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Univar, Inc. (UNVR)

Q2 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to Univar Solutions' Second Quarter 2019 Earnings Conference Call. My name is Julie and I will be your host operator on this call. At this time, all participants are in a listen-only mode. After the presentation, we will conduct a question-and-answer session. Instructions will be provided at that time. [Operator Instructions]

I will now turn the meeting over to your host for today's call, Heather Kos, Vice President of Investor Relations at Univar Solutions. Heather, please go ahead.

Heather Kos
Vice President-Investor Relations, Univar, Inc.

Thank you and good morning. Welcome to Univar Solutions' second quarter 2019 conference call and webcast. Joining our call today are David Jukes, President and Chief Executive Officer; and Carl Lukach, Executive Vice President and Chief Financial Officer. This morning, we released our financial results for the second quarter ended June 30, 2019, the first full quarter that includes Nexeo Solutions' chemical distribution business which we acquired on February 28 this year. We have posted to our website a supplemental slide presentation to go with today's call. The slide presentation should be viewed along with the earnings release. Both of which have been posted on our website at univarsolutions.com.

During this call and summarized on slide 2, we will refer to non-GAAP financial measures for which you can find the reconciliation to the comparable GAAP financial measures in our earnings release and the supplemental slide presentation. As referenced on slide 2, we will make statements about our estimates, projections, outlook, forecast or expectations for the future. All such statements are forward-looking, and while they reflect our current estimates, they involve risk and certainties and are not guarantees of future performance. Please see our SEC filings for a more complete list of the risks and uncertainties inherent in our business and our expectations for the future.

With that, I'll now turn the call over to David for his opening remarks.

David C. Jukes

President, Chief Executive Officer & Director, Univar, Inc.

Thanks, Heather, and good morning, everyone. Since our last update, we've made significant progress on the integration of the legacy Univar and Nexeo chemical ingredients and distribution businesses. And I'm more than satisfied with our execution to-date. I'm pleased to say that our strategy is working and despite operating in what now [ph] wide (00:02:28) reported as a challenging and weakening market, we were able to deliver solid second quarter results, marginally ahead of expectations.

Higher gross margins from favorable mix and improved sales force effectiveness, the first cost synergies from the integration program and improved operating efficiency drove earnings, offsetting any market weakness. We're now operating as one company, Univar Solutions, and have seen the benefits of this strategic step.

For the second quarter, we reported a gross profit of $577 million. On an estimated pro forma basis, this is down about 5% year-on-year, driven by approximately 2% of FX, a little over 1% by the anticipated dis-synergies, and 1% by continued adverse conditions in Canadian ag. It's important to note though, that on an adjusted EBITDA basis, our year-over-year performance is essentially flat at $201 million. This, in my view, is an early proof point of how Univar Solutions is offsetting weak market dynamics and holding EBITDA flat through cost control, mix improvement and synergy capture.

You'll hear later from Carl that our outlook for the year is being lowered from $750 million midpoint to a new midpoint of $732.5 million. Again, in my view, this slight reduction in full year guidance is prudent, but another verification of our strategy delivering as we expected. Even with the continued lower demand and choppy market dynamics, we believe we can hold our year-over-year total adjusted EBITDA almost flat due to cost control, mix improvement and synergy capture. Of course, if we see some uptick in the second half, we can improve on this expectation.

Finally, because of our early progress and the work of the organization, we are raising our gross synergy target by $20 million from $130 million to $150 million. We're also raising our integration cost estimate from $150 million to $225 million. But roughly half of the $75 million increase is due to additional ERP functionality we are accelerating into earlier implementation.

We're also active in monetizing excess assets and working capital, which provide substantial funding for the integration costs. Carl will have more detail on this. But overall, I'm very pleased with the integration process and the expected financial results and returns. Now, before I turn the call over to Carl, let me mention a few items that I feel are going to continue to drive long term value at Univar Solutions.

Our U.S.A. transformation continues to progress positively and our newly combined sales force is stable and maturing. Our sellers are energized and excited about the opportunity in front of them as they learned innovative new ways to sell the value of an expanded list of industry leading products from our supplier partners and from our enhanced Univar Solutions platform. We have a team geared to bring unrivaled industry and products expertise to deliver more efficient solutions to customers at a time when, due to the economic headwinds, they need the most.

During the quarter, we held our first ever national sales meeting with Univar Solutions. Over 1,000 sellers and product managers, along with a number of our supply partners came together as one united commercial team, represent the marketing, product management, and each of our separate but dedicated sales channels.

One of the featured events was a two-day gallery walk for our key supplier partners. This was a unique opportunity for them to interact with our sales and product management teams in a collective and collaborative forum. Supplier feedback has been extremely positive and they told us this was an event like now other. The feedback was best summarized by one partner who said, "The event was better than any tradeshow I've ever attended, subsequent virtual sessions are scheduled to prepare our teams with additional training to support our new and expanded line card."

Additionally, our counselor sales process, which helps build long-term win-win customer relationships, has already been introduced to all new sellers. The class is scheduled throughout the rest of 2019. We continued to invest in having the best equipped and skilled sales force in the industry. You may have seen our press releases during the quarter, announcing new or expanded products authorization we were awarded from supply partners such as Dow, Novozymes, Axiom Foods and Seaweed & Co. These partnerships on the leading chemical and ingredient products they bring truly excites us, reflect the benefits of our dedicated industry focus model and add to our expanded portfolio of natural ingredients. Our supply partners recognize the value that our expertise and digital capabilities bring them and believe in our objective to redefine chemical distribution and help them streamline, innovate and grow.

