

Solvay Q2 2021 earnings call - transcript

Operator

Ladies and gentlemen, welcome to Solvay's Q2 2021 Results conference call for analysts and investors. Solvay team, the floor is yours.

Jodi Allen

Good afternoon. And welcome to our second quarter 2021 earnings call. My name is Jodi Allen 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 risks and uncertainties. You may refer to the slides related today's broadcast, which are available on our website. With that, I'll turn the call over to Ilham.

Ilham Kadri

Thank you very much, Jodi. And hello everyone. I'll begin my remarks today as usual with health and safety overview shown on slide three. Today we have 32 colleagues who are infected with COVID-19, down from 124 since our last call. Yet we remain very vigilant given the pickup in infection rates with the Delta variants. At this time, we continue to maintain our remote working routine globally to ensure high levels of safety, though, we are also slowly reopening some of our administrative sites in certain countries with appropriate safety measures in place. Our Solvay Solidarity Fund that many generous investors along with the management team helped to co-fund has stepped in to support hundreds of families in the past month. We supported hospitals in the communities in which we operate in India, in Bulgaria, Italy, a few examples following the recent COVID outbreaks. The Fund earlier in the week, announced two million euros to support our communities in Europe and in China who have been touched by the dramatic floods earlier in the month. We are making sure they have what they need and are pleased to have the ability to support our communities in tough times.

Moving to results, you may recall in our last results call, I talked about the three Rs, which are representing Solvay. One R for resilience, one R for recovery, and one R for reinvestment. We learned through the crisis about the resilience of our businesses, and it has been a stress test, as you know, through the COVID-19 crisis. And we see now during this recovery period, the resilience of our people. I'm truly proud of them and I'm truly proud of the teams. They do an extraordinary job every day and Solvay's becoming an even better company, an even stronger company, thanks to their effort. Our team is fully mobilized to take advantage of the recovery that is clearly underway. It is now visible in about 90 to 95% of our portfolio, as you can see in our slide here, and as demonstrated by the strong demand environment and top-line growth across most businesses. No surprise, only civil arrow, parts of oil and gas and a portion of soda ash remain challenged.

Moving to slide five, sales in Q2 were up 20% organically. In fact, June sales volume surpassed 2019 levels. The surge in demand is particularly strong for our specialty products used in automotive, electronics and building markets. For example, sales grew 59% in automotive. This includes all businesses that sell to auto across company, including specialty polymers, special chem, silica, and few others. And indeed, I'm very excited to tell you today that specialty polymers sales were at an all-time high this quarter. Another example, sales grew 23% in building and construction or sales grew 15% in electronics. From a geographic view, all regions contributed to the sales growth in the quarter with Europe up by 23%, North America up by 17%. Latin America up 54% and Asia Pacific up by 12%. Yes, as you are all aware, many industries, including ours, are impacted by the ongoing logistic constraints. For Solvay, we estimate about 40 million euros of missed sale or one and a half percent in sales constraint directly related to these issues. And you can imagine we would have had an even stronger quarter had it not been for these constraints.

Inflation headwind in Q2 amounted to 50 million euros compared to 15 million euros in quarter one. As expected and it's clear to us now that the majority of the impact will be in the second half and more to come on that later. Our teams are working hard to offset the rising costs with price this quarter. As you know, there is a lag between cost and pricing. By the way, we are using this as an opportunity to build a much stronger pricing culture in the company. Our pricing actions continue to be positive. I can assure you the businesses are highly focused on securing more. Moving to profits, we continue to deliver on our promises. Structural cost savings of 51 million euros were achieved in quarter two. So telling 131 million euros for the first half of 2021. We will remain on track to meet our 200 million euros target for the year. So all these actions on pricing, on structural costs, and obviously the volume growth all translated into an EBITDA of 602 million euros in the quarter. Supported our delivery of 47% EBITDA growth and improved our leading margin actually sustained our quarter one EBITDA margin of 24.5%, which is a record.

Moving to cash. This quarter marks the ninth consecutive quarter of positive free cash flow. We generated 135 million euros in quarter two. And in the first half, we are 25% ahead of last year. I'm truly pleased that the focus and discipline we brought to cash management since 2019 is clearly paying dividends and having an impact. And we are therefore raising our guidance, more on this later in the call. Finally, on slide six, our focus continues to shift to reinvest in for the rebound to support future opportunities. And we continue our disciplined approach to capital allocation at the group level, which aligns directly with our growth strategy. We also continue to win new business and form new partnerships that will drive and accelerate future profitable growth in many of our core specialty markets. As you are all aware, it's estimated that 30% of auto production will be

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electric or hybrid vehicles by 2030. As a reminder, we set up a battery platform in the fall of 2019 as part of our GROW strategy, which has been growing exponentially for several quarters, even during the peak of the crisis last year. Since then we have been building partnerships with key manufacturers, with our clients and partners, as we position ourselves as a total solutions provider.

