Solvay Q3 2022 results

Analysts call transcript

3 Nov 2022

Operator

Welcome to the Solvay Q3 2022 Results call for Analyst & Investors. Solvay team, the floor is yours.

Jodi Allen - Solvay, Head of Investor Relations

Good afternoon, ladies and gentlemen, and welcome to our third quarter 2022 earnings call. This is Jodi Allen, head of Investor Relations and I'm joined today by our CEO, Ilham Kadri, and our CFO, Karim Hajjar. To start, we want to apologize for the delayed start today as we were busy managing some technical issues that seem to be behind us. 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 uncertainty. 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 - Solvay, CEO

Thank you very much, Jodi. And hello, everyone. I'll begin my remarks as always with a health and safety overview. Compared to the third quarter of 2021, the reportable injury and illness rates are down across the group and COVID cases continue to decline, so the situation is truly under control. As usual, we continue working hard to raise the bar towards zero incident goal.

Moving on now to our results. I'm very, very proud, beyond proud actually of the results we achieved this quarter and this entire year to date, setting new records in so many areas. You've heard me talk about the quality of our team and the strong performance is a testament to their efforts and hard work, and it's not just the result this quarter that I'm proud of. It's a journey that we have all been on together over the past three and a half years.

I'm truly humbled and when I look at what has been accomplished since I joined the company, one thing is very clear, Solvay today is not the same company it was back in the beginning of 2019. Thanks to the hard work of our talented teams, we have undergone a complete transformation and today we are a stronger company and are better positioned for future growth. We've grown EBITDA over 30% year to date versus 2021, and this excludes any impact from currency. When I look back further and factoring in our upgraded 2022 guidance, we're on track to grow EBITDA by 11% since 2019 despite the 2020 pandemic. We improved operational efficiency by demonstrating cost discipline through challenging times, which included the delaying of the organization. Our total cost savings since 2019 has reached EUR 450 million and we will deliver our targeted EUR 500 million in structural cost reductions ahead of our 2024 commitments.

We strengthened our customer partnerships and frontline organizations. You can now see the value proposition we create for our customers is real and we have the innovations and margins to back it, and we have demonstrated an improved, steadier free cash flow generation that is enabling us to take big bets and invest for our future. This is in fact the 14th consecutive quarter of positive cash generation. Another metric I'm truly and particularly proud of is our returns. We reached an all-time record high ROCE, return on capital employed, at 15.4%, almost double the level of 8.2% at the end of 2018. This is truly remarkable progress. We've done this by raising the bar operationally, optimizing our industrial footprints, upgrading the quality of our portfolio of businesses, pruning those businesses that couldn't be improved. Further prioritizing and focusing on higher end specialties growth as we deliver the value propositions our products and solutions bring to our customers. And obviously, we will continue to prune our portfolio.

In fact, we didn't stop at operational performance. You can also see the results of our actions to improve the balance sheets while funding our pension. You may not realize it, but our debts and pensions were reduced by EUR 3.4 billion or 40% since 2019, and the pension cash out is down over 60% from EUR 216 million in 2019 to around EUR 85 million this year. In fact, we currently have the lowest ever leverage in the history of the company now at 1.2 times versus the start of 2019, which was 2.1 times. With this, you can tell that I am beyond pleased with these accomplishments. So, coming back to Q3 specifically, our businesses continue to perform strongly against the backdrop of significant inflationary pressures. Phase grew almost 30% to EUR 3.6 billion in quarter three, and this was led by pricing while the demand momentum continued in several key markets where we also saw some volume growth in addition to pricing.

These markets included automotive driven by electrification and continued penetration of our specialty polymers. Aerospace driven by higher simple aircraft rates thanks to the continuing recovery. Agro sector driven by demand from more sustainable chemistries used in crop protection. Mining, driven by high production rates, especially in copper, and of course, in oil and gas volumes were also higher given the current robust demand. In essence, our best-in-class portfolio enabled us to capture this growth and in fact grow our sales above market growth rate in each of these areas.

From a geographic view, we reported double digit sales growth in all regions. I would like to highlight Europe's growth at 42%, followed by Asia-Pacific region growth at 30%.

Q3 EBITDA was up about 40% on a comparable scope and foreign exchange basis with all three segments contributing to earnings growth thanks to value pricing and resilient volume. This translates to an EBITDA margin in quarter three of 25.4%. In fact, two percentage points higher than quarter three last year, reflecting the improved operating leverage. Free cash flow was EUR 452 million in the third quarter, the 14th consecutive quarter of positive cash generation. Now speaking of CapEx, we have many investments underway to support our growth. These investments are in technologies and processes that we know and we master across our business segments.

Remember, earlier this year we shared our plans to invest in a fully integrated suspension PVDF operation in Taboo in France, making it the largest PVDF production site in the European region to support the growing EV battery markets. Our strategy is to build regional capacities in high-end products for high-end markets to support customers in the European region and in the US for customers in North America. Why? Because customers prefer a local source to supply their needs and the authorities provide substantial incentives in order to localize strategic supply chains for electrification. Our strategy has been to fully integrate our suspension PVDF production with security of supply of raw materials, which are critical while being cost competitive and align with best in class leading partners to de-risk our investments.

So today, I'm extremely excited to announce the next step of our global strategy, which is to expand these critical materials that support the electrification trend into North America. This time, we are pleased to be working with the great partner Orbia with a leader in their field. Orbia brings the key raw materials necessary including fluorspar, which enables Solvay’s production of PVDF. I must say firsthand that this is in many ways an ideal partnership with two strong complementary leaders coming together to create a locally produced, vertically integrated competitive supply chain, which will enable production of suspension grade PVDF to serve some of the leading battery makers in North America. You may have heard the big news last week from the Biden administration, which awarded Solvay with $178 million of government funding. These elements of supply security and financial support further de-risk the sizable projects, which by the way has extremely compelling returns and it's expected to be commercial by 2026.