Since the launch of Univar Solutions on March the 1st, our confidence in the strategic rationale and value creation opportunity has grown as we focus on streamlining, innovating and growing our own business. We've identified additional cost synergies as we integrate the legacy companies, and in some situations, have expanded our scope, begin to optimize the business where we can and where it doesn't disturb or risk the integration process. We're working diligently and rapidly to simplify business processes, remove redundancies, eliminate bottlenecks, optimize our consolidated supply chain, and digitize our business. These actions will structurally reduce our cost base and enable us to leverage our scale for the benefits of our customers and supplier partners into the long term, creating a sustainable competitive advantage.

Now, let me turn the call over to Carl. He will walk you through our second quarter results, update you on our Nexeo value-creation opportunity, and explain our full-year guidance. Then, I will close with some further details on the progress of the integration. Carl?

Carl J. Lukach

Executive Vice President & Chief Financial Officer, Univar, Inc.

Thanks, David, and good morning, everyone. I would like to start by saying that overall, we are pleased with our performance in the quarter. We executed well in what was and continues to be a choppy industrial market environment as our customers continually adjust to their expectations and their orders. Over the course of the quarter, we saw progressively weaker demand from our customers in most global industrial end markets. While our second quarter reported sales of $2.6 billion were up 11% currency neutral, largely from including Nexeo, our estimated pro forma sales were down 9% currency neutral reflecting the lower demand.

So, we did what we always do in market conditions like these. We focused intensely on those factors within our control like remaining disciplined with our spending, continuing to build the strength of our sales force and, most notably, capturing the valuable and growing treasure chest of synergies from the combination of the legacy Univar and Nexeo organizations.

In the second quarter, we reported GAAP net income of $16.3 million, or $0.10 per share. This included $49 million integration and transaction-related costs and reflects the higher share count resulting from the Nexeo acquisition. Adjusted earnings per share for the quarter was $0.42 compared to $0.47 in the prior year. Higher share count and stock comp expense, along with an FX headwind, more than offset the addition of Nexeo, which was in line with our expectations.

Last quarter, we told you we would frame our discussion of performance by focusing on six key metrics. To remind you, these key metrics are gross profit dollars, adjusted EBITDA, cash flow, return on capital, debt leverage and synergy capture from the integration. Let me update you now on each of these metrics for the second quarter.

First metric, gross profit dollars. On a reported basis, gross profit dollars grew 18% currency neutral to $577 million and we expanded our gross margin by 120 basis points to 22.3%. As David explained, our estimated pro-forma gross profit dollars were about equal to last year excluding FX dis-synergies in Canadian Ag despite lower sales. Second metric, adjusted EBITDA. Our second quarter adjusted EBITDA of $201 million in the quarter grew 16% from the prior year or 19% excluding the impact of currency.

Adjusted EBITDA margin expanded 50 basis points to 7.8% from the prior year. Like gross profit, our estimated pro forma adjusted EBITDA was about flat with last year currency neutral reflecting the higher gross margin, cost synergies from Nexeo and disciplined cost management despite, again, much lower sales.

Third, free cash flow. Our cash flow year-to-date is ahead of last year, largely because we invested less in net working capital than we expected as a result of the lower demand environment. This is a testament to the countercyclical nature of our cash flow and business model, which provides us strength and resiliency in a sluggish macroeconomic environment. Our top priority for use of cash in the short-term continues to be deleveraging.

Fourth, return on invested capital. ROIC defined as adjusted net income divided by net assets deployed was 9.9%, down from 10.9% at this time last year reflecting the addition of legacy Nexeo Chemical assets. We project a steady rise in our ROIC as we successfully execute our integration and synergy capture plans.

Next, debt leverage. Our leverage ratio was 4.1 times at the end of the quarter, essentially flat with the same quarter last year, and up slightly from the first quarter this year. We continued to prioritize our use of cash for debt pay down and remain on track to end this year at about 3.6 times excluding any pay down of debt from any potential strategic divestitures.

And finally, synergy capture. As you saw on our earnings news release this morning, we are raising our forecast of annual run rate net synergies to $120 million, up from our prior estimate of $100 million. We also doubled our estimate of net synergies that we will capture this year from $10 million to $20 million. I'll go into more detail on this subject later in the call.

Let me now share with you highlights from each of our geographic segments. In our U.S.A. segment on a reported basis, adjusted EBITDA increased 31% to $128 million from including legacy Nexeo but boosted by a higher overall gross margin and disciplined cost management which included cost synergies.

On an estimated pro-forma basis, adjusted EBITDA in the U.S. was essentially flat with the prior year despite the lower demand. Reported gross profit grew 29% and gross margin increased 110 basis points including the impact of dis-synergies that David mentioned. In this challenging environment, we managed our operating costs well and our U.S. conversion ratio increased 70 basis points to 34.1%.

Outbound freight and handling costs continued to edge downward from peak levels last year. Cost per pound, however, remains high reflecting lower utilization of our internal fleet. We do, however, anticipate favorability in the second half of this year as we work to integrate and optimize the legacy company's transportation teams.