Our solutions focus on performance, safety, increasing power density, and range. As you may recall, sales two batteries have almost doubled since 2019 and our sales into batteries in quarter two grew by 82% year on year. Market growth rate and our leadership position makes this a clear core growth area for Solvay. And many of you have been asking us during roadshows what gives us our competitive advantage? So let me summarize for you the key elements. First, we have a manufacturing presence on three continents, which is highly valued by our partners. Second, we are leveraging our broad portfolio of battery solutions that is unmatched in the industry and meets key performance and safety criteria. Most of you, of course, know about our leading position in PVDF, which is used inside the cells, but this is not the only thing we give or we're providing in the batteries. We also supply other polymers, like electrolytes materials within the battery. These include lithium salts and other specialty additives within the special chem business, for example. We also provide thermoplastic polymers, which are used in battery cases that literally circle the battery. And we are even commercializing other technologies in our portfolio to add to our suite of battery offering.

And customers are choosing us for all these reasons. And this is in addition to all other solutions we supply to the automotive industry at the service of light weighting along with electrification. Last quarter, I shared with you that we continue to invest in additional capacity. By quarter one 2022, we will have doubled our PVDF capacity in France and China, and we have even more significant expansion plans coming up, so stay tuned. In addition to our own generation five solid batteries development, and I remind you, we are commercializing now generation two. We're also investors in startups, like a company called Solid Power, which recently announced its plan to be listed on NASDAQ. We were amongst the founding investors and recently OEMs, including BMW, Ford have joined us in what we think is an exciting opportunity. Solvay has been collaborating with this entity for several years, and these investments align very well with our innovation strategy. And as I mentioned, our value proposition goes beyond batteries and automotive is one of the largest markets for Solvay. As we shared in our growth strategy, lightweighting is the other key driver in auto replacing metals with various polymers and therefore consuming less fuel, emitting less fuel or greenhouse gas emission and enabling cleaner mobility.

And we see this in our increased penetration of specialty polymers in under the hood applications. Some examples there include coolant lines, water pumps and various connectors, all of which require a high degree of performance, thermal properties at lower total cost of ownership. And we have a number of new wins in the second quarter as we turn our sales culture into a hunting culture. For example, I cannot share customer names, but I will share that in quarter two, we secured considerable new business. Therefore, and to support continued growth we are expanding not only PVDF capacity, but also elastomers and sulfone polymers and PVDC capacity. Let me now move to electronics market, which is another exciting market. Sales to these market grew by 15% in the quarter, marking the second consecutive quarter of double digit sales in electronics. Demand trends in semiconductors used fab equipment, which is boosted by 5G and display markets where various polymer materials are widely used propelled us in recent months. We're also continuing to expand our production of electronic grade H2O2.

I'm sure you have read about the amount of investment happening with fab manufacturers. Around \$50 billion has already been announced by companies like Intel, Samsung and TSMC. All of these are underway already, and this presents a significant growth opportunity for Solvay because we manufacture some of the purest hydrogen peroxide available in the world. It's a critical specialty in the production of semiconductor chips as the complexity of computer chips and the miniaturization of the circuits in them increases, the demand for high purity H2O2 grows. Last quarter, I told you about our H2O2 expansion underway in China. Today I am pleased to share with you that we are also extending our production in Taiwan with the new joint venture that's aimed to serve the booming semiconductor industry in that country and region. We are finalizing the agreement in the coming weeks and production will begin in 2023.

And as we speak, we are also planning investments in both the US and EU, and we are finalizing those contracts now. And we look forward to sharing more in the coming months on each of these investments. So listen, these are just a few examples of new businesses that address some of our core technologies areas of investments. And it's clear that we are extending our share of wallet, we continue doing so, and we are winning. So now with that, Karim will review with you in more detail the group segments and financial performance. Karim?

Karim Hajjar

Thank you, Ilham. Good morning. Good afternoon, everybody. Before I dive into the segments, you'll remember that we indicated last quarter that a full year EBITDA impact of scope and currency was estimated at 120 million euros for the year. And you can see today that Q2 includes a 31 million euros impact, mainly from currencies and to scope reflecting the six business lines that were divested late in Q1. I'll now start with an overview of the three business segments. And as usual, we'll refer to for this on an organic basis, namely at constant scope and currency, which obviously eases comparisons. Starting with materials on slide number eight. Sales in the second quarter were up 12% versus the quarter last year, Q2 last year. Sequentially, they're up 3%

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against the first quarter of 2021 driven by very strong performance in the specialty polymers business. As you heard from Ilham, sales of specialty polymers were up 20% in the second quarter reaching 536 million, an historic record. And this reflects increased demand in multiple markets, including automotive, electronics, consumer goods, and medical equipment. By far, the greatest driver was automotive where we saw polymer sales increased 52%, and that excludes batteries that Ilham already shared with you. Moving to composites, sales were only down 8% organically, but you will recall that in the second quarter, last year, we were only at the beginning of the steep decline that became very evident in the third quarter last year in particular. On a sequential basis, the good news is that sales are improving, albeit modestly. Talking 4% against Q1 last year, and that follows a 13% sequential improvement in Q1 relative to Q4 2020. We're really encouraged and we welcome the recent increases in aircraft order books and the customer news on future rate increases on single aisle aircraft. In the meantime, the footprint optimization and the restructuring programs that were very quickly put into place last year with three site closures, one in the UK, two in the US, these programs are all on track and they will support a rapid growth in profitability as demand picks up. To wrap up our materials, segment EBITDA increased 35% year on year. EBITDA margins improved 600 basis points, primarily due to the high volumes that I've described in specialty polymers, also to sustained pricing, as well obviously significant cost reductions, especially in the company's business.