And we're not only making investments with the future SpecialtyCo side of our portfolio, but we also have a number of opportunities in EssentialCo. In addition to our battery focus and to further support the green energy transition. We've also made an announcement in September related to our ambition to create a powerful rare-earth specialties hub in Europe, starting in Lachelle, France by entering the magnet value chain. Then in October, we took another step to advance our rare earth specialties by taking full ownership of our stake in Japan, further leveraging our global plans in rare earth chemistry. As you know, rare earth metals are essential to ensure the green energy transition and support development of more sustainable solutions for electric mobility and clean energy generation.

In July, we announced our plans to expand electronic grade H202 production in the US to meet the increasingly stringent specification of the semiconductor industry and we have more Peroxides opportunities underway, which we will share in due time. And in Soda Ash & Derivatives, as you know, we expanded natural soda ash in the US by acquiring the minority position of our Green River, Wyoming operations announced in May, but the markets will also need additional capacities and it'll remain very tight, at least for the five years to come with fast growing demand in lithium carbonates and photovoltaic panels as well as in bicarbonates, flue gas treatments, and pharma applications on the top of building and construction.

Our improved cash generation and our strong balance sheets have enabled us to make all of these investments each with attractive returns and in attractive markets where we have leading technologies that offer significant value to our customers. We know that we are facing challenging times, but we have the strategic focus and the financial resources not just to navigate these times confidently, but to emerge again and again with strong growth at the right time.

Finally, our teams continue their journey of bringing new technology and process innovations to the market. In September, as you may have heard, we announced that we are reinventing our own 160-year-old soda ash process. This major milestone will enable three improvements, almost revolutionary ones. The process will lead to 50% less CO_2 emissions and this is aligned and will enable our carbon neutrality for soda ash and obviously One Planet's climate ambition. It'll reduce water and brine consumption, and last but not the least will eliminate limestone residues to the sea. We're also continuing to evolve our sustainability ambitions in soda ash production and have recently established a partnership to create a circular economy for soda ash production in Rosignano, Italy that will support our lower carbon footprint ambitions. We also have an exciting new innovation to share based on sodium bicarbonates called Alve one, which was awarded the 2022 peer to peer prize.

It offers a sustainable alternative to the incent [inaudible] chemical blowing agents used for thermoplastic foams with 10 times lower CO2 equivalent emissions. In fact, our innovation has been accredited as a safe substitute for ADCA or azodicarbonamide, which has been classified by REACH as a substance of very high concern. Finally, I'm so pleased to share that our Actizone F5 – an innovative 24-hour antimicrobial sanitizing technology – that we launched back in September, 2020 in Europe is now fully approved by the EPA in the United States of America. Now, Karim will take us through the group segments and the financial performance in more detail. Karim, the floor is yours.

Karim Hajjar - Solvay, CFO

Thank you, Ilham. Good morning and good afternoon everybody. I'm going to go directly to our business review and as usual, I'm going to refer to figures on an organic basis, meaning at constant scope, constant currency, unless of course I indicate otherwise. Sales in the material segment increased 37% driven by strong demand for specialty polymers and for composite materials, and it led to record third quarter sales and earnings. When it comes to Specialty Polymers, sales reached new records. They were up 40% compared with the third quarter of 2021. They were up 5% against a very strong second quarter of this year. With both pricing and volumes contributing to that growth, we saw continued strong demand in markets such as automotive, including EV batteries, electronics, including smart devices, as well as healthcare applications, such as hemodialysis and pharmaceutical packaging.

Our sales in automotive outgrew the market due to our leading positions in strongly growing electrification and light weighting applications. I know that this is not new news, but the momentum continues. You may recall, in fact, last quarter I highlighted our new PVDF capacities that came online in China, thereby doubling our production capacities to meet the growing demand for electric and hybrid vehicles. Ilham today just now mentioned our investments in North America, which is designed and will capture a significantly leading piece of the growing market there. This decision not only positions us to capture strong growth for years to come, but it will also generate very attractive returns way beyond the minimum thresholds we set. Our efforts over the years are paying off and it is evident that we have the right innovations and the differentiated portfolio to best meet the needs of our customers in this very attractive growth market.

The most recent market forecast for 2022 from LMC indicates growth over around 7% in light duty vehicle production globally. And beyond the auto market, it's worth noting that Specialty Polymers delivered growth in the electronic market as customers continue to invest in semiconductor production and in an expanding 5G infrastructures. Growth in healthcare was also strong in areas such as biomaterials, medical devices and pharma packaging. Sales in composite materials grew 27% year on year, particularly strong sales growth to the civil aerospace market. Now, that was largely driven by production increases in single aisle programs, including the Boeing 737 MAX and the Airbus A320. Also, there was some recovery, which was really good to see in the Boeing triple seven cargo and in the respective engine part programs, as well as very strong rebound in the business-jet segment, which makes for a very healthy civil aerospace profile in Q3 whereas sales to the space and defense were flat year on year. Supply chain issues, slow production rates at some key customers, sales of composite materials to the high performance automotive market grew by double digits as our innovative materials contribute critically to light weighting and design flexibility.

In addition to the aforementioned market tailwinds, customers gave substantial attention to our ability to deliver products despite inflationary costs, raw material availability and logistic constraints which are facing the industry. They've seen us work really hard to overcome these challenges. And frankly, it was great for me to meet the materials team last week on their way back from a very successful K-fair in Germany that had just wrapped up. The team were energized to see their customers and partners face-to-face again and came back with plenty of ideas and possibilities. I spoke to a couple of them earlier in the week. They're fully mobilized and they're going to focus on converting these ideas, these opportunities into solutions for our customers of course, but also critically into more growth and more business for Solvay. So, watch this space.

Wrapping up Materials, segment EBITDA increased 43% compared to the third quarter last year, reflecting both price and volume growth in Specialty Polymers and in Composite Materials. And that's what led to record 34.6% EBITDA margin in the third quarter, up almost two percentage points in the quarter thanks to improved volume and mix.

