 25% in the quarter.

The solutions segment, which you can see on slide number seven, delivered sales that were down 10% in the first half, down 14% in the second quarter due to volumes whereas pricing was stable overall. I'll start with Novecare where I'm really pleased to share that the business saw growth in home and personal care and in agro markets, whereas the curtailing markets proved resilient. Growth in those markets offset about 60% of the significant decline in demand in oil and gas and in total contained the sales decline to 16% in the second quarter. On the plus side, the oil and gas turnaround plan has essentially been delivered now and the wider focus on cost control and lower input costs enabled Novecare to maintain its EBITDA margin, and you remember this is not the first time we managed to deliver that result.

Sales in technology solutions were down 18% in the quarter due to lower demand in the copper mining market which was affected by lockdown measures in certain countries. The aluminium market, on the other hand, was not as impacted by lockdown measures, and our sales in this market grew by 27% in the quarter. Aroma performance again performed very well, growing sales by 14% in the second quarter and outperforming the general food industry. The main driver is the demand for our natural vanillin technology where we have very strong leadership positions. We continue to move the industry to natural vanillin and are working with key consumer players.

Overall, the solution segment EBITDA was down 26% in the second quarter, reflecting the speed with which businesses adapted, matched production levels with demand. EBITDA margin was 16% in the second quarter.

I'm now going to turn to Cash on slide eight. The strong free cash flow performance in the first half was almost €400 million above last year's performance and was driven by a group-wide focus on cash with the second quarter coming in at €233 million. The primary driver of that strong first-half performance is the ongoing focus on working capital that we've consistently demonstrated for over a year now, and that represents €331 million of the improvement. We quickly adapted production and inventory levels to demand patterns, but also, we were particularly pleased that our razor-sharp focus on receivables has led us to set new records in terms of reduced overdue levels. It's really critical in times of the macro challenge that we're going through.

Tax cash out was lowered by €122 million in the first half due to the one-off tax gain that you recall of €65 million associated with the additional voluntary pension contributions that we alluded to in the first quarter.

Finally, we quickly adapted our capital expenditure plans and generated a cash benefit of €61 million compared to last year and you can see that reduction makes a modest contribution to our cash flow improvement.

We also made significant progress with our deleveraging plan this year. Net debt in the first half of this year is down €0.75 billion, reflecting strong operational free cash flow €0.43 billion and of course the €1.3 billion proceeds from the polyamide divestment. That said, you'll recall that we also made major contributions of €460 million towards our pension obligations in France and in the US. When we turn to pensions and restructuring environmental provisions, it's worth noting that operationally we've delevered by €60 million, but this is offset by an €87 million increase in provisions for the additional restructuring plans announced both in the first quarter and the recent composite restructuring plans. This is in accounting impact and I'll come back to the cash consequences.

Moving to slide number nine, as Ilham explained, we achieved €170 million of gross savings in the first half of 2020, which more than offset inflation of €37 million in the first half. About €80 million of that saving were structural actions that we accelerated and deepened, and they fall into three categories. One, restructuring: this is the largest impact, and it includes labour costs. To date, we've saved €36 million. Indirect spend; when we look transversally, and we look across our businesses, we managed to deliver €32 million; this is structural and sustainable. Productivity efficiencies is more of what we've been doing historically and include yield improvements. In the first half, these delivered €12 million. We also took significant temporary actions to manage the steep and sudden changes in demand. The total of these actions to date is €90 million in savings, and they include actions like furloughs, salary freezes, but also a complete and very strong focus on all discretionary spending which is a given in times like this. And obviously any discretionary spending has been essentially very, very low during the lockdown period.