In our Canada segment, adjusted EBITDA increased 1% on a currency neutral basis and declined 2% on a reported basis. Solid performance in a core industrial chemical business and certain commodity products, along with some contribution from the Nexeo acquisition, was partially offset by a lower demand from the Agriculture sector as our Ag customers consumed excess stocks from the prior two years.

As our EMEA segment grew adjusted EBITDA 2% excluding the impact of currency in a challenging and somewhat weakening macroeconomic environment. The second quarter was the 23rd consecutive quarter of currency neutral EBITDA growth for our EMEA segment. Gross profit was roughly equal to last year on a currency neutral basis; however, gross margin expanded 100 basis points, driven by mix improvement.

The beneficial Brexit impact of approximately $2 million that we realized in the first quarter largely reversed in the second quarter. And as a reminder, our EMEA segment results are not impacted by including Nexeo. We are being disciplined with our spending as we navigate through a slower market environment in Europe.

In our LATAM segment, adjusted EBITDA grew 8% on a currency neutral basis benefiting from solid performance in Mexico's energy market and the Brazilian Ag market, along with strong cost control and some contribution from Nexeo. This was partially offset, however, like in other markets by softness in industrial demand across both Mexico and Brazil.

Gross profit grew 12% on a currency neutral basis while gross margin decreased 160 basis points due to changes in product and market mix. We expect our customers in Brazil to continue to take a wait and see approach to business demand.

Moving now to cash flow, we invested less in net working capital during the quarter than we expected due to the lower demand. This increased our cash flow. For reference, last year's second quarter change in net working capital was unusually high given the timing of Easter.

Cash interest in the quarter was $26 million. We still expect cash interest for the year to be approximately $140 million. Cash taxes in the quarter were $13 million, on track with our full-year estimate of $50 million. Our effective tax rate for adjusted EPS in the quarter was 25.1%, lower than the prior year second quarter of 31.2%, which increased adjusted earnings per share by about $0.04. The six months year-to-date tax rate of 28% is down slightly from last year's 28.4%. We now expect our full-year effective tax rate for adjusted EPS to be within a range of 28% to 30%. Capital expenditures to maintain our facilities and grow our business were $29 million in the quarter. We continued to expect $100 million in CapEx for the year.

Now, before I turn to the outlook, let me share with you how we are doing with our Nexeo value capture work. Today, we are raising our estimate for annual run rate gross cost synergies from the previously announced $130 million to now $150 million. That's gross cost synergies. We are not changing our $30 million estimate for dis-synergies at this time, although work is progressing well to offset these in the future with incremental wins. And we have not yet included an estimate for growth synergies from having a larger and better trained sales force in the U.S.A. and from cross-selling products to each legacy company's customers.

Our annual run rate net synergies therefore has increased from $100 million to $120 million. We are also doubling our estimate of the net synergies we will capture in this calendar year from $10 million to $20 million. Today's increase in estimated synergies results from updated assessments by each of our workstream leaders in the comprehensive disciplined process we are running. Jen McIntyre is our Chief Integration Officer and she has us ahead of plan. We are well organized, executing at pace and yet at a very granular level of detail. Confidence along with our team morale is high. We are also raising today our total three-year estimate of one-time costs from $150 million to $225 million. Our workstream leaders have identified new opportunities to further streamline our processes, advance our digital functionality and systemically reduce our cost per transaction on an ongoing basis.

To capture these savings, which are additional to my previously mentioned $150 million, will require us to broaden our IT scope now while we migrate rather than later. Once complete, our expanded scope will enable us to further reduce administrative costs as a percentage of sales and will add incremental savings to our new annual run rate of $120 million net synergies. To scale the opportunity for you, in our U.S.A. segment alone, every 20 basis points reduction in administrative costs as a percentage of sales will equate with an annual run rate savings of approximately $15 million.

A little more than half of the $75 million increase in three-year one-time costs can be attributed to the broader digitalization functionality, with the remainder attributed to revise estimates for severance, spec consolidation and integration team costs. We see these expenditures as having a higher return on investment.

And lastly, as a reminder, we continued to expect to generate substantial cash funding for these one-time integration and optimization costs from the sale of excess real estate and optimization of net working capital. Both of these actions are well underway.

Turning now to our updated outlook for 2019 in the third quarter. As we told you last quarter, we were not anticipating any second half uplift in the market. But as we mentioned in this call and as you have seen in the media, market demand for chemicals and ingredients remains choppy and has progressively declined in the first half of this year, decelerating particularly in the second quarter.

Many of our supplier partners and peers have significantly reduced their forecast for the second half of this year, to reflect expected slower macroeconomic activity. Based on this and recent trends, we also believe it's prudent to change our demand outlook from flat to lower than last year.

Taking into account the lower than previously expected market demand and balancing against this our improving execution and the higher forecasted net cost synergies from the Nexeo integration, we are trimming our full year outlook for adjusted EBITDA approximately 2% to a range of $725 million to $740 million, compared to our prior forecast of $740 million to $760 million. The steady flow of growing cost synergies provides us valuable offset to the weaker macroeconomic environment.