Moving to Chemicals on slide number seven, third quarter sales rose 34% as we were again able to manage inflation costs with price increases. Volumes declined 5% overall in the segment, mainly because of reduced demand at Coatis and some production issues, which I'll detail further as I go into each business. Third, Soda Ash & Derivative sales increased 55% thanks to the continued strength on tight supply and with price increases that offset the significant rise in energy costs.

End markets for our products remained solid for soda ash and bicarbonate, volume was down very slightly as our growth was constrained in the quarter, mainly by industrial outages at our natural soda ash facility in the US. The war in Ukraine and resulting embargo on solid fuels like anthracite and coal, which are used for energy generation, had an impact. And whilst that wasn't a significant impact, there was also an effect on our industrial production efficiency and impacted volumes as well.

Peroxide sales were up 29% driven by pricing. Volume was down slightly as strong demand in electronics and graphic paper markets were insufficient to fully compensate for the reduced demand for HPPO from our mega plants.

For those of you who attended our webinar on our Peroxides business about a month ago, I think about that, you recall that we provided details about that business and we demonstrated a proven track record of strong resilient cash generation and very high cash conversion. We also detailed our well-established strengths against competitors in terms of costs, scale, process, technology, leadership, and of course we laid out our focus on the most attractive market segments in peroxides as we look to the future.

The Coatis business is facing the normalization we've been anticipating with sales down this quarter by around 1% on an organic basis, coming from decreased volumes against a relatively strong third quarter last year. Now, although pricing remains slightly positive, volumes are down, predominantly in Latin America, but also the business in Europe is also currently at low levels.

In Silica, sales grew 34%, pricing actions across the tire and the industrial markets that we serve were able to more than offset the slight volume reduction. Looking at the chemical segment, overall EBITDA is up 22% thanks to high prices across all businesses. The chemical segment delivered an EBITDA margin of 25.2%, which is down to 2.1% against Q3 last year. But if we exclude the impacts of Coatis and Rusvinyl, the segment EBITDA margin actually is stable with the third quarter last year. Despite the very significant increase in energy related costs. Coatis and Rusvinyl continue to normalize to mid-cycle levels versus the high cycles. We've had the benefit of enjoying the last couple of years and that reflects the competitive pressure ramping up, combining with a demand softening in those two businesses respectively.

Turning to the Solutions segment on slide number eight, you will see that Sales in that segment in Q3 were up 20% driven by price increases, whereas volumes were modestly lower. Strong demand growth in agro, electronics, and mining were the biggest growth drivers in the segment.

In Novecare, sales increased 20% year on year, mainly due to pricing as volumes were slightly down overall in the quarter. Growth in agro was again driven by demand for green solvents in crop protection applications. Demand was pretty resilient in home & personal care, whereas volumes in coatings were slightly down as it is associated with the construction market that is slowing down, particularly in North America.

Special Chem sales increased 23% thanks to strength in semiconductors and this was partially offset by weakness in the Rare Earth Specialties business, which goes into automotive catalysts and we see softer demand there.

Technology Solutions sales increased 16% organically due to sustained demand in mining, particularly copper mining. As the team was awarded new business thanks to a new mine that started in Latin America. Aroma performance sales were up 13% in the quarter. Now, although demand was strong enough to allow for price increases in the food & beverage sectors as well as flavors & fragrances, volumes declined in the quarter as some products turned long on the added capacities and on the back of exports from China-based peers. Nevertheless, pricing more than offset cost inflation.

Turning to Oil & Gas solutions, sales grew 26%. Continuing the strong momentum we've seen in the first half of this year. The strong sales performance was driven by price and volume increases with overall demand for oil and gas chemicals being supported by high levels of oil prices.

Third quarter EBITDA in the segment rose 21% extending further the trend of the first half of the year. EBITDA margin in the segment was up north 0.8 percentage points to 19.1%. When we compare the EBITDA margin for that segment with the 17.8% levels that we saw in 2019 to 2021, it really shows the impact of the transformation, the impact of the value over volumes pricing strategy as we go to market and really meet our customers' needs, and frankly affects our team's unrelenting focus on meeting our customers' needs for higher value products as well as the benefits of the structural cost reductions that have been sustained in each of those businesses.

Turning to corporate and business services activities, EBITDA was a negative EUR 19 million in the third quarter, much lower than the 58 million negative of last year, and actually quite a bit lower obviously than the 84 million negative results in the second quarter of this year. There are two main drivers to that improvement. One, our energy business generated double-digit profits this quarter, which is great to see versus recent quarters of modest losses. Now we made tremendous efforts to stabilize that business and this is showing too – in terms of results, but I will say that it's important to stay cautious because energy markets, especially in Europe, remain challenging and certainly remain volatile, but it's great to see that improvement.

The second reason that our results in corporate and business services improved is frankly that we have now passed the point of peak investments in cybersecurity and digital transformation and our spending in the third quarter is now back to more normal levels. Now on slide nine and 10, you can see the details on the EBITDA impact, which I've said previously, is in fact is 40% year on year. The strong pricing of the quarter amounted to EUR 836 million . At the EBITDA level, it is more than offsetting the 485 million increase in variable costs, and in fact, you can see that it's impact of 351 million on both sides along with some help from volume and mix. That more than compensated for the increases in fixed costs that result both from inflation that we're all going through, but also the investments we're making.

Now before turning to cash flow, and since Ilham already highlighted the strength of the balance sheet, I would like to bring your attention to an increase recorded within environmental provisions. Thanks to the recent completion of technical studies of analysis of remedial steps for certain costs over the next 20 years, to meet our legal obligations relating to the past use of fluorosurfactants in our West Deptford, New Jersey facility. We made a provision of EUR 93 million in terms of anticipated remediation costs.
Now I will turn to cash on slide 12, free cash flow reached EUR 452 million in Q3. The strong EBITDA growth nearly offset the higher working capital, which increased due to price and cost inflation and to higher value inventories. Indeed, it's worth noting that working capital increased by EUR 547 million compared to the end of September, 2021. That's over half a billion. But, and here's the important piece, the strong focus, the discipline that's helped us to deliver the cash flow comes from the fact that we manage our working capital very, very tightly. Our working capital to sales now stands at 12.4%, stronger than the 14.5% reported at the end of Q3 2021. And actually, to remind you, it compares with 17% as being the industry benchmark. So 12.4 % versus 17% industry, that helps to generate the cash, but also as Ilham highlighted, we are making strategic investments this year to support future growth, and so our CapEx increased to 233 million for the quarter.