Finally, last month, as you will have noticed, we announced a non-cash impairment which totalled €1.46 billion as a result of the significant short-term effect of the COVID crisis, which triggered the reassessment. Approximately €1.2 billion of this relates to the former Cytec goodwill, predominantly the Composites business and the balance consists of oil & gas and some other intangible assets, all of which are fully detailed in the notes to our financial report that were published today. While the pandemic is certainly impacting our performance in certain markets in the near term, we consider the fundamental long-term attractiveness of our Composite Materials and our technology solutions to remain unchanged, driven by strong demand for light-weighting, electrification and resource efficiency that we believe is here to stay. We continue to pursue new business opportunities in composites and, following this difficult period, we estimate the return to double-digit growth over the midterm in part due to our self-help measures.

And with that, I'll hand you back to Ilham.

Ilham Kadri
Thank you, Karim. I'll now share some comments on the outlook for the remainder of 2020 and an update on the growth strategy. As you would expect, the nature and timing of the rebound will be specific to each individual key market. So markets such as civil aero and oil & gas are expected to continue to experience headwinds similar to current levels, whereas auto and construction markets are more likely to improve gradually towards year-end. Other markets, including healthcare, agro-food, personal care and electronics are expected to demonstrate continued resilience. Against that backdrop, we fully expect to maintain our leadership position. As you know, order books provide limited forward visibility, and the uncertainties associated with the various market recoveries make it difficult to provide reliable forecasts. That said, we expect the continuation of weak demand trends from Q2 into the third quarter with a modest improvement in quarter four.

Notwithstanding these uncertainties, we are certain of one thing, and that is our determination and focus on cost measures and on self-help measures. At this stage, we anticipate that cost reduction will total around €300 million in 2020, including €150 million of structured cost reductions. In addition, our focus on cash remains a top priority, and we expect our free cash flow generation to be similar to the 2019 level despite lower profit. Our expectations assume a resumption of €25 million in investment for a selected number of value-creating projects to meet the needs of customers as they rebound. This implies a total CAPEX of around €600 million in 2020.

So, before we take your questions, I'd like to share with you a few updates in reference to our growth strategy. First, on our cost targets, we increased cost savings targets, as you know, from a minimum of €300 million when we first launched our plan in November, to €410 million. So, the €150 million of structural cost reduction we are forecasting for this year will represent 35% of that commitment, further illustrating our determination to accelerate the Group's transformation.

Second, an integral element of our strategy is our commitment to sustainability. You may remember we launched our ambitious goals in February, solving key environmental and societal challenges through science and innovation. Together with our customers, this is a critical part of our plan. We will be hosting an ESG webinar in October; we will share with you the date and we will share more about these plans in the near future, and I hope you will join us.

Finally, during our strategic review, we said we had opportunities to optimise certain businesses. We also stated that the review of our portfolio is a continuous process and that we will always test whether we are the right owner for every business, and we will ensure that we are not leaving value on the table. In the past year, we have taken concrete steps to enhance and drive operational improvements in certain businesses that we do not consider to be core, and I'm pleased that our operational actions have yielded strong results. We have, therefore, launched processes to explore strategic options to monetise some businesses predominantly within the solutions segment. If, and only if, we find valuations to be sufficiently compelling, our intention is to complete these in the next year or so. We expect this first step to contribute favourably towards simplifying Solvay's portfolio and creating more shareholder value.

Thank you very much for listening, and I will now take your questions with Karim.

Jodi Allen
Thank you Ilham and Karim. Before we start the Q&A process, can I kindly remind you to limit yourself to one question only to allow time for all participants? And now I'll hand you over to the moderator.

Q&A

Operator
Ladies and Gentlemen, we will now begin our Q&A session. If you wish to ask a question, please dial ZERO ONE on your telephone keypad and you will enter a queue. After you are announced, please ask your question. Once again, please dial ZERO ONE on your telephone keypad to ask a question. Thank you.

The first question comes from Martin Rödiger from Kepler Cheuvreux. Sir, please go ahead.