We are also adjusting our outlook for free cash flow to a range of $275 million to $325 million, inclusive of the $63 million legal payment we made in April and before one-time integration costs and transaction fees. This adjustment is precipitated by our lower assessment of the Agriculture market in Canada. In the third quarter of 2019, we expect adjusted EBITDA to be between $180 million and $190 million, up from $157 million we earned in the third quarter of 2018.

With that, I'll turn it back to you, David.

David C. Jukes

President, Chief Executive Officer & Director, Univar, Inc.

Thanks, Carl. As I mentioned at the start of the call and as you heard in more detail from Carl, our integration of the legacy Nexeo and Univar organizations has made significant progress during the quarter, and our strategy is working. As we work through each integration milestone, we remain focused on the opportunity we have to streamline, to innovate, and to grow.

Since the beginning, our philosophy and approach to integrations remain consistent and moving forward, with the best of the best on systems, assets, processes, and people, while staying focused on delivering increased value to our customers and suppliers. It is of paramount importance that the right leadership and personnel in place with clear accountability to deliver bottom-line results. I'm pleased to say that our whole organizational structure is finalized, and thus far, our employee retention engagement has exceeded my expectations. Our people are excited by the values-based, purpose-driven culture of Univar Solutions, and are performing really well in the sometimes trying circumstances of any integration process. I want to thank them publicly for their commitment and support in building a place where the best people want to work.

Going forward, we'll continue to focus on the execution of our plans, whilst effectively managing change to deliver new opportunities and further streamline, innovate and grow our company. Our U.S. commercial team, led by Mark Fisher, have completed the sales force territory redesign ahead of our original estimates and then I'll execute on the implementation plan. Our sales force attrition remains at the low levels we observed since we closed the deal. And our sellers are excited to have an estimated 20% to 25% of free capacity to grow and sell to new customers.

We've identified the right sellers to support our two new focus industries home care and industrial cleaning (sic) [Household & Industrial Cleaning] (00:26:28) and metal working and lubricants. Similar to our other focus industries, these two verticals are now staffed, with subject matter experts to help customers identify and solve their most crucial problems, supported by dedicated technical support and application development capabilities through our now global network of solution centers. Real opportunity remains with our improved sales force efficiency and cross-selling opportunities.

Our ERP migration is running smoothly and we have an excellent leader and team of experienced professionals in place. They've already successfully mapped our legacy Univar master data to the legacy Nexeo data. Our training plans are finalized for all impacted personnel and the first of our six ERP implementation waves is beginning in two months, with the entire migration continuing to beginning of 2021.

Going forward, we'll continue to look for ways to optimize our processes across all functions and identify new value capture opportunities. Aside from the integration, I mentioned in our last call

that we have started the strategic review of various lines of business within our portfolio to determine whether we have the best home for those business. We have a number of profitable and attractive businesses that, like the legacy Nexeo Plastics business maybe adjacent to our core chemical and ingredient distribution business. We're advancing in our analysis and are still early in our evaluation process, but this is a high priority for us. As a reminder, our capital deployment priority continues to be debt reduction, that any proceeds from a sale will be used to pay down debt with our aim to get below three times levered by the end of 2020.

Before concluding, I'd like to mention a few other highlights. In June, we released the first Sustainability Report with Univar Solutions. This report entitled Our Home, Our Responsibility, covered the 2018 goals and achievements from both the legacy Univar and legacy Nexeo Solutions organizations as well as sets the stage for our approach to sustainability now as Univar Solutions. Sustainability is a priority for us as it touches each of our core values and aligns with our vision to redefine distribution and be the most valued chemical and ingredient distributor on the planet, as well as being better stewards of the earth's resources.

Univar Solutions will continue to work started by each legacy organization and build on their solid foundations to establish a new and enhanced focus on sustainable business across our operations globally. This includes reaffirming our commitments as signatories to the UN Global Compact, engaging with our workforce to continue our work and transparently reporting of performance. Also we're pleased to announce that Univar Solutions is co-recipient of the NACD Responsible Distribution Industry Excellence Award, the first time for either legacy company. This award is presented to companies that demonstrate a sustained and rigorous commitment to NACD Responsible Distribution. The association's third-party verified environmental, health, safety and security program. This marks an early landmark for the new Univar Solutions and we're both honored and proud to be recognized by the NACD for excellence in these critical areas of our business.

Univar Solutions is uniquely positioned to improve our profitability, grow our market share and grow the size of the distributed chemicals market, all while advancing the digitization of our entire business. We can now act to that, [ph] track these set of (00:30:19) growth drivers unlocking what Carl referred to as a treasure chest of vital cost and growth synergies from the combination of the legacy organizations.

We have multiple levers in our control including accelerating the integration cost synergies and continue to improve our sales force execution to create value for our suppliers, customers and shareholders. We're doing this in the demand environment which, has increasingly become more challenging and uncertain. Whilst not easy, we've operated in these markets before and are confident in our ability to remain agile and execute effectively, sustainably and responsibly.

Thanks for your attention. And with that, we'll open it up the questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Your first question comes from the line of Steve Byrne from Bank of America. Your line is open.

Luke Washer
Analyst, Bank of America Merrill Lynch

Q

Hi. This is actually Luke Washer on for Steve today. Thank you for taking my question. I wanted to ask a little bit more about your integration with Nexeo. Would you able to provide more detail regarding kind of the process of your progress, of your sales integration specifically, kind of where you're hiring or consolidating maybe at a regional level?