And finally, and very importantly, free cash flow conversion stood at 36.8%. Now given the high level of free cash flow and in line with the dividend policy of the company, the board of directors has validated the decision to pay an interim gross dividend of EUR 1.54 per share. For those who are not familiar with Solvay, the dividend policy states that the interim dividend payable in January will represent 40% of the total dividend paid in the previous year. Now, this will leave us the flexibility to fix the final dividend in early 2023, taking in to account the full-year performance in 2022, but also the investment needs of the company as well as, of course, the prospects for 2023. And with that, I'll hand the call back to Ilham

Ilham Kadri - Solvay, CEO
Thank you very much, Karim. As you know, the excellent results that Karim just detailed led us to pre-announce on October 24th and raise our full year 2022 EBITDA guidance to around 28% organic growth relative to the full year 2021, which equates to around EUR 3.2 billion using current forex rates. This compares with our previous guidance of 14% to 18% organic growth issued in July. To give you some additional color on the updated guidance, we considered the strong performance year to date as well as our current view of the fourth quarter.

Starting with costs, we estimate the increase in our variable costs in the range of 35% to 40% for the full year 2022, which is roughly in line with what we saw in quarter three turning to demand. As we look at our fourth quarter order books, we see signs of demand moderation across most businesses now in materials, and the line demand remains solid in key markets that some customers in Europe particularly have indicated that they will be managing their inventories more closely in the coming months in anticipation of a potential downturn.

In chemicals, demand for soda ash remains strong while in silica we're preparing to adapt production in some sites in response to a softening demand environment. In solutions, the agro markets remain healthy, though we see softening in areas such as coatings and consumer-facing markets. None of these indicators are alarming to us, and in many cases, demand levels seem to be only modestly below normal seasonal patterns as we head towards the end of the year. So today, I'm also pleased to share that due to our improved performance, while including our full year 2022 free cash flow guidance to deliver around one billion euros. The strong performance will be delivered whilst also increasing our capex, which we now expect to reach around a billion euros by year end as we accelerate our growth plans. Our cash flow will also be delivered despite a significant increase in working capital because we will stay single-mindedly disciplined in our focus on cash.

Looking ahead into 2023, we are cautious about the environment, yet confident in our ability to navigate challenging conditions. Although some of the weaknesses we expect in quarter four may well worsen into next year, we are well equipped and we are already to respond to such challenges effectively, notwithstanding the possibility that there could be some ease invariable costs, we are working with our commercial teams to ensure that we meet our customers' expectations and needs and that we preserve our leading margins wherever possible. Most importantly, remember what I just said earlier, that today we are a better and stronger company and we have demonstrated this repeatedly over the last three and a half years. And even if markets and macroeconomic conditions worsen, you can expect us to do better than peers because we have structurally improved on so many measures, not the least with much lower cyclicality than in the past.

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

Q&A

Jodi Allen - Solvay, Head of IR

Thank you, Ilham. We'll now move to the Q&A portion, and I will kindly ask that you try to limit yourself to one question per person if possible, so that everyone has an opportunity to participate. Moderator, please go ahead.

Operator

Thank you. Ladies and gentlemen, we will now begin your Q&A session. If you wish to ask a question, please press one on your telephone and you will enter through the queue. The first question comes from Matthew Yates from Bank of America. Please go ahead.

Matthew Yates - Bank of America

Hey, good afternoon everyone. Karim, perhaps a question for you just on this incremental provision you took. If I remember correctly, in 2019, you estimated the cost would be about three million. Now you're saying 93 million, so that's obviously a very significant change. Can you just elaborate a little bit more on what's happened in the interim? Does this include legal fees as well as sort of physical restoration and whether there's any other sites beyond New Jersey that we need to consider?

Karim Hajjar - Solvay, CFO

Thanks, Matthew. Good afternoon. I honestly don't recall anything to do with 2019. What we have been doing every year is disclosing very clearly the contingent liabilities and we couldn't make any provisions, notwithstanding our desire to do so because we didn't have a basis for reasonable estimates. Now, what's different and why do we make a provision now? The answer is very straightforward in that we've now undertaken independent, detailed, technical studies aimed at quantifying precisely, let's say, with reasonable confidence the future cost of remediation over the next 20 years. And that is an estimate that now that we have it, we didn't hesitate to make that provision. It's just around $100 million, actually EUR 93 million. So this reflects, let's say, the application of a prudent policy. What I will say maybe as well is that EUR 93 million, we are going to do our best to accelerate and front load the remediation work. But it will go over 20 years and it certainly won't have a material impact on our cash generation.

Matthew Yates - Bank of America

So just on the materials business, if I look at Q3, you've made about 150 million more in EBITDA versus the same quarter in 2019, which is a phenomenal achievement. I'd just like to understand that a little bit better. You referenced a number of 450 million of structural cost savings at the group level on an annualized basis. Can you break that down? How much of that specifically relates to the materials division on the cost side? Thank you.

Ilham Kadri - Solvay, CEO

Indeed, you've seen it very well, Matthew, and I'm really glad to see Materials, part of the SpecialtyCo, really getting more pricing and more volume growth consistently. Where we see it is in the automotive, for example, market driven by electrification and continued penetration of our Specialty Polymers. Remember, Matthew, we replace metal, we penetrate each car making it lighter, therefore it consumes less fuel, it emits less CO_2. And therefore it enables clean mobility. So that's not only in ICE cars, but also the move to EV and hybrid is positive for Solvay because we can double our revenues by car and you're going to see it consistently in the coming years.

Aerospace also had a very good quarter. August was really a good month for us, driven by higher civil aircraft rates. As I said, you see continuing recovery in quarter three, our composite sales were up 28%, as you've probably seen in the financial report outperforming closest peers. And this is really good, Although we have been struggling in Europe in the past with supply chain and labor constraints facing the industry, we could really diminish the backlog. The Agro was good, more sustainable chemistries and obviously other businesses. So that's what we've really seen in the Materials.