Martin
Hello, good afternoon Ilham, Karim. I will limit it to one question, it's the underlying depreciation & amortisation charge, which was quite high in Q2, much higher than in Q1. Can you help me to understand what was the reason for that and is that the right run rate going forward? I doubt that, because I think that you had, in the 1.5 write-down, also other intangible assets being affected. So normally, D&A charges on an ongoing basis should be lower going forward. Maybe you can clarify that.

Ilham Kadri
So the question Martin is about the depreciation, right? And amortisation, right, Martin?

Martin
Yes, the underlying depreciation & amortisation.

Ilham Kadri
Underlying, yes. I've got this now. Karim, can you provide –?

Karim Hajjar
There was essentially a relatively modest amount of depreciation – accelerated depreciation of spare parts. I think that's probably the only factor worth of note.

Martin
And the run rate going forward?

Karim Hajjar
Oh, this is not a run rate. This is very much COVID-related. When you face over too many spare parts, essentially we depreciate, then we move on. So, no, I think there is no impact on the run rate of depreciation for Solvay based on this.

Martin
So for Q3, we should look more to Q1 figures?

Ilham Kadri - Yes.

Karim Hajjar - Correct.

Martin - Okay.

Karim Hajjar - Absolutely.

Ilham Kadri - Thank you, Martin.

Operator
The next question comes from Alex Stewart from Barclays. Sir, please go ahead.

Alex
Hello, good morning. I'm interested in your comments about the auto sector, because in the trading statement on 24th June, you talked about auto and aerospace and construction and several other markets being down 40% in the second quarter. And then it was only down 26%. You mentioned, as one possible reason, the increased penetration of polymers. I can't see how that bridges the gap, with car production down 45% in Q2. So, can you, perhaps, explain why the actual result in the second quarter was so different to what you had indicated back in June, would be incredibly useful? Thank you.

Ilham Kadri
Yeah. We couldn't hear you very well, Alex, but I think the question (the line is bad) it's about the auto, right, and why we outperformed the auto market, right?

Alex
No, sorry. Sorry, let me ask the question again because that wasn't it.

Ilham Kadri
Yeah, please. That's better.

Alex
You talked about auto sales being down 26% in the second quarter, but in your trading statement from the 24th June you said that several markets, including aerospace and auto, had revenues down 40%. So you had previously talked about down 40%, you delivered down 26%. I'm interested why there's such a divergence in the last month, if you could possibly explain that. Thank you.

Karim Hajjar
Let me start. Again, the guidance we gave in our trading update was indicating the market trends as we saw them. The figures you quote, the 26%, is Solvay's outperformance against that backdrop. And the reason for it, I'll turn to Ilham to give a reminder of some of the key factors that helped us to outperform.

Ilham Kadri
Yeah. So Alex, it will be a bit of rendezvous between you and us on explaining a bit how – why Solvay's special – as a specialty company, and how we target whatever the market there that we need to outperform our specialty market. And obviously auto is part of it. So it's mainly on specialty polymer, it's only down 26%, as I mentioned. Two things that I said, we are in automotive under-the-hood application, where invisible we replace metal, right, in auto. And basically the value proposition is to make the car lighter at a lower total cost of ownership, decreasing the consumption of fuel and therefore emitting less CO_2, again at lower total cost of ownership. And those are things the auto OEMs, they just love it, right? And I gave you an example of the battery casing. We started with a few auto platforms in Germany and now we're expanding in other models. So specialty polymers, again, whatever does the market, they need to outperform the market. Obviously, you cannot defy gravity, but we are winning new applications, creating a new market. So I think that's important.

Now, the light in the tunnel and I'm sure you have LMC data, obviously, they see some improvement between quarter two, three and four, right, so less decline in quarter four. And I remain optimist on also between now and the end of the year.