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.

A

Sure. We can explain that a little bit better. I mean, I think we've said before, Jen McIntyre leads our integration program. We have a very thorough and a very detailed program that we're going through, which is on plan. It's actually ahead of plan. It's allowing us to increase our synergy targets as we've done through today.

We also mentioned on the call that our commercial teams, the mapping, remapping of the sales territories has been completed ahead of schedule, is now going into implementation. So, we expect every new seller to have his new territory and be in place within the next 60 days, but every seller now knows what their new territory is, what their new [indiscernible] (00:32:31) is, what their new lead management is, and the new industry is in place. So, that's a very exciting development for us.

We also said at the beginning of the program that we would be retaining every single seller that we have through the joint companies, no performance, no permitting, and we've done that. Our commitment is to do that and actually we think we're going to have some more sales territories opened up. So we're recruiting more sellers into the sales organization over the coming period.

Luke Washer
Analyst, Bank of America Merrill Lynch

Q

Great. Thank you. And, again, kind of post the acquisition, do you see yourself getting rewarded with increased supplier agreements from suppliers?

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.

A

We do. I mean, we recognize there would be some dis-synergies and the dis-synergies are very much in line with where we expected them to be. We have chemistries – compete in chemistries in the legacy – next year on legacy Univar organizations, which we knew we couldn't sit next to each other. So we have been able to map our way through those. There's no surprises in there at all and this is why dis-synergies are happening pretty much as expected. And the wins that we expected to get are coming in as well. So, we're very pleased, our suppliers are very supportive. We did consult with our suppliers before we put the integration plans together, to get the inputs on what they would like to see, what they wanted kept, what they wanted change and what they wanted more of.

And so, we've been very integrated with our supplier partners all the way through. But as you can see through some of the announcements that we've made and some of the increasing relationships we have with partners like Solvay, BASF, they're really excited about what we can do, how we can grow their business and the business model that we're putting in place.

Luke Washer
Analyst, Bank of America Merrill Lynch

Q

Sounds good. Thank you.

Operator: Your next question comes from Kevin McCarthy from Vertical Research. Your line is open.

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC

Q

Thank you. A couple of questions, I guess, on demand. It sounds like you're baking into the 2019 forecast and outlook for negative demand. And I was wondering if you could kind of talk through what has changed in your view on a regional basis. And then related to that, maybe provide some color, if you would, on the monthly patterns that you're observing in the demand function.

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.

A

Sure. Let me try and answer that for you. So – I mean I think we said in our last call that we expected demand in the second half to be flat. And what we are seeing is a slower economy. What we saw is the demand patterns slowdown during the months of May and June and we've seen that continue into July. August is always a – it's a holiday month, so it's difficult to call. So, Q3 is really a September month. And so, it's difficult to understand exactly what Q3 will bring right now. Certainly, we're seeing a slower economy in Europe. We're seeing enhanced amounts of anxiety around some of the key markets there, particularly the UK, with the operated situation. And the U.S. has slowed sequentially as the months have gone on.

We're not alone in that. I think pretty much every chemical producer who's reported is guiding down for the second half. So, whilst our outlook was directionally correct, the sluggish conditions that really impacted us and our supply partners and are proven to be more challenging than we forecast. So, we think it's prudent to guide down. Having said that, what we do have is we have a prudent sales force execution. We have disciplined cost to margin managements, and we have the synergies coming in from Nexeo earlier and slightly larger than we expected. And that offsets – it goes a long way to offsetting that kind of market demand. So, we think that we have a pretty strong hand going into what is increasingly choppy market conditions.

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC

Q

That's helpful. I appreciate the color there. And then, secondly, if I may on Canada, I was wondering if you could elaborate on two things. I guess the source of strength that you saw on the industrial side and then the weakness in Ag and sort of how those two net out in the quarter. Do you think it turned out to be net favorable or net challenging versus your prior expectation?

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.

A

Look, I think, our – I mean our core chemical and ingredient distribution business has done really well. We've got a good team there managing that business. And what they're doing is what any good distribution does in dry market conditions. It controls the controllables. So, that's what it's done. We're leveraging some of the capabilities that we put through EMEA and through the U.S. to be able to think about focused industries, growth in differentiated products, making the product mix better and managing the margin.

Meanwhile, we have the Ag business, which is largely weather-dependent and we've had three years of poor weather, which is unrivaled, and we have supply chair fairly soft and we have those farmers that are planting, planting some of the lower cost products. So, almost a perfect storm in Canada. Bad pun actually, there's a perfect storm in Canada. Sorry about that.

Now, I think what we are doing there in Canada is not just sitting there, twiddling our thumbs and saying, gosh, it's just the weather, there's nothing we can do. We're doing all we can to change the business model there and to de-risk that going forward. So, I think the addition of Novozymes in that – because that's moving to BioAg and does that. So, you'll see us continue to change the profile of that business to de-risk it going forward. But the core industrial business is going really well. It's going what it does, cost management, it's mix improvements, and it's doing the basics of distribution really well, which our Canadian team are very good at.

Carl J. Lukach
Executive Vice President & Chief Financial Officer, Univar, Inc.