On the costs, I'm very glad to see 450 million euro. And this is going to happen much faster than 2024. It reflects that we have been doing some restructuring in the company – delayering since 2019 – in corporate services, et cetera, and restructuring of composites, which has really brought a lot of benefits. Remember that we shut down and we closed low return on capital employed assets. In the 2020 crisis, we didn't waste that crisis. And it really helps us to do some very good restructuring in some of the lowest return assets. And we are very glad, I'm very positive about the speed with which we are bringing these EUR 500 million savings in.

Matthew Yates - Bank of America

Thank you both.

Operator

The next question comes from Chetan Udeshi from JP Morgan. Sir, please go ahead.

Chetan Udeshi - JP Morgan

Thanks for letting me ask a couple of questions. I think the first question I wanted to ask was, and maybe, let's put it this way, most companies in chemicals in Europe seem to think they can hold prices, even if demand weakens. And maybe it's a straight question to you, Ilham and Karim, both. If I look at the bridge for the first three quarters, you guys have had over several hundred million of positive net pricing. Now of course, I think you probably will also indicate the same that you'll aim to hold prices. My question is, are there any pockets within the portfolio where you think we should be more careful in terms of assessing the pricing outlook as we go into next year? I mean, I would be more interested in how much of this 700 million can you actually sustain going forward. That was the first question. The second question, going back to the US investment, can you help us contextualize in terms of the capacity of that investment? Will it be closer to what you will have in France, 35,000 tonnes? Is it lower? Is it higher? Any sort of color on how many tons are you adding in the US?

Ilham Kadri - Solvay, CEO

Thank you very much, Chetan, for those questions. On pricing, it's a legitimate question. We hear it from our investors and discuss it with customers. Remember that we've made significant progress in the last years, building competencies in our commercial teams. I don't want you to think, and have any doubt, that this is not a top-down pushed from Brussels to the rest of the world in our commercial teams. I told you that in H2 last year, we started training the muscle called pricing and value pricing. We've seen some inflation last year, and obviously we were prepared when the crisis started this year with the Russian War. And basically we already started in the fall last year to renegotiate our contracts and really look at our gaps, etc.

So the net pricing you see today, Chetan, even if you exclude variable costs, but also fixed cost and even the hedging, it remains positive. So indeed, we came a long, long way. So in general, as Solvay, remember, that each and every one of our businesses has a leading position in their marketplace. This is important. Because when you are a leader, you are also a price leader, and we have built these positions with our customers over time. When you look at the portfolio and going to more specifics, around half of the portfolio, actually shy of half can be supply/demand related. And we have enjoyed a tight supply situation in 2022. And for a large portion of this portfolio, I'm talking about soda ash, I'm talking about peroxides and some others, the supply will remain tight as we look forward.

So this is important and this is structural for the next few years. And we are a leader in these markets, and we have many contracts with pricing mechanisms supporting cost wash-off. And more recently, as I told you, in the second half of last year, we reviewed the thousands of contracts in the company. We put energy surcharges and sometimes even logistics surcharges, like in Peroxides. So, we expect to keep that portion of our pricing power in this area, and obviously it's a pricing mechanism; and there is a smaller portion that is not structurally tight. We would adapt price volume, we call it price volume elasticity, to keep our critical market share.

Let's move now to the second half of our portfolio, which I would call more of a specialty pricing driven, and this is where we sell -- we don't sell products, we sell a value proposition and we invoice products. And we are learning how to do it better and better because solutions are customized, innovative solutions that are designed to meet specific customer needs, including the way we are packaging, shipping, our stock or safety stock. So in these specialties, those industries are more risk averse to change with high barriers to entry, they have longer qualification time. And as I've said before, we offer mission-critical services here, including lower total cost of ownership. It's not because the customer is buying at a higher dollar or euro that the total cost of ownership is not lower. Actually, often it's lower. And of course, we offer security of supply, which often these days come over pricing.

For this part of the portfolio, we will continue pushing the value pricing. I think it's a new culture and top-selling products that invoice them to protect our margin. And we have recently demonstrated that. So we also know that our customers understand that a sustained level of profitability gives us the currency, the confidence and the willingness to reinvest in capacity, innovation and our energy transition.

I'll tell you, I was at the K-Fair in Dusseldorf with the team. Karim talked about this event, for Materials. And many customers were asking about our investments in the U.S., in batteries. I recently met Soda Ash customers who are telling me that the market is tight, they know the market will be tight until 2027. What can we do about that? And this is in our common interest. Between suppliers and customers, you need to have a win-win situation. And we support our customers to also drive pricing down the value chain. So listen, decent pricing and profitability creates a virtuous circle that helps everyone.

Chetan Udeshi - JP Morgan

Yeah, just any color on the capacity of – especially if you can't give a fixed number, but how should we think versus your investment in capacity in France, for example?

Ilham Kadri - Solvay, CEO

You will understand, and I think I said this before, and it's not new that disclosing capacity is competitively sensitive. You may remember, Chetan, for Tavaux, we said that after the investments, we would have up to 35 Kt, but this is the total. There was a capacity before, and we did not indicate those for obvious reasons the current capacity. And I know it's probably not easy for you to make some computation and comparison specifically when you compare apples and oranges. Tavaux investment is different. It's a brownfield investment. The infrastructure was there, whereas this new U.S.A. project consists of almost 2 greenfields, Chetan. So the investments cannot be compared directly.

That said, we can confirm that these investments will make us the undisputed leader in North America. The industrial investments will be located in 2 sites. Orbia’s investments will be in their own sites and will comprise probably 2 plants with the critical materials we need, not far from our Solvay sites. Investments will be in our Augusta, Georgia plant and will comprise VDF and PVDF.