Turning to chemicals on number nine, second quarter sales in the segment were up 31% with all businesses contributing to that growth. Soda ash continued to improve, sales up 10% in the culture driven by higher volumes, slightly offset by lower prices. As a reminder, last year Solvay chose to preserve pricing at the expense of some volumes. And that strategy has proved its worth over time. It creates value. Now the business is starting to capture that volume again. We see continuing recovery in building and in automotive markets, which support growth in flat loss, whereas demand for container glass, which is used in hospitality and restaurant catering industry remains soft, which is clearly understandable given the circumstances. Sales in the bicarbonate product line, and remember, that's about a quarter of the soda ash business, they were up 4% and they reached record levels due to strong demand for our SOLVAir technology, which is used in flu gas treatments in the US to clean air. Peroxide sales were up 17% for the recovery across four regions, market conditions remain strong in HPPO, and that drove top line growth. If you recall, this is used to produce polyurethane films for industries, including automotive and building. So this progress reflects the clear rebound brushing and those markets. Strength in this market overcame the continued softness in pulp and paper, which is associated with the declining graphic paper market. Our silica business had yet another strong quarter with sales growth of 70%, yep, 70%, a strong demand for replacement tires and to the benefits of market share gains that we've announced in our past as well. The penetration of our new sustainable mobility solutions are driving increasing demand. And it's further reinforcing our position as the innovative market leader. The Coatis business in Latin America is continuing its record run with sales almost double Q2 last year. And that showcases how our leading regional position benefits us in favorable market conditions. We also benefited from strong performance in the Rusvinyl joint venture, thanks to continued strong demand in the face of tight local supply, which is boosting pricing for PVC. Looking ahead, however, we remain cautious and we do expect market conditions to rebalance, and therefore for performance to moderate somewhat for both Coatis and Rusvinyl businesses. Overall, the EBITDA of the chemical segment was up 49%, thanks to the growth in each business, EBITDA margins were 30.4%, that's 510 basis points higher than Q2 last year.

Moving to slide 10, I'll review the solution segment and the segment that delivered sales growth of 19% organically in the quarter. Beginning with Novecare, sales were up 21% driven by double digit growth in coatings and industrial products, which as you're aware, are used in auto and in building as well as construction markets. Home and personal care and agro were slightly down versus last year, mainly because of supply chain and logistic challenges. Whereas oil and gas remains stable.

In agro in particular, we formed a new partnership to supply our specialty ingredients for a new sustainable product line that will be launched this quarter. The special chem business delivered sales growth of 33%, reflecting the rebound in the automotive and electronics sectors. That said, although demand in auto remains strong in the quarter, we are starting to see some impact from the chip shortages. As Ilham mentioned, growth continues in electronics driven mainly by semiconductors and by capacitors. Technology solutions sales grew 17% in the quarter. That growth continues to be supported by high demand for copper also propelled by the electrification trend. We are gaining market share with existing customers. We're also gaining a high share of new mine openings, other product lines, which include phosphorus, specialties and additives are also supporting the growth. In aroma sales were down 5% in the quarter relative to the record levels that were recorded in Q2 2020. The vanillin business using food flavors and fragrances remains strong. Wrapping up solutions, the segment delivered EBITDA organic growth of 42% against Q2 2020. And that reflects the strong, the continued recovery across most markets. Focused cost reduction measures have also supported EBITDA margins, which amount to 18.5%. That's a 250 basis point improvement over Q2 last year.

Now I'll provide you with an overview of the structural cost savings, which you can see on slide 11. Progress continued with structural cost savings on the second quarter of 51 million euros, bringing the half year total to 131. There are three main areas of delivery in the second quarter. One, restructuring; reductions in labor costs contributed 22 million euros in the quarter. Indirect cost reductions were at 24 million and indirect cost reductions, I'll remind you, really begins to really shows results from the zero-based budgeting approach has been in place for a while now and is really delivering very, very strong results. That's really encouraging. Productivity efficiencies that our sites continue to yield good results with five million in the quarter. Now, as a reminder, we previously raised our full year structural cost reduction expectations from 150 million to 200 million. Our

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performance in Q2 is on track for the 200 million that we've indicated. Indeed, we're also taking steps to reinvest some of these cost savings in order to accelerate, further accelerate the group's transformation in matters, such as digital, for example. Cumulative cost reductions, if we take a step back and look at it over 2020 and 2021, are expected to be around 375 million euros, which is around 200 million net of all fixed cost inflation. And that further sustains our leading EBITDA margins. In overall terms, strong top line growth combined with continued cost reduction delivery, and that supported an EBITDA achievement of 602 million, which is a 47% organic increase against Q2 2020. It's also worth noting that EBITDA for the first half of the year was around 5% stronger than in 2019. And that's despite the fact that sales were down 2% over that same period for the more EBITDA margins of 24.5% in the first half of 2021, which is cost leading, that is 208 basis points higher than in the first half of 2019.