The other piece I would like to really stress out is the batteries, right? And I think when you talk about the electrification, the green deal, the EU stimulus and you see a number of states in the EU not only giving bonuses to consumers to scrap their cars and buy new ones, but even higher bonuses if they buy cleaner cars, right, either hybrid or electric. We like that. In an ICE car, internal combustion engine, they can use up to six kilo of our top technological polymers; if you go to EV they use up to nine kilo; and if you go to hybrids they use up to 12 kilo. So, again, whatever the market does, we can penetrate with our technology, and the batteries is a fabulous opportunity to really innovate. And then we talked about, obviously, recycling of the battery.

So I'll stop here.

Alex
But, sorry, just to be very clear on this. In your trading statement, you said businesses related to oil and gas, automotive and aerospace were the most significantly impacted, with revenues down 40%. So there's no indication that that's what the market was down, you said the revenues relating to auto were down 40%. I don't want to unnecessarily push this point, but there is clearly a divergence between what you had talked about in June and what you reported, and I'm just trying to understand why that was.

Ilham Kadri
Yeah. So here we highlighted the specialty polymer part, yeah, Alex. There is the Special Chem part, which is in catalysis, right, and there the dynamics are different. You know that we are in China 5 and 6, you know the regulations have been moving from China 5 to China 6, which has been normally positive for Solvay. However, due to COVID-19 China has actually pushed out a bit the Chinese 6 regulation to actually empty the stock of China 5 cars. So, that we've seen also some delays in our plans.

Alex - Okay, thank you.

Operator
The next question comes from Mubasher Chaudhry from Citi. Please go ahead.

Speaker
Hi. Thank you for taking my question. Just one on free cash flows. I just wanted to get your thoughts on, first of all, cash tax. Even with the €65 million benefit taken out, the cash tax payment has been a little bit low in the first half versus the P&L tax. So I was just wondering whether there is a cash tax payment coming up in the second half? And then related to cash flow as well, how do you see your working capital trending in the second half of the year as, well, business revenues pick up a little bit more? Should we be expecting an outflow for the full year or should it be flat for the full year? Thank you.

Karim Hajjar
Okay, great questions. So I'm going to reframe your question to make sure I've understood it, which is why is the cash flow forecast we're indicated essentially lower in the second half compared to the first half? And you're correct in identifying some of the elements. But I'm going to start somewhere else. Remember, since early last year, and Ilham was very, very clear, says we are going to really work on improving the quality, which meant also the phasing of our cash flow and you've seen that being delivered. Therefore, the past is not an indicator of the future. You're right in saying that there was a high quality but a non-repeat of the €65 million that I announced and described in Q1 associated with the additional pension fund contribution we made. But there's a couple of other points I want to

highlight. One, you will recognise that we've been really working hard on structurally driving working capital to a different level. One cannot continue to drive such structural change quarter-in, quarter-out.

So there's something around, it's high quality – and I'll come back to that second point on quality – but there's an element of the quick wins are essentially behind us, bearing in mind we started off from a very strong platform already. But by far the biggest factor behind all of this is the fact that second half profits are expected to be lower than the first half. Remember, Q1 is essentially flat against last year; that won't be the case in the second half. But also, we've announced restructuring plans in Q1, we've announced a further restructuring plan with composites, we will be accelerating and therefore paying cash restructuring costs. That will essentially mean our cash spend this year will likely be a good €20-30 million higher than the typical €50-60 million you've seen from us historically, and that completes the answer on the phasing on the cash. Clearly, if we can generate more cash we will.

Now, going back to the level of working capital, etc., we will make sure we invest for our customers as the [inaudible] happens. That is far more important to maintain our leadership position and be there for our customers. That said, as I look at the working capital, I'm going to share with you one or two operational KPIs that we look at. Take inventories. Our ability to maintain inventories at 15.1 of sales, which is lower than last year, lower than the first quarter despite the rapid decline in Q2, to my mind is very strong, and our challenge and our absolute resolve is to maintain that.