I'm very, very pleased because this is two giants, undisputed leaders in their own domain coming together, joining forces. And as you have probably seen, the United States of America, through the Department of Energy, has granted Solvay $178 million in grants, which is more than welcome. The joint venture will be 51% share Solvay, 49% Orbia as a structure and obviously will consolidate the numbers. We contribute IP technology and market access to the JV, our market leadership and know-how on the suspension PVDF and Orbia contributes to the security of supply of key materials. Back to you.

Operator
The next question comes from Wim Hoste from KBC securities. Sir, please go ahead.

Wim Hoste - KBC Securities
Yes. Good afternoon, everybody. I have two questions if I may. The first one is can you update on the separation plan, maybe the milestones that have already been achieved? What will come in the next few months or so? So that's the first question. And the second one is can you maybe elaborate on the energy cost outlook for 2023, and not only your own, but also kind of the contract book you have with third parties, et cetera. Can you maybe offer a bit of clarity on that as well?

Ilham Kadri - Solvay, CEO
I will take the spin off and Karim the energy. We are very glad with the progress. We don't see any elements preventing us from achieving the target date, which is the second half 2023. That was what I announced to you at launch, and we keep that timing. It's a challenging project and we value quality versus speed. That's what I told you.

A critical point for these companies is that we continue setting up the 2 companies now. We -- in terms of organization- redesign, we are preparing the capital structures for both companies. Obviously, we now enjoy a much lower debt ratio in the company, as I told you. And this is a great achievement, making us even stronger while we prepare for the spin-off and for the 2 companies.

That's where we stand. So really, all green lights. We're not derailing. We will see the macros in due time, and we continue monitoring them. But definitely, we are sailing full-steam toward the second half of next year for the launch.

The energy question, Karim?

Karim Hajjar - Solvay, CFO
Yeah, is your question on the energy cost or the improvement that I talked about on the energy business?

Wim Hoste - KBC Securities
Well, it's actually both. So the outlook for energy costs in 2023 versus the contracts and hedges that are in place. And then also, in addition to that, the third-party business? Maybe some clarity there on the contract book, et cetera.

Karim Hajjar - Solvay, CFO
Okay. That's a very helpful clarification, thank you. Now, obviously I don't have a crystal ball as to what the energy costs are going to be next year. How cool is it going to be this winter, to what extent will European industrial consumers be able to curtail demand? Let's see, we brace for quite a challenging time, but we're as ready as we can be, frankly. So rather than speculate on what may or may not happen in energy, let me tell you what we do – we anticipate, and Ilham already mentioned some of the key elements. First thing we did is renegotiated a number of our contracts, particularly in the supply/demand impacted part of our portfolio. And that gives us an element of say, margin protection or certainly cost pass-through capacity as energy costs go up or down. And that is, we've got far more of that now than we did a year ago. That's important.

Secondly, I don't know if you were attentive, but when Ilham talked about the EUR 700 million plus positive pricing power, let me just remind you. That pricing power is a multiple of the hedging that we had in 2022. We still have hedges in place for next year. They will provide a degree of protection. But frankly, the best protection for us is to show the customers, the capacity to pass through costs. And that's really where we stand. So when Ilham expressed the confidence in our ability to navigate these challenging times, of course, it takes into account certain assumptions on energy costs and how we will respond, and we've got plans in place to deliver. But let's see, it's going to be challenging. We think we're ready.

Ilham Kadri - Solvay, CEO

Net pricing, and I think I said this, net of variable and fixed costs and hedging is positive, which is frankly, extremely rare in my career. And I think having said that, the hedging is just helping us to gain time, but we are starting now to relook at our pricing, our portfolio, the impact on our customers and the value we create with all transparency. And we look at the mirror, we share the value created more and more.

On gas, we are living with less gas. We told you that we have plans for the 32 sites in Europe, 10 of them consume 90% of the gas we are buying in Europe. And for each plant we have a mitigation plan. So, we are very ready for the winter.

Karim Hajjar - Solvay, CFO

Now on the second part of your question for the Energy business, I will give you a bit more color. And I'll start by giving a reminder that the energy business that we have, it concentrates expertise that's designed to meet our own needs in Solvay in terms of sourcing and energy hedging as well as CO_2. And it also serves the needs of a few external industrial customers, particularly in Europe. Now, that expertise gives us really good market access and intel. It is not a speculative activity. That's just as a reminder. Now, the reality is we've had a few losses in the last 3 quarters from memory. We disclosed those last Q4 when they were quite significant. And we have been taking many, many steps to improve that business, improving controls. We've completed a review of every single third-party contract and explored ways to optimize what is a very volatile and challenging market context. We're making good progress. We're not all the way there. There's more to do with some of our customers there. But frankly, what you see here is an improvement. It comes from one thing and one thing alone, painstaking negotiations with customers to adapt contracts to this volatile market situation that we face. And frankly, we're pleased with the improvement. I wish I could say we can repeat this every single quarter, but this is where we're at. I hope that's clear for you, Wim.

Wim Hoste - KBC Securities

Yes, absolutely. And thank you and congratulations with the very good results progression.

Ilham Kadri - Solvay, CEO

Thank you. Thank you very much, Wim.

Operator

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

Alex Stewart - Barclays

I just wanted to loop back on this energy cost question, because I think most chemical companies have given some guidance about the increase next year. And Karim, I appreciate you don't want to speculate on where energy prices or gas prices will be, but you do have a hedge book. So you know what a portion of your energy costs are going to be next year compared to what they have been this year. So perhaps on the part of it that you do have visibility into, could you possibly give us some sense of the inflation like other companies do? That would be really helpful.

And then the other question is on this PFAS provision because for years, I think that Solvay has maintained the line that there was no wrongdoing in New Jersey around your site there, and there was always a feeling that you felt you hadn't done anything wrong. The fact that you're taking a EUR 100 million fine implies that you have come to the decision that there was something wrong and that there will be remediation costs, which is perfectly reasonable and not large in size. But the fact that you've taken costs and that you've accepted some responsibility also now opens you up to the potential for personal injury suits or class action suits relating to the problem that this EUR 93 million is supposed to fix. So if we look past the pure sort of engineering cost to fix the problem as it stands, how do you see the potential for further financial ramifications as a result of this decision you've made? I'd be really interested to hear your views on both these things.