Now I'm going to turn to cash and invite you to turn to slide number 12. We continue to focus on further improving our cash management, free cash flow of 135 million in Q2 and 417 million in the first half of the year. Now, as Ilham mentioned, this is 25% higher than the first half of 2020 on an equivalent basis, by which I mean you exclude scope, currency and one time elements. By one-time elements, particularly the 78 million in one off tax impacts in Q1 last year. What drove the 25% in improvements in cashflow? Well, firstly, from a pure operational standpoint, what do we see? We see top-line growth, which funded an increase in working capital. And what I'll highlight is working capital would have increased by around a quarter of a billion euros had we not made further structural improvements, but we have made these improvements and you can see that evidence when you look at our working capital to sales intensity, which went from 16.3% in both Q2 2020 and in Q2 2019. So it was flat at 16.3 and today, where are we? We're at 13.7%. That's a very clear indicator of improvement.

What does it come from? Well, we've given you examples in the past, I'm going to update you; receivables 8,000 customers, always over a billion euros. Overdues are key. They improved from around 6% in Q2 2019 to around 2% today. And in fact, it's systematically around the level of 2%, which is really good. We've also continued to make progress renegotiating credits with key suppliers, and that has improved our average DPOs, days payable outstanding, to 52 days. And that compares to 50 days this time last year. And in fact, it compares to 44 days in 2019. So all the programs we launched when we announced the growth strategy are delivering and you can see on the bottom line. If I turn to CAPEX, we are a bit behind. We expected to spend about 25 to 30 million more than we did. Now, as you know, we have a target for the year of around 700 to 750 million euros. So what happened? very simply was we experienced some delays in the first half due to a variety of challenges, including raw material shortages, for example, steel, some COVID restrictions. You remember the weather conditions in the US had a bit of an impact, but mostly supply chain and logistic issues also had an impact on our key suppliers of equipment, for example.

Now we clearly expect a spending acceleration in the second half, as we have many exciting and important projects on the horizon. Several of them were mentioned by Ilham earlier, and there will be more announcements to come. The benefits from our continued de leveraging of the balance sheet also supports the significant improvement in our cash generation; indeed pension and financial charges were 34 million lower than in the first half of 2020, and that reflects these efforts. Against that, you've seen that we're delivering strong cost reductions in relation to restructuring actions, while restructuring costs, the cash out, has increased by 22 million in the first half this year, compared to the first half of 2020. And you know that the paybacks are really attractive because they are at around two years or less. Another clear indicator is a significant improvement in our free cash flow conversion, which I'll remind you was 26% at the beginning of 2019. And we're now trending towards 32% based on our upgraded guidance for 2021.

Finally, a word on our debt. Globally, the level of debt at the end of June is stable compared to the level of debt at the end of 2020. So the strong cash flow that I've described in the first half and the inflows that relate to the six divestments I've described funded both the dividend payments of 388 million euros. And it funded the 102 million euros voluntary contribution to our pension obligations in the first quarter of the year. Talking of pensions, our voluntary contributions since the fourth quarter of 2019 total 768 million euros. As of the end of Q2 2021, pension liabilities amounted to 1.7 billion euros. That's one billion euros below the level at the beginning of 2019. And there's more, we're actually planning another 300 million in additional contributions to pension schemes in the next 12 months. To say it differently, the quality of our portfolio, our class leading profitability is coinciding with sustained focus on cash generation, on de leveraging, and also on optimizing our liability management. And these together are supporting our strong credit ratings, which are stable at triple B and at BWA2 at S&P and Moody's respectively. With that, I'll hand you back to Ilham, who provides our outlook for the remainder of the year. Ilham?

Ilham Kadri

Thank you, Karim. I'll now comment on our outlook for the full year shown on slide 13, based on our stronger than expected results for the second quarter and our continued trends in order books heading into the third quarter, we see solid demand continuing. What has become clear, however, is that the increase in variable costs related to raw materials and logistics will play more of the factor in the second half as they may materialize before the full benefit of our pricing actions become visible. So our prior estimates for annual inflationary cost was between 150 and 200 million euros, if you may remember. We now see that escalating to between 200 to 250 million euros for the full year. To date, we have absorbed about 65 million euros in the first half, so headwinds here will increase. Our businesses, have done a good job mitigating the headwinds, and we continue to raise

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prices in the market to offset as much as possible. As you know, there are often lags, which average about three to five months and this is what we will be experiencing in the second half.

On supply chain and logistics bottlenecks, they are likely to continue. And we have mobilized by establishing a dedicated multifunctional team to address these matters on a case by case basis and support our businesses, our customers, and engage actively with our suppliers. In addition, there is still a degree of uncertainty, as you know with the COVID variants and its effect on parts of the world as we emerge from the crisis. Now, taking all these factors into consideration, we'll remain confident in our ability to continue to drive organic growth through new business and make more progress on pricing. Our upgraded full year EBITDA guidance is now in a range between 2.2 billion and 2.3 billion euros representing 20 to 25% growth on an organic basis against 2020, and around 4% against 2019. We also expect to continue to deliver on free cash flow. And now we estimate generating around 750 million euros for the full year. This is 100 million euros more than we guided last quarter and 40% more than the equivalent figure in 2019, while continuing to invest in the exciting growth program we shared earlier. As Karim mentioned, this would represent the cash conversion of around 32%. This is higher than our strategic commitment.

So as you have seen in our bottom line results and in our margins, we are emerging stronger from the crisis and we will continue to focus on transforming to a simpler, leaner and more specialized organization focused on profitable topline growth. So with that, Karim and I will be happy to take your questions now.

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Jodi Allen - Solvay SA - Head of IR

We will now move to the Q&A. And I would kindly ask that you can limit yourself to 1 question per person, please, just so that we can address as many people as possible today. Moderator, please proceed.