The second point, receivables. I mentioned to you that in times of challenge like this liquidity management is the biggest source of corporate distress. We have 11,000 customers. We're so focused on receivables management, I've never seen that in Solvay before and it's paying off. That's why our overdues are just under 4.5% of all our receivables and that's a record. And I thought we'd set a record in December last year, we were at 4.9%. Again, can we sustain it? It's not a walk in the park. We'll absolutely continue to focus on that systemic sustainable performance, and that's why we will invest but we'll keep the discipline.

Mubasher Chaudhry
Thank you. Just to clarify on the tax part. Do we expect any tax payments for the second half or is the low tax payments that you've seen in the first half is the run rate that we should we be thinking about? Thank you.

Karim Hajjar
At this stage, nothing at all is anticipated in that regard. So, essentially the cash flow expectations are very much driven by the factors I've described.

Mubasher Chaudhry - Okay. Thank you very much, much appreciated.

Operator
The next question comes from Mutlu Gundogan from ABN AMRO. Sir, please go ahead.

Mutlu Gundogan
Yes. Good afternoon everyone. My question is on cost savings. So the gross amount is €170 million in the first half. You did €50 million in Q1. What were the net savings in Q1 and Q2? And then, relating to Q2, how much of that was from furlough? And then looking at your full-year guidance of €300 million of gross savings, how much of that will be net and how much of furlough would you expect in Q3/Q4? Thank you.

Karim Hajjar
So I've already indicated that inflation was €37 million in the first half; you can extrapolate that easily. So 300, you can deduct two times the €37 million I mentioned, and you get to a net figure. There are many other factors that impacted the costs, of course. We've highlighted the key aspect. For example, you've got the negative impact on fixed cost from destocking, and our stock levels are – our inventory

levels are down. But there are many other factors that have compensated for it. So the key elements are those that we've mentioned and you've correctly retained.

Ilham Kadri
And I think what's interesting, Mutlu, is out of the 170 I have explained with Karim, €80 million is structural and will follow the structure. And basically, almost 50% of the structural is restructuring plans which we already shared with you our intent during the growth strategy. And obviously, the composite material starting in a bit Q2, right, to execute their restructuring plan, and 40% is indirect. The rest is productivity. And the €90 million temporary is mixed bag of T&E – travel ban, obviously – and many other things. And the target as we said is €300 million for the year, which is already, a nice achievement as compared to our five-year target of €410 million, which represents 35%.

Mutlu Gundogan
Thank you very much. I mean, just an add-on, why won't you just simply give the net number in the press release each time?

Karim Hajjar
Because inflation is a recurring part of the business. And fundamentally, it's about what is it we can do. I mean, there are many different ways you could present the figures. I've been focusing on what is within our control, inflation certainly is not. Makes a lot of sense. And the maths are the maths.

Ilham Kadri - And we can – yeah, it's the maths. So we can –

Karim Hajjar - You can count on us…

Ilham Kadri - We can engage with you offline.

Karim Hajjar - Yeah, yeah.

Mutlu Gundogan
Yeah, no, I mean, just because other companies do it as well, so – anyway, it's just a thought.

Karim Hajjar - I hear you. Thank you.

Ilham Kadri - Thank you.

Karim Hajjar - Appreciate it.

Moderator
The next question comes from Jeff Hare from UBS. Sir, please go ahead.

Jeff Haire
Hi, this is Jeff Hare from UBS. I just wanted to ask two if that's all right, just a confirmation question. The structural element of the €300 million cost savings for this year, is that additional fixed cost savings taken from the GROW strategy? Or is that on top of the €410 million?

And then secondly, I was wondering if you could talk a little bit about how the sales for the group or the volumes of the group progressed through the quarter and what they look like in July, please.

Ilham Kadri
Yeah, great question. Karim?

Karim Hajjar
To pick up with the costs. So maybe we start by reminding that when we announced our GROW strategy, we indicated a €300-350 million gross cost savings over five year. In the first quarter we said, no, no, we're going to do minimum of €350 million. And with the composite restructuring we announced a few weeks ago, we raised to about €410 million. Okay, so the €150 million, which is half the €300 million for this year, represents about 35% of that five-year commitment. We said at the time we're going to front load our efforts, and clearly this crisis has helped to deepen and accelerate that pace of progress beyond anything we were imagining at the time.