Karim Hajjar - Solvay, CFO

I'll try to be genuinely as helpful as I can, Alex. The question on energy costs is really important.
So rather than just focus only on energy, let me start by looking at variable costs, raw materials, logistics. Everything we're seeing, everything we're reading points to an easing of cost pressures in 2023 compared to 2022, and that's important. The extent of it, time will tell. But certainly, when we listen to some of the major shippers, et cetera, there's a debottlenecking, there's easing of the supply chains. So I think the tendency is favorable from a cost point of view. On energy, it really is anyone's guess. But let me tell you what we do. We don't plan on one number, we look at scenarios. We simulated our exposure in a EUR 100, EUR 150, EUR 195 or EUR 200 and EUR 250 per megawatt hour cost-base. And the outcomes are EUR 0.5 billion different between the high and the low, and these are based on TTF natgas prices. So that's the degree of uncertainty now, because our job is to manage that like we have done in the last 12 months. That I can give you scenarios and outcomes with EUR 0.5 billion plus of cost variability. Against that, there is some hedging protection, more importantly, some cost pass-through capability that will help to protect our margins.

Ilham Kadri - Solvay, CEO

Just to complete what Karim said, I remind you all that when we renegotiated our contract, like in Soda Ash & Derivatives for example, many, many now have energy pricing structure and clauses in the contracts. So that's important to remind everybody.

On to PFAS. Let me rewind the story a bit. Remember this is for me, just yet another step in our journey.
Our first step when I joined the company in 2019 was that we wanted to exit the fluorosurfactants chemistry. This is not regulatory. It is a push. It was our will to really move to non fluorinated surfactant innovation. We launched in 2019 just 6 months after I joined the company. Which led us, by the way, to stop using it and switch manufacturing in New Jersey department last July 2021 to fluorosurfactants-free technology after qualification at our customers. So that was really the target. We doubled down in innovation and, frankly, we are extremely pleased with the teams who did that.

Now that we do not use fluorinated surfactants to produce our polymers anymore, we undertook another step which is a technical study, and it explains a bit, Alex, why the EUR 93 million. We started the technical study and analysis, enabling us to better understand and estimate the remediation cost in our New Jersey operations around the plants, which is the EUR 93 million announced today. And this spending on remediation should take place over the next 20-year period. So the provision now when you do a technical study, obviously, by IFRS rules, the provision reflects the estimated future cost of remediation for specific identified activities and is expected to accrue over a period of 20 years. Though as a company, me, leading it, we expect to accelerate such things. So that's -- and we don't expect this expenditure by the way, to have any material impact on Solvay's cash generation in the future. So for me, those are the principles, and we are pleased. We can better anticipate the remediation related to our past use. This doesn’t deal with “wrongdoing” because everything was regulatory compliant, so this is just an anticipated remediation of our past use, and we continue, obviously, to cooperate with the authorities in this topic.

You talked about litigation. Whilst we continue to defend ourselves, we won't speculate on how long proceedings will take. But please understand that I cannot discuss any pending litigation. But I remind you, Alex, that many of the U.S. cases relate to firefighting foams, and Solvay never manufactured or sold them. And indeed, out of the thousands of cases pending in the U.S., only about, I think, 18 claims today, named Solvay, and we have already been dismissed from all but one of these cases while others in the industry continue to defend against hundreds or even thousands of these cases. We are cleaning up this slate. It's very clear. Our path is very much appreciated by the authorities. And obviously, in the view of Power of Two, we want to get into the split as clean and clear for you as well, guys, because there's always the recurring question there. I think all of you should take the news positively today, that we have done a technical study, that we have a number linked to this. And obviously, I cannot comment on what we are doing beyond that. But as soon as we have more clarity, we'll come back to you.

Operator
The next question comes from Peter Clark from Société Générale. Sir, please go ahead.

Peter Clark - Societe Generale
It's on the material margin in the third quarter. You sort of outlined all the components behind why it's touching 35%, and I'm assuming that Composites must be back at the 29 levels or above. But even so, that Specialty Materials probably nearer 40% than 35%. Now I know 3Q is seasonally strong on top of all the other components, but I'm just wondering how we should think about that? Because clearly, this is taking it to a new level. I accept you've done a lot of work to get it to a new level, but how do you see the margin there?
And just a follow-up on the webinar, I was on the Peroxides webinar. And there was a little discussion on contracts and pricing, but not much was disclosed. On the HPPO side of things, my understanding is there is some contract protection there more so than elsewhere in the Peroxides business. So, if things go a bit dicky in Antwerp, what happens? Those are the 2 questions.

Ilham Kadri - Solvay, CEO
Yes, on Materials, I am very pleased. I told you since 2019, I used the bold words “crown jewel,” and they had to demonstrate that. I really believe in the Specialty Polymer side (then we can talk about Composites) that we were sitting on real jewels in the company, unique products. Nobody has the breadth and the broadest portfolio of unique high-performance polymers on the top of the pyramid for performance. Let me remind you that Solvay divested PVC. Polyamide too, when I joined the company. We are really sitting on the top of the pyramid.

Customers come to us when they need spec 1 and spec 2 and spec 3. So a high temperature resistance, a high greave resistance and a high wear-resistance. They have under the hood applications replacing a metal part next to the engine. So this is a specialty product and solution, value pricing is key and the value proposition is stronger than ever.

So Peter, we started application by application, I think we talked more about Materials one day. Perhaps we should do a roadshow with you and invite you to our Bollate or our Spinetta plants in Italy to really show you the pieces we produce with our customers, the value proposition we bring to them. Because as soon as you replace a metal part, it can produce a lower total cost of ownership. So the customer may pay more for our product. But the parts with our polymers cost much less, and it enables lightweighting and clean mobility, too. So I think that's what we try to do. Its value-pricing, understanding the value proposition and baked-in by the electrification and lightweighting mega trend.
We did internal reorganization. When I joined the company, Materials was organized as a technology company. So we had aromatics, fluoropolymers and sub-products behind this. What we have changed now since 2021 is that we are organized by markets and sectors internally. So we drive our businesses by market; we understand automotive better. What do they need? We have key account managers for customers like Bosch and others. In healthcare, it's the same. We understand hemodialysis better, what do they need? The same for industrial applications, for our growth platform Battery Materials. We launched it in 2019, look where we are now. We have a regional strategy, which is being executed by region. So we are really much more educated, much more mindful about what the market needs and our customers need. And therefore, I think we can extract better value, much more value and share it with our customers.