Operator

(Operator Instructions) We already have a question from Mubasher Chaudhry from Citi.

Mubasher Ahmed Chaudhry - Citigroup Inc., Research Division - VP

Questions. I'll stick to the one. I think you've been talking about the fact that you're switching more towards spot volumes in Soda Ash. Could you provide us with an updated split of your spot versus contracted volumes as it stands today? And can you talk about whether this is likely to have an impact on your customer relationships going forward when you want to switch back towards contracted volumes? Some comments on strategy there would be helpful.

Ilham Kadri

Yes. Mubasher. Do you want to take it, Karim and I follow up. Yes, yes go ahead.

Karim Hajjar

Sure. I mean, spot markets clearly are very, very supportive. Pricing is really increasing but as you know, our frameworks with our customers means that we contract annual in advance. We're about 90% contracted. Typically, we're in the 80% to 90% range. So, that means we do stand to benefit incrementally in the second half of the year from the spot prices that we see today. More importantly, what we welcome is the fact this is very, very conducive for the annual negotiation discussions that will kick in the final quarter of the year there, which from a strategic standpoint is incredibly important as well to us. Ilham?

Ilham Kadri

And Mubasher, great question. I've been in the job for 2.5 years. And last year already we practiced the same tactic, we like contracts. And obviously, at the fall, we do, as Karim say the 80-20 rule. So more than 90%. We had a bit less this year. And frankly, when we saw the pressure on pricing already in the fall last year, and even before facing an inflationary environment, we let go some volume at low margins to our competitors and we were waiting to see more favorable environment. And what happened this year is exactly what happened actually during the crisis is that the market started to be a bit tighter, more spot volume, obviously, were available, specifically in the seaborne. And also, the North American players started increasing prices.

So we took back volume at the higher prices and a higher margin than what we would have done or contracted last year. All in all, we have long strategic relationship with our customers and we do honor our pricing. And I think Soda Ash is doing a great job, not only in their annual negotiation, is taking advantage of favorable intra-region good flow. And obviously, even the Chinese players, game plan, we have changed, and margins have been so squeezed that they needed to act on them. So all of this is favorable for us, and we are taking advantage from that as we speak.

Operator

We have another question from Matthew Yates from Bank of America.

Matthew John Peter Yates - BofA Securities, Research Division - Director in Equity Research, Head of European Chemicals Research & Research Analyst

You mentioned the significant jump up in raw material costs. Can you just elaborate a little bit across the business, where would you advise us that you might see the most acute margin squeeze in Q3 on that pricing lag? And maybe a bit more fundamentally, you're doing 30% margins in the Materials business, that's a pretty low point in the composite cycle. I guess as part of that, it means that your polymers are probably more of the mix at the moment. But given the structural cost savings you've made, where do you think divisional margins are going to settle out for Materials in 2 or 3 years' time once the Composites are back at a more normalized level of revenue?

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Ilham Kadri

Great question indeed. And as you know, Composite Materials have gone through interesting times, but they are exiting as a better business. Yes, you're right, and your observation is good. Actually, I'm happy with what I see specifically in the Materials side. I told you that our Materials segment is our crown jewel, and will bring it from good to great. Composite Materials have an annual pricing and long-term deals because of the structure of the businesses with Aerospace. This is formula-based. By the way, if the raw materials increase like epoxy or carbon fiber, it takes it anywhere between 3 to 5 months to apply the pricing. So, this is part of the game. Tet, they are actually doing the right job for the H1 net pricing, if I take pricing minus the variable cost, is more or less breakeven for Specialty Polymers specifically. But okay, they can do better and they are doing better. We have a unique situation in many technologies in many businesses. And as we speak, they are executing the prices increases versus the raw material inflation we are seeing. And we're getting smart and smarter about the availability of raw materials. And not only raw materials, by the way, but the logistics as well are also increasing, and we are air freighting.

We more than doubled our airfreight cost to our customers, right, to not set that down. So yes, I mean, outside pricing, and we always own on our pricing, we are having a conversation with our customers, and this is happening as we speak. And frankly, the question will be at the fall this year about preparing 2022, right? So, in terms of raw materials in general, just to give you an idea, the increases we've seen are coming from crude oil, followed by minerals and biochemicals and natural gas. So those are the big categories, right? And about 3/4 of our variable cost comes from energy and raw material, logistics and packaging is about 1/4. And as I mentioned in my speaking and written remarks, in H1, we have seen EUR 65 million of that inflation. And obviously, we have raised the cost increase to EUR 200 million to EUR 250 million for the year, implying that the H2 cost inflation will be anywhere around EUR 135 million - EUR 185 million.

It is what it is. Everybody is facing that. And this increase in cost estimates is also making us to actively fight for our margin. Our margin, by the way, have never been that high, 24.5% for the whole group. You may remember in the old recent days, 22% margin was great margin for Solvay and historically, actually above our peers. We'll continue fighting for protecting our margins. And on margins expansion it's about the value proposition and how unique it is. And as we speak, we are pushing a new pricing culture in the company. And doing things we've never done in the past in understanding the value creation for our customers. And I talk to the team wherever we create value, we need to share the value created with our customers and not leave it on the table. So you can count on us to just do that.

Operator

Our next question comes from Sebastian Bray, Berenberg.