Ilham Kadri
So Jeff, it's €150 million we're taking the structural savings, right. And there is a lot of self-help going on this year. May not repeat, I hope, after the rebound happens, so – and we all hope that we are going to enter into a more – of growing more than reinvestment. So the €150 million structural, that's the part you need to take into account against the €410 million of savings. Make sense?

Jeff Haire - Yep. Thank you.

Moderator
The next question comes from Laurent Favre from Exane BNP Paribas. Please go ahead.

Laurent Favre
Yes. Good afternoon, everybody. My question is on CAPEX that you just guided at €600 million. I was wondering if you could give us a bit of an update on your investment in bicarbonate and soda ash? Can you invest just on the bicarb side? Or have you had to push both, I guess sides of the investment away? When do you think you will be able to be up online if you're not spending on these projects this year? Thank you.

Ilham Kadri
Yeah, thank you, Laurent. Hi. Well, listen, as I told you last time that we have frozen our volume capacity extension, right, in Green River in Wyoming just because there is no need for additional capacity at the moment, right? So that's what we've done, with other capacity increase through the Q3 crisis.

Now as you can see, we are a company who is looking at the short term with an eye on the long term; I call it having an eye on the microscope and the telescope. As we see that our free cash flow has reached record, we feel comfortable and confident that we are going to hit a free cash flow for the year equal to last year number. As soon as we can, we will reinvest to emerge stronger, because I believe that companies which are going to really win and emerge stronger are those who are going to prepare for the rebound. That's number one.

So we have invested €.25 million of growth projects and we have our prioritisation as a team. It's all centralised in the hands of executive committee and I, and we do an arbitrage for the best projects with the highest IRR which are strategic to the growth agenda.

Number two, we also look at what needs to happen from really disruptive technologies in terms of building a specialty company. And programmes like EV, for example, electrification, programmes like the Actizone which I discussed – I shared with you and we fast track it during the last three months – are just great examples of what this company has in the pipeline. And I must confess, we didn't share with you more of this and we will do more in the near future, sharing our innovation pipeline right with you. Karim?

Karim Hajjar
That is the general point; you mentioned a couple of businesses, bicarbonate, soda ash. Clearly, we're not going to invest in any business where there is spare capacity; that makes sense. Bicarb is one of our really good growing resilient businesses; I'm not going to confirm nor deny what we're going to do specifically. What I can say, to Ilham's point, is we will invest to make sure we're there to grow with the market and our customers.

Laurent Fauve - Yes. Thank you. That's very clear.

Karim Hajjar - Thank you.

Moderator
The next question comes from Laurence Alexander from Jefferies. Sir, please go ahead.

Laurence Alexander
Good morning. Could you discuss your philosophy – I don't want to get into specifics that where you'd be, like, negotiating against yourselves, but can you get into your philosophy on disposals, and then of course, the flip side of bolt-on M&A.? How you think about valuation, return on capital, how you decide when a business is suitable to be – move to someone else's hands.

Ilham Kadri
Well, listen, I mean, M&A is part of our portfolio management, right? And I always say that we have an eye open but there is no transformative acquisitions at the moment on our table, or I would consider. First of all, we need to manage the crisis and go through it. And if there are bolt-on technologies which can support the core and reinforce it or extend it, we will consider that, right. But at the moment, we are really focused on – with no distractions – into delivering our GROW strategies, the GDR and the O, navigating through this crisis and I'm very proud of our teams on what they deliver. And we are really staying focused on this at the moment.

Laurence Alexander
And for disposals?

Ilham Kadri
For disposals, as I said– and I hope today has been a bit of a nice [inaudible] for you [inaudible] that is not [inaudible] and we are re-evaluating [inaudible]. As I shared with you in my closing remarks, we are looking for [inaudible] some of the businesses [inaudible].