A

Kevin, it's Carl. If could add to that, too. Size-wise, the two more or less netted out. Our Canadian segment reported flat, more or less flat for the quarter versus prior year. And the up side that we realized on the industrial side more or less offset the Canadian down. The addition – we do have some gyrations in working capital that we're really activity managing through in the Ag space, and that is actually at the root of one of the lead precipitators for lowering our free cash flow guidance for the year. So, it's a dynamic situation there as the industry working through excess stocks.

Kevin W. McCarthy
Analyst, Vertical Research Partners LLC

Q

Thank you, both.

Operator: Your next question comes from Laurent Favre with Exane BNP Paribas. Your line is open.

Laurent Favre
Analyst, Exane BNP Paribas

Q

Yes. Good morning, all. Thanks for taking my questions. The first one going back to what Kevin asked. I mean, I guess you used to assume a flat second half when suppliers and all the chemical companies we follow used to say up; now, you're saying down when they are all saying flat. So I'm just wondering what are the areas that makes you particularly concerned and make you think that on easier volume comps you will still have a down second half. Are there areas where there was stability and resilience in the second half of last year where you've started to see some weakness? Basically, any color there would be helpful.

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.

A

Sure, Laurent. Good afternoon, I think, to you. So really beginning of the year, we laid our key assumptions, which really a flat industrial demand. There is very small recovery in Canada Agriculture from the historically low and then progress on new supplier authorizations and the continued improvement on our sales force, and we see that.

The change in our guidance really is directly related to the industrial demand, which has softened with multiple global companies publicly guiding to a weak second half of the year followed by a third consecutive year of poor conditions in Canada. So we can see it to execute and what we can control and we've demonstrated progress on [ph] some of the (00:40:59) authorizations, improving our sales force efficiency and increasing our synergy estimates. They're all helping offset demand softness.

No, I don't have a better crystal ball than anybody else on the economies, but I remain conservative about what we'll see in the second half because there is so much uncertainty in pretty much any economic market that you look at. I think it's prudent for us to listen to what everybody else is saying and be prudent. If we see an uptick in demand, then we'll benefit from that. But I think it's prudent for us not to hope for that. Hope is not a strategy.

Carl J. Lukach
Executive Vice President & Chief Financial Officer, Univar, Inc.

A

Laurent, it's Carl. I'm going back to what you said about easier comps in the second half, if I could just add a point on that. This started for us, we think, back in October of 2018 when we first saw this choppiness and kind of trend line down that we talked about 5-ish percent lower volume in orders. We're not talking about a cliff here. The trend lines are not a cliff and we're not seeing that or projecting that into the second half. But it is lower today than it was back in October when this dropdown started. And I'd say may be accented in Europe. We don't know if it's the summer vacations coming up or how long that will last and what September will bring. But it is the easy comp part of your comment, I'm just reacting to that.

Laurent Favre
Analyst, Exane BNP Paribas

Q

Thank you. And then the second question was on the free cash flow guidance. So, am I right that excluding what you're doing in Canada, your free cash flow guidance should have been, let's say, more optimistic than what it is? In other words, that on the lower demand you get lower EBITDA, but you would have had working capital flow back?

Carl J. Lukach
Executive Vice President & Chief Financial Officer, Univar, Inc.

A

Sure. Yeah. You're exactly right, Laurent. You're exactly right. Lower demand, we will harvest working capital. And the lower EBITDA, we project would be more than offset by the harvesting of working capital. What's working in our reduction of the forecast there is really in the Ag space. I think that traditionally, historically, customers in the Ag industry in Canada prepay, pre-buy, protection products for the following season in the fourth quarter. Our market read is that our customer base in Canada had such a rough time over the last two years and now three years that they may not be setup to do that here at the end of the fourth quarter.

And we do, historically, have received a lot of cash in the fourth quarter from prepayments in the Ag space. So, we're adjusting that expectation downward and that is really the root of why we are lowering our free cash flow guidance. The transitory...

Laurent Favre
Analyst, Exane BNP Paribas

Q

Okay.

Carl J. Lukach
Executive Vice President & Chief Financial Officer, Univar, Inc.

A

...issue is that we hope will rebound next year.

Laurent Favre
Analyst, Exane BNP Paribas
Q

Okay. Thank you.

Carl J. Lukach
Executive Vice President & Chief Financial Officer, Univar, Inc.
A

Thanks. Thanks a lot.

Operator: David Begleiter from Deutsche Bank. Your line is open.

Katherine Griffin
Analyst, Deutsche Bank Securities, Inc.
Q

Hi. Good morning. This is Katherine Griffin on for David. Thanks for taking my question. So first, I was wondering if you could just talk a little bit more about the update on the portfolio optimization and if any divestitures have been identified, if they're underway, and sort of whether those are aligned or not aligned. Thank you.

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.
A

Hey, Katherine. So look, I can't share any updates with you today. As we mentioned in the call, we got a number of profitable and attractive businesses, like the Nexeo Plastics business, maybe adjacent to our core chemical and ingredient distribution business and may have a better growth profile in someone else's hands.

So, we're advancing in our analysis and are still early in the valuation process. But our goal is to focus on owning businesses where we can maximize the value and look to sell those, could be worth more to someone else. And then to use any proceeds from that to prioritize debt pay down.

Katherine Griffin
Analyst, Deutsche Bank Securities, Inc.
Q

Okay. Thank you.