Sebastian Christian Bray - Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst

It's on the pension liability. Once the additional EUR 300 million has been paid into the pension over the next 12 months, what will the annual cash out be? And does this effectively draw a line under the additional voluntary contributions or would you look to reduce this further beyond the additional EUR 300 million payment?

Karim Hajjar

Sebastian, thanks for raising that question. So look, you're absolutely right. It's an important question. I'm going to give you 1 fact and 1 estimate. The historic fact is that in 2019, the cash pension costs was of the order of EUR 213 million. The estimate going forward, rightly taking into account what we've done and what we're planning, we'll take that to an equivalent of around EUR 80 million, plus or minus EUR 5 million to EUR 10 million, let's say, for the mid- to long term, at least as far as I can see this, 5 to 10 years from now, we're talking of around EUR 80 million. In essence, a EUR 130 million sustainable improvement annually. That's what we're targeting.

Now will there be more beyond that? Honestly, no. I think then we may also have a few opportunistic, but nothing of any significance, which is why we're also focused in parallel on optimizing our liability management. So, for example, replacing a hybrid last year that was cost high equipment of 5.1% with 2.5%. All of that is also paying dividends that we see it in the bottom line already. And that's part of the journey as we continue to delever.

Operator

We have another question from Chetan Udeshi from JPMorgan.

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Chetan Udeshi - JPMorgan Chase & Co, Research Division - Research Analyst

A couple of questions. Firstly, I'm just looking at the cash flow, it seems the total proceeds from the divestments in first half were close to EUR 100 million. If I'm not wrong, I think the total EBITDA from divestments was EUR 50 million. So it implies that these were sold at very low multiple. I'm just confirming whether is the math correct? Or am I getting something wrong? That's first.

And the second question was more around the free cash flow guidance upgrade. Is that just a function of EBITDA upgrade flowing through to free cash flow? Or are there any changes in any of the assumptions on free cash flow? Because I would have thought with higher earnings, maybe the working capital would have gone up more than was previously thought. So just any color on that would be useful.

Karim Hajjar

A couple of things on that. I'll start with your second question on the free cash flow upgrade. It really reflects 2 things. One, it reflects the profit upgrade. Absolutely, that's fundamentally the biggest driver. But the other thing also reflects the fact that our working capital management is really, really tight. I don't expect a lot more, but we will continue with the level that we've achieved. That really is it, and there's nothing at all of any one time or anything else. It's a very, very clean set of sustainable numbers that we're dragging here.

To your first point, on that EUR 100 million. The math is not wrong, but it's not complete, by which I mean there are certain arrangements in place where we have some deferred proceeds, deferred consideration contingent sets in delivery, and we're confident that we'll get those earnouts.

I'll -- I know, I'll keep it simple, earnouts. So no, and the multiples are actually pretty attractive. And the other thing is we've also transferred about EUR 50 million because you're not looking at cash. You're looking at the enterprise value. So our provisions, pensions and environmental also go down by EUR 50 million. So if you look at multiples, you need to factor that in as well, of course.

Chetan Udeshi - JPMorgan Chase & Co, Research Division - Research Analyst

That's clear. And if I come back to free cash flow, I think, Ilham, you said the free cash flow guidance for 2020 already imply conversion above your strategic plan that you announced in 2019. Is this a sustainable run rate or is this maybe a phasing issue that we eventually have to go to 30%, 33% is not necessarily something that may be, let's say, a structural number. What I'm trying to get to is, is 30% still a target? Or clearly, the run rate today justifies that the aim should be better than 30% eventually?

Ilham Kadri

I guess it's Chetan, and believe me, I get your question. And normally, I don't like to change strategic KPIs in the middle of the year. Now definitely, you heard me from day 1, I told you that cash has been always important in my management playbook. This company, and that's why I'm truly proud of our teams. Free cash flow is important to me in good times and in the bad times. And what happened last year is that frankly, whatever we told you at the full 2019 as part of the GROW strategy, has been accelerated, and we gained probably 2 years, thanks to COVID-19 crisis where we accelerated our reforms. And yes, Chetan, I will probably deviate from my principles, the first time I do it in my career, this is going to be sustainable above 30% going forward.

Obviously, we had some very abnormal savings in the past years, etc. I challenged the team this year to turn the temporary into structural. They are doing a fabulous job, and we are accelerating our programs, including the way to structure our company to better serve our strategy. And obviously, we want to also invest in growth. And you've seen the list, although it's selective, and we'll do it with discipline of capital -- on capital deployment, we have some very cool, exciting growth projects where we are investing in and we are, as we speak, negotiating the final terms of the contracts, and we'll come back to you in the coming months. So yes, the plan is to be sustainable in the north of 30% going forward.

Operator

We have another question from Geoff Haire from UBS.

Geoffrey Haire - UBS Investment Bank, Research Division - MD and Equity Research Analyst

Just 1 question. Just coming back to the Composite business and particularly the Aerospace business within it. From memory, I think whenever you acquired the Cytec business, you were over-indexed towards Boeing versus Airbus. Is that still the same? Or has that balanced out now?