Ilham Kadri
Within – yeah. Can you still hear me, Laurence ?

Laurence Alexander
Yes, I've heard – no issues from my side.

Ilham Kadri
Just checking that someone is still on the call, sorry. So what I'm saying Laurence, is that we are still looking – we are looking now and exploring strategic options to monetise some of our businesses, right, within the solution segments, which we don't consider as a core. But as I said, we're not for sellers. If and only if we find valuations that are compelling and aligned with our expectations we will do that and we will go for it. So these are the first steps in our way to look at simplification and strengthening the core businesses.

Laurence Alexander - Thank you.

Moderator
The next question comes from Matthew Yates from Bank of America. Sir, please go ahead.

Matthew Yates
Hi, everyone. I just wanted to ask a question about some of the restructuring you're doing around the salesforce you alluded to in your prepared remarks. You talked about changing some of the incentives, introducing some account managers. Could you maybe just flesh that out a little bit: what you're changing and what you're expecting the uplift on top line to be going forward?

Ilham Kadri
Yeah, it's a great question. Thank you, Matthew. Well, listen, at the end of the day, I know that in order to unleash the potential of Solvay, not only we're going to do the right job in terms of managing customer, cash and costs, and you've seen us in action very decisive and agile during the crisis. But the reality is that we lacked top-line growth in the past decade as you nicely told me during our one-to-one discussions. And I think the only way in my experience to do this specifically for Specialty Company is to drive more hunting mind-set. And we need to have more hunters than farmers in the company.

So what we are doing, we launched Solvay’s Sales Academy, it's a big, big event for us, where we're going to build the curriculum from a field junior stage manager to sales account manager, to regional manager, key account manager for sub-key account clients of the company.

And the way we're going to do it is first of all on assessing the competencies we have, driving the CRM, the client relationship manager through which, by the way, good news at Solvay we have it; we have it across company so we are going to reinforce it. It was not reinforced top down; it’s going to be mandatory to drive a bit visibility and great visibility at my level and ExCom level about the pipeline, etc. So we started doing that. We're going to reinvest in the front line. We want to have people who understand more even the value proposition and delivery because at the end of the day, we're not selling commodities. Most of the time we're selling actually, as I said in auto, lower total cost of ownership, better sustainability profile. You know, really, I mean you need the high technology mind-set and bring the value proposition to your customer, show the money you're going to save or bring to the table and share the value created, right, with them, to not leave a value on the table.

So I think we are doing all of this and changing incentives, I have a simple mantra is that you hit the pockets, you hit the behaviours. Today, the incentives are extremely not homogeneous across the company because we have had very decentralised model. So, by 1st January 2021, we will be changing the incentives to drive performance more hunting spirit and ownership mentality.

Ilham Kadri - Okay, one more. Go ahead.

Operator
Yes. We have a new question from that from Chetan Udeshi from JP Morgan; please go ahead.

Chetan Udeshi
Yeah. Hi. Just a couple of questions. First question was just on the operational leverage in second quarter from volume decline, because if I just take into account forgetting about gross net savings, if I just look at the OPEX and the P&L, it's come down by €62 million. The prices are up. Raw materials probably are down. The implied drop through from volume declines seems like more than 50% in second quarter. Can you maybe just help us understand how to think about that drop through in second half of this year, whether it will be different, whether it will be same? And the second question was just, I mean, at this point, I know the visibility is low, but do you expect third quarter EBITDA to be at least better than second quarter?

Karim Hajjar
Okay, so in terms of your first question, in broad terms, if you look at the sales evolution across our segments, you ought to quickly come to an understanding that EBITDA will have fallen by €0.3 billion

had we not offset and mitigated. Against that, I mentioned the fact that we have pretty good pricing power, that's been sustained, a few tens. And then clearly, the cost savings net of inflation. That essentially gives you a good indicator. But bear in mind that first quarter was clearly much more resilient and the second quarter is the biggest factor that shows up first half performance. Going forward, essentially, our fundamental belief – I'm going to say it this way – our fundamental belief is that our job is to ensure that we variablise any fixed costs and preserve our margins. You can't do it in one quarter, we certainly will do it over strategic period. So as we recover, I expect margins to expand again, fundamentally.