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.
A

But I can't give you any specifics right now.

Katherine Griffin
Analyst, Deutsche Bank Securities, Inc.
Q

Okay. Thank you. And I was just curious, so we've heard over the past couple of weeks from some of your customers mentioned sort of changing trends in customer [ph] products (00:45:38) more towards [indiscernible] (00:45:39) ingredients, clean and natural. Have you seen any of that impacting demand kind of distinct from macroeconomic weakness and is that seen as an opportunity in terms of where you're applying the focused industry's growth? Are you seeing any of that impact?

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.

A

No. There was a little blip midway through your question, so I think your question is about trends on natural ingredients, is that right?

Katherine Griffin
Analyst, Deutsche Bank Securities, Inc.

Q

Yes.

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.

A

Okay. So, yeah, we do see that and we do see our focused industry model aligning very well with identify market trends, getting out of market trends, and bringing the latest in global trends to our mobile customers worldwide. And so as we announced with the addition of someone like the Seaweed & Co. in the last quarter, we're adding to our portfolio of natural products. We do see an increasing trend in natural products and we intend to be at the forefront of that.

Our focus is the model aligns perfectly with that. We're able to bring the expertise, dedicated expertise whether that's to Personal Care customers or to Food Ingredient customers or wherever that is to bring the natural products which can help our sustainability goals.

Katherine Griffin
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you.

Operator: Laurence Alexander from Jefferies. Your line is open.

Daniel Rizzo
Analyst, Jefferies LLC

Q

Hi. This is Dan Rizzo on for Laurence. How you guys doing?

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.

A

Good. Thank you. How are you?

Carl J. Lukach
Executive Vice President & Chief Financial Officer, Univar, Inc.

A

Good morning, Dan.

Daniel Rizzo
Analyst, Jefferies LLC

Q

Good. Given relatively important everything you're already doing with integration, are there any leverage you can pull if the environment were to weaken further?

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.

A

Well, I think, what we do is what we always do in times like this. I mean, this is not the first time we've seen weakening markets. So, I think, the first thing on the integration, we've already pulled some things ahead and we have doubled our outlook for this year on synergy capture. So, that's a big, big step. What we don't want to do is to damage the integration or put the integration at risk by bringing things artificially forward that damage the flow of what we're doing. So, we're not going to put the RP implementation at risk for instance just to try and save a few dollars in this year.

What we do look forward to are growth synergies that come from this integration. So, getting that sales organization aligned and in place is really important to us because it frees up that 20%, 25% of free capacity for them to go on prospect and hunt for new growth. But what we'll do is what we do in any tightening of demand. We'll control the controllables. So, we'll manage our cost effectively. We'll look to service our customers better. And what we'll do is we'll look to bring the new and inventive ways that they can stay in business and they can save cost and their pipelines.

And we've actually seen a significant increase in our pipeline of opportunities in some of the differentiated chemistry. Some are 16% increase in the opportunities there as we look to change formulate out some existing ingredients to have more sustainable, more cost-effective solutions. This is exactly what our customers want. They want someone who can provide solutions to them in times of difficulty. And we see that as an opportunity for us, and we see ourselves incredibly well-placed to deliver on that.

Daniel Rizzo
Analyst, Jefferies LLC

Q

Okay. Thank you for the clarification. And then, my other question is you mentioned natural ingredients as potentially an area of growth. I was just wondering what percent of sales that is and how fast it is growing.

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.

A

So, we have a wide range of natural ingredients. I can't give you growth numbers on them, and also growth numbers from a low base are going to sound very exciting. But remember what they are, they are going to be fairly low-volume, fairly high-value products. But we have a growing stable of natural ingredients. Remember last year, we acquired a company called Earthoil in Europe which took us further into natural ingredients. So, we do see being at the forefront of this move in the marketplace is very important to provide value to our customers.

Daniel Rizzo
Analyst, Jefferies LLC

Q

Okay. Thank you very much.

Carl J. Lukach
Executive Vice President & Chief Financial Officer, Univar, Inc.

A

Thanks, Dan.

Operator: Bob Koort from Goldman Sachs. Your line is open.

Robert Koort
Analyst, Goldman Sachs & Co. LLC

Q

Thank you. Good morning.

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.

A

Good morning, Bob.

Robert Koort
Analyst, Goldman Sachs & Co. LLC

Q

David, I was wondering if you could talk about I think from the onset of the Nexeo deal, you, guys have talked about having a very rigorous robust integration and plan. So, I'm just curious the increased spending on the IT scope, can you give us a little more detail how that developed and specifically what are those components of elevated costs that weren't in your original expectation?

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.

A

Sure, Bob. I mean I think what we've done is we've gone through the processes. We've discovered new things that we maybe will have underestimated the benefit of or didn't fully understand the due diligence, and that's led to the $20 million increase in cost synergies that we've been able to announce in the last 24 hours.

I think when we look at our IT capabilities, I think what we've done is look at the core Nexeo system, the ability to optimize that as we roll out, and the ability to be able to bring forward some of the

optimizations that we kind of had in our mind for 2021, 2022, 2023, combining digital platforms with optimized flows that will allow us to systemically reduce our transaction cost.

So, this is new learning for us, as we really get deep under the covers about added functionality and added sort of capabilities and automizing more of the processes that we have, which will feed great sort of ease of use for our customers, ease of use for our people and more cost effective solutions through the business.