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Ilham Kadri

Yes. I mean, obviously, we had a long historical relationship with Boeing, but we are also present at Airbus, specifically in the narrow bodies and the single aisles where we have highly penetrated. And as we speak, I'm really -- I'm excited but what would I see, what I hear, we've done what we have to do in terms of turning around the business, exiting 3 sites, which were the lowest return on capital employed without losing the volume and we did it in the middle of the crisis. As you know as well, it takes a long time to gain new share in Aero. But we have exciting innovations and not only in the thermoset composite traditional Cytec innovations, but we are also now, and that's the idea of having Materials together, and I'm not sure I announced it publicly, but Specialty Polymers and Composites are merging as those 2 businesses. So they have 1 president as we speak. This is new from first of April. And why I did that is to force and to accelerate those exciting innovation, either Specialty Polymer in aerospace, or thermoplastic composites, which I remind you, is the best combination of Specialty Polymers and thermoset composites and bringing recyclable circular polymers to the aerospace industry, which both Boeing and Airbus love.

We're also growing in Defense, which is really a great business for us, and not only it's a good business, but it's a source of innovation. So all in all, I think really happy with what I'm hearing. We are more optimistic, although in our numbers, we see a recovery by 2023 to the level back of 2019 in build rates. But very encouraged to see deliveries of 737 MAX, 105 delivered year-to-date. And there are some estimates out there of 240 deliveries in the year. So this is depleting the stock and the inventory, it's around 400. So it's going to probably accelerate the 737 MAX. And Boeing estimate now is reaching 31 per month production in early 2022. This is what they are saying. And Airbus production were in A320 will increase from current level of 40 per month to 45 per month beginning in Q4 2021. It's also good for us and the A320 estimate is 64 per month by Q2.

So all in all in all, very happy with all of this. It's going to take time. We did what we have to do with the decisiveness. I'm very proud of the Composite teams. And frankly, those numbers to put it into perspective are even more remarkable. As you may remember, 2019 was the best Composites year -- EBITDA Composites year in their history. So, when we compare our numbers now to 2019, and I was freshly landing in this company, you're right, the team delivered in 2019 in Composites a record year. So it gives all the dimension of the achievements and the record achievements we are announcing today. Thank you for the question.

Operator

We have another question from Jaideep Pandya from On Field Research.

Jaideep Pandya - On Field Investment Research LLP - Analyst

Just wanted to understand your carbon strategy sort of with regards to Soda Ash and once Soda Ash is sort of gone. You've been -- obviously, you guys are masters of managing carbon and you've been buying carbon since it started really. So you're still -- you've said in numerous calls, you've been still buying carbon. So are you doing this because you want to sort of ring-fence your carbon deficit in Soda Ash? Obviously, you're trying to reduce it organically as well, the deficit?

And then when we think about sort of life of Solvay, aside from Soda Ash, how do we see the deficit? And what sort of price are you guys planning the next 10 years forward? Because obviously, we are around the price that you guys have in annual report around 50 for the time being. So if you can give any color on that?

Ilham Kadri

Thank you for the question. Well, listen, 60% of our emissions are more or less coming from Soda Ash historically. You know that the rest is 40% from the other businesses. When I joined the company, and I did my due diligence on the different businesses prior to issuing with the team and sharing with you the GROW strategy, obviously, I looked at the carbon pricing. And you're completely right. I think it's the time of Rhodia even where they were mastering carbon and probably saved the company.

Now we keep what is good, what works very well. And you're right, hedging on carbon, what we can hedge, we cannot hedge everything. We did that, and we are probably hedge a 100% of what is eligible to hedging between now and 2025, and we started hedging post-2025. The team is doing it extremely well, I must say, better than any mandate I had in my career, and that's what we've done.

Number two, when I joined the company, I think it was 1 of my first policy changes in the company, first week or second week of March 2019 after the incentive on free cash flow, we changed the internal carbon price into EUR 50. And at that time, we were a bit accused, I mean, we debated internally that we were a bit tougher because carbon prices were around 20-ish. But we could see the direction of travel, and we implied EUR 50 per ton internally, which, frankly, now looking back, it was one of the best decisions we've made in quarter 2 2019 because it helps us to make the hedging, protect our competitiveness and do what it takes, which is now a competitive advantage.

So CO2 is a tangible part of Soda Ash cost structure to protect our contribution margin, which allow us to secure the long-term investments and continue to serve our customers, anticipate as much as possible due to emission price movements and allocation

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over the coming years. And that's why hedging is there. Today, the EUR 50 is probably going to be north. We are debating that in the company. By the way, we are stress testing the 50 at EUR 75 a ton in our SPM. Our Sustainable Portfolio Management we stress test a 75. So the question is not 50 or not, are we going to go to 75 and a 100? And that's what we believe we should be doing.

Now as you know, Europe is going to the green deal. There is the Fit for 55 policy published and the ETS and CBAM policies going on. In all of this, at the end of the day, we have a clear strategy, sustainability strategy called Solvay One Planet. You remember that in February last year, we joined the Paris agreement in October, with SBTi. We told you that we are going to exit coal, and we have shown you by now that in Reinberg in Germany, we had the first case where we are exiting coal, using biomass. So those are wood chips recycled and wasted at a high IRR, so it's higher than WACC. And with the support, obviously, of the authorities, leading to the lowest greenhouse gas emission emitting plant in the world, including versus natural.