On Peroxides, we have a leadership position, with highly competitive assets around the world. We are the only one who can build the mega-plants to meet the solid demand. So yes, we have 3 mega-plants in joint ventures. We deal typically with long-term contracts with guaranteed margins. That's giving us visibility and stable cash flows. So that's what we talked about with Peter Browning, our President of the Peroxides business, when we hosted our webinar. And this is good news because it helps us to really see it coming in and sit on guaranteed returns, which give us visibility and help us to continue reinvesting.

The second part of the business is merchant, but, and as you know, hydrogen peroxide is a key chemical used in many essential industries like aseptic packaging, equipment sterilization, water treatment, surface disinfection and hand disinfection. And normally, those market tend not to be impacted by economical cycle. So we continue to see resiliency. We see this in Soda Ash & Derivatives and Peroxides is another very resilient business. We like this because we are the best-in-class in terms of production processes through our process innovation leading us to have the best competitive assets in the world.

Peter Clark - Societe Generale
Got it. Thank you. I'll remember the trip to Italy, by the way. Very impressive.

Ilham Kadri - Solvay, CEO
Thank you.

Operator
The last question comes from Geoff Haire from UBS. Please go ahead.

Geoff Haire - UBS
Thank you for taking my questions. I just had two questions. First of all, there was a €39 million gain, I think from the unwinding of energy hedges in the quarter. Do you expect something similar in the fourth quarter as well? And also just coming back to Karim's comment on working capital. In an inflationary environment, that difference between the balance sheet and the cash flow seems very large. Maybe you could outline how exactly you've managed to do that and whether it's sustainable going forward.

Karim Hajjar - Solvay, CFO
Actually, well done for reading Page 21 of our financial report. Not everybody does that, so your question on the EUR 39 million hedging gain is really important. So let me tell you what we're talking about here. We're talking about a cash flow hedge derecognition. Now in Q3, what we did is we adapted some of our hedges because we changed our sourcing of materials, including coal, due to the disruption to the energy suppliers in Europe, gas curtailments and what have you. And this was motivated by a need to secure alternative sources of energy to underpin our business continuity. Now when you do that, you can no longer meet the "highly probable" test, which is what IFRS requires you to do. So as a result, there's no choice. IFRS requires you to derecognize these impacted hedges, and you can't consider them to be cash flow hedges. Now it's a technical accounting consequence, and it's because the hedges simply can't be cash flow hedges. Now the key here is that it doesn't make a single bit of difference economically to Solvay. Now the hedges were designed to cover our exposures from the third quarter of this year through to the end of 2023. So what have we done? We've now recognized the full EUR 39 million as not meeting the cash flow hedge definitions, and we've taken a small profit - less than EUR 10 million in the third quarter, which is a benefit - the economic benefit that accrued during the quarter, and we expect the remainder of that EUR 39 million to accrue – to be recognized – between now and the end of next year. So that's really all, I hope that helps. But it's to me, very high quality and it's purely this accounting technical requirement.

On working capital – one of my favorite subjects – let me just remind you, and I think I mentioned it when I did my opening remarks. Benchmarks would point to 17% as a good performance on working capital. Now you've seen us do better than that. You've seen us do between 12.5% and 15%. Let me tell you 1 or 2 facts, and I'll start with the fact that our working capital has really grown. If you look at our total revenue in 2021, it increased from EUR 11.4 billion. And if you take Q3 revenue and annualize it, you end up at EUR 17.6bn for the full year 2022. If you apply that benchmark of 17% to the revenue number, you would expect our working capital to balloon by about EUR 1 billion. Take that and just hold on to it – that EUR 1 billion expectation – and see what happened in Solvay. If you look at the actual evolution of our working capital, you're going to see an increase from EUR 1.4 billion to EUR 2.2 billion. In other words, an increase of EUR 0.8 billion. So what does it tell you? It tells you we're doing better than the benchmark. But it also tells you that we're really laser-focused – relentlessly focused – on that. And it happens every week; we're tracking it. And we're not looking at the big numbers, we're looking at the key, call it, operational KPIs. I look at DSO, which means day sales outstanding. We look at overdues, top customers, days payable outstanding, days of stock in sales. And it's part of the weekly biorythm. It's driven – I won't say hard – but in a very consistent, disciplined manner. And those entities, those businesses that are not fully performing as we expect – can I say – they get quite a lot of constructive encouragement. That's our culture, the performance culture, the delivery that's doing it. So, to your question, is it sustainable? Absolutely. If it's doable, we'll do it. We're proud of what's been achieved. It takes hard work. It takes relentless focus. The one thing that does help is we don't have to push water uphill to achieve it because the bonuses of some of our commercial people and of our business leaders doesn't just come from achieving profits and but comes from converting the profit into cash, and that makes this job a lot easier. So yes, it’s sustainable. Does that help, Geoff?

Geoff Haire - UBS

Thank you, yes.

Jodi Allen - Solvay, Head of IR

And thank you, everyone. This now concludes our formal Q&A session and actually the call, apologies again for the delay in starting, but we went a little over to address as many questions as possible. And I just want to remind you that we may get an opportunity to see some of you as we'll be attending several conferences and road shows in the coming months. And we also plan to continue with our webinars because we've been receiving lots of positive feedback. So we're actively behind the scenes preparing some more. And we'll let you know those dates once we're ready. And today, if you have additional questions that we didn't get to, please contact any one of us on the investor relations team and we're happy to take additional questions. Thank you so much, everyone.

Operator

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