But I can't really quantify quarter by quarter what that is likely to be. It very much depends on your assumptions as to the nature and shape of the rebound and its timing.

Ilham Kadri
And I think we have demonstrated, Chetan, now adaptability and flexibility. You know, I mean, we implemented furlough in the company for the first time probably at a large scale like we did in May, right. So, and we are using – we are adapting the internal activity between production, in research and innovation, technical service, whatever, to the customer demands. At the end of the day, our contact is the customer and that's what drives our needs. And we follow the order books, at a daily level, right?

On the improvements, again, I remain optimistic on auto. We have one third of our businesses, they show really great resilience. Composites, for example, we are driving very fast as you can see our restructuring programme. We will reach a run rate by the end of the year in term of the €60 million of savings with €30 million of investments. So that's a great job done by our teams. And the volumes will probably still down in Q3, because we have a comp against Q3 last year with 737 Max. But going forward, the bottom will be behind us and we foresee a slight improvement in Q4.

And China is also positive to us. You've seen our number, 20% increase between the first quarter and the second one. In H1 actually China for us we scored in sales 1.7% for this semester as compared to last semester. So this is domestic Chinese sales, and we believe that if it continues without a second wave, we will have much to do in China as well.

And then you have all these innovative programmes; the Green Deal, the investment in Europe on electrification, cleaner mobility, all of this. Hygiene and cleaning is becoming even more important. So all of this will continue. And then the working capital, you've seen it, from day one I said last year, cash is king. We have now a disciplined approach to working capital as Karim said, from inventories receivable. And we will continue doing so. Right?

Karim Hajjar
Maybe time for one final question

Operator
Yes. The last question comes from Alex Stewart from Barclays. Sir, please go ahead.

Alex
Hello again, you'll be pleased to know it's a very simple question. The €600 million CAPEX guidance you talk about for 2020. In your second quarter release, you define CAPEX as including IFRS 16 lease payments, which were about €100 million for the year. Can you confirm whether that €600 million is CAPEX as it appears on the cash flow statement or CAPEX including the lease payments? Thank you.

Karim Hajjar
It includes the lease payments.
It represents a $200 million-odd reduction compared to last year

Alex
So it's about €500 million of capital expenditure out of the cash and investing line.

Ilham Kadri
Say that again Alex?

Alex
So your lease payments are about €100 million and they come out, I think, of your financing cash flow. But can I –

Karim Hajjar
The €600 million is including leasing and it's cash and it's this year.

Alex - Okay.

Karim Hajjar
This is in our full costs.

Alex - Very good. Thank you so much.

Ilham Kadri
Yeah. And an on CAPEX, by the way, just to close with this. Obviously, you you've seen us right ? so our intent is not to cut anything to the bone. We have an eye on 2020, an eye on 2021 and beyond. We will reinvest where it make sense, right, selectively, with high look on the IRR and returns.

And we are, as we speak, zero-based budgeting our CAPEX across the company. So, we have an ongoing process where we are looking at all our spending, in the company, by assets, by business units, and zero-based budgeting. So we will share with you more in the next quarters. So, with that I think we should close by now. So, I wish you all and your family a safe and restful summer so, thank you very much.

Karim Hajjar - Thank you.

Jodi Allen
Thanks, everyone. If you would like to follow up with any other questions, the investor relations team is available for you after the call. Thank you very much.

Operator
Thank you Ms Ilham Kadri and Mr Karim Hajjar.
Ladies and Gentlemen, this concludes today's conference call. Thank you all for participating. You may now disconnect.