I love this because it's not an anecdote anymore. And what I asked Soda Ash team is to build an energy transition program. By the way, they are part of the 28 projects we have for the company. Today, we have more or less 1.8 million tons of CO2 already in execution to exit. It's about 1 million cars off the road every year, which we cite, we price and we know how to do them, and we are still collecting more projects. So Soda Ash is part of those. We are negotiating Dombasle as we speak. I started personally traveling again, and I stopped by Dombasle, was my first visit after my lockdown on my second shot of vaccine, and they are preparing the switch and the exit of coal. And I know that Soda Ash team and our President is also negotiating in Torrelavega in Spain. So yes, it's just part of Solvay One Planet, and we are executing flawlessly.

Karim Hajjar

The very simple comments, which hopefully will help complete your understanding Jaideep, which is this. Look at surveys to our Ash business, factually, you'll find that we're far and away the most consistently profitable Soda Ash operator globally. That is, I believe, on the record and publicly verifiable. Secondly, the fact that we've hedged forward into the midterm also means that we're shielded from the cost that you see in the market. The fact that spot yesterday was EUR 52.85 doesn't matter. The fact that I look forward at the December '21 contracts, we see EUR 53.30, also doesn't matter why because we are well hedged. But like Ilham said, we're taking the action strategically to improve our resilience. So no, CO2 is not a factor.

Operator

We are taking our last question from Lisa De Neve, Morgan Stanley.

Lisa De Neve - Morgan Stanley, Research Division - Equity Analyst

Yes. You mentioned your EBITDA guidance was supported by a strong order book. And you also mentioned EUR 40 million of lost sales due to supply chain challenges. So just to understand a little bit the dynamics here. Are these EUR 40 million of sales lost or just delayed?

And also, can you share with us an overall training update on organic growth as we move into the second half, especially given the strength of these organic growth rates we've actually experienced and you delivered. And if I can sneak in a second quick question. And can you share or give us an idea within your Composites business, what the narrow-body versus wide-body splits is, within commercial aircraft exposure?

Ilham Kadri

Thank you, Lisa. Well, listen, the missed sales, I mean, it's due mainly to logistic constraint in quarter 2. Everybody is struggling these days, and the situation is the following. We've seen, frankly, is unprecedented in my career. We have port congestions, container shortages and low build rates, as you know, for ships are closing, a large capacity shortage and rapidly increasing spot prices. So, what we call the FCL, the overseas container transport market, is at its highest point in history. And key indicators, frankly, I may be wrong, there will be no major breakthrough expected before 2022 on this tightness. So we need to live with that.

So the EUR 40 million, some of it is going to travel to quarter 2, but some of it as well may actually disappear and so what because customers may not be waiting and if a supplier has better access to non-congested port, they may actually pick up the goods and be it. So actually, the interesting question, Lisa, is what we are doing about that? And I asked to put a war room in place. I was not to say war room. So it's task force in place to secure operation capacity in the market. And this is my multifunctional team. We have logistics experts, we have our procurement team. We have our suppliers supporting us. And they can change arrival for they can go with the raw materials from a country to another because it's easier to do. They change, they find containers, they change departure ports. They find alternatives. So they find solutions by finding, by helping the GBUs, and this is across the board, it's double digits, almost triple digits, and people working hard to help the businesses.

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And frankly, I am personally engaging with the C-suite with my executive committee. I'm not talking only to customers and investors, obviously, I'm picking the phone and talking to shipping companies and leaders to support us, and we are trying to build a strategic relationship because this may be structured in the future, including between regions.

Lisa De Neve - Morgan Stanley, Research Division - Equity Analyst

Sorry, general trading updates because you sighted a very strong order book.

Ilham Kadri

There is general optimism from global economy. I mean, thanks to the massive savings accumulated then. And currently important investments and trade growth going on despite those supply chain constraints. We see a very solid order book and solid demand for our solutions and products, which continue in June and July. So yes, this is not changing a lot. Markets include automotive, electronics, building and construction will continue to play positively, although as you know, the ship shortage could cause some turbulences, there is around 2.2 million units according, I believe, to LMC, traveling between 2021 and 2022 is not going to impact us a lot.

So it's baked in our guidance. But also the chip shortage and the boom in electronics and semiconductors is supporting our eH2O2, which is really booming. Asia, double-digit. China, you know the numbers probably softening a bit, but we have a good presence, we are building our strategy in China as we speak. So it's a great area of an opportunity for us. What was another question from Lisa?

Lisa De Neve - Morgan Stanley, Research Division - Equity Analyst

I wondered whether you could share how much this business between narrow-body versus wide-body within composite commercial aircraft?

Ilham Kadri

Historically, it was 50-50, Lisa. Now you know due to the MAX former issues and COVID. Otherwise, it will wait more in single aisle, as you

know, which is expected, of course, to grow more as the rates increases. I'm very excited actually with single aisles because we have a better representation in it. The composite [commercial] is lower than in the widebodies. So we like the future. But obviously, with the MAX former issues and COVID, the 50-50 is going to weigh differently when MAX issues will be behind us.

Jodi Allen - Solvay SA - Head of IR

I think we've reached the end of our questions. So thank you very much, everyone, for your participation today. And as always, the Investor Relations team is here to answer any additional questions today. So thank you so much, and enjoy the rest of your summer.

Operator

Thank you. Dear speakers. Ladies and gentlemen, this concludes today's conference call. Thank you all for your participation. You may now disconnect.