So right now, it's difficult to exactly quantify what those are and, as Carl mentioned, 20 basis points in the U.S. is $50 million. We do think there's a real opportunity to systemically improve our transaction cost, as we enhance our digital capabilities. What we'll have though is a technology platform, a base ERP and digital capabilities across the Americas with a single catalog or products, price availability of 50-odd document, the downloads. I mean a really, really robust functionality, which will allow us to be much more efficient, much more effective and give a much better customer experience, as well as reducing systemically the transaction cost of operating our business.

Carl J. Lukach
Executive Vice President & Chief Financial Officer, Univar, Inc.

A

And, Bob, it's Carl. Just to add a little more color on that. I mean just in terms of the nitty-gritty that you've asked about there, I mean think of it as our systems to price products, order processing, customer order processing, issuing the purchase orders to our supplier partners for the chemicals, inventory management, billings, collections, it's all those end to end processes that you tap into when you talk about this extra money that we want to spend in. And the outcome in addition to lower cost will better set the stage for our future digitization aspirations. So, we build a better house by making these improvements now versus later.

Robert Koort
Analyst, Goldman Sachs & Co. LLC

Q

Got it. And can I ask, you mentioned in the slide deck the U.S. sales force execution improvement. And I think sales force execution and change in the culture of your sales force seems to have been a little bit of a bumpy path. So, can you maybe give us some granular anecdotes of what you mean by improvement there?

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.

A

Sure. And you're right, it has been a bumpy path, but culture change takes time as we've consistently said. I mean what we're doing is we measure the effectiveness of our sales force in a number of ways. So, we look at them in the core rates, the close rates, the win-loss, a little bit of gross profit dollar growth that we're seeing from them, and we're seeing improvements in pretty much all of those areas. Firstly, we've reduced the turnover in our sales force. The sales force turnover now is at fairly low levels. It's around 10%, 12%, which is kind of normal performance management levels. And it's been there now for a number of months.

So, what that means is the trend that we've done in the last couple of years is sticking and the people are sticking with us. So, we have a maturing sales force, which is building relationships with these customers.

What we're seeing is our customer numbers starting to tick upwards, not massively but tick upwards. And that's a good sign to take any amounts of churn and change that we have going on with the integration of two sales organizations. What we're seeing is an increase in our pipeline of opportunities particularly in our focus industries. So, over the last quarter, it's been a 16%, 1-6% increase in the number of opportunities we expect to close in our differentiate chemistries as a direct results of the focus of our dedicated industries. So, we see that working well. The sales conference that we had put real energy into the sales organization and to see that see team interact with our core suppliers and to see what our suppliers are seeing and saying about how they're operating is truly exciting to behold.

So we're seeing a number of metrics, a number of ways which we see that sales force improvements really kick in. And that counselor sales program that we have that builds in long-term win-win customer relationships, it's all about relating, discovering, advocating and supporting our customers. We continue to invest in that.

We have the first class of legacy Nexeo, legacy Univar employees last week. I spoke to that class last week here in Chicago and we'll continue to invest through the rest of this year on an ongoing basis on having the best equipped and skilled sales force in the marketplace. But I point to reduce churn. I point to that ticking up of the customer numbers. I'd point to that increasing our opportunity pipeline and closes is real evidence that we are able to say that the sales transformation process is really taking roots.

Robert Koort
Analyst, Goldman Sachs & Co. LLC

Q

Got it. Thank you.

Operator: Jim Sheehan from SunTrust. Your line is open.

James Sheehan
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Good morning. Thanks for taking my question. So, on the U.S.A. segment turnaround, which you just spelled out as trying to gain momentum, what kinds of targets do you have in mind for that segment in 2020 as the sales force execution continues to make progress and you executive better on cross-selling opportunities?

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.

A

Hey, Jim. So, I mean, look, we're not giving 2020 guidance yet. We know that in 2020 we're going to have a larger and more trained sales force. We'll have a higher concentration of Univar sellers in the market, so a higher density. We got more prospect in larger pipelines, large potential wins. We got improved value and use pricing tool to more cross-selling. So, there's a lot of things which are there to be excited about, but we're not giving 2020 guidance yet.

James Sheehan
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Got it. And in terms of dis-synergies that you've seen on Nexeo, you've spelled that out for the second quarter. Pardon me if I missed this earlier, but what's your outlook for potential dis-synergies that's incorporated into your second half 2019 guidance?

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.

A

We expect the full-year dis-synergies to be around $30 million. We think we're running at that sort of rate. So, that's what we'd expect to see. We expect those to be more impactful in the second half than in the first half. But we do – we expect our synergies to go a large way to offsetting those, which we think net dis-synergy is around $30 million hitting in the second half. But what we have is an improving execution on synergy capture to offset that and also improving offset programs with our sales organization to win back products with our chosen partners on some of those products where we've lost out.

Carl J. Lukach
Executive Vice President & Chief Financial Officer, Univar, Inc.

A

Jim, it's Carl. If I could add to that, it might be a little easier to net dis-synergies against the benefits of the cost saving synergies. And the way that cadence looks like it's projecting out for us through the rest of this year, is that in the second quarter, we captured a low-single-digit millions of dollars net, the growth cost synergies net of the dis-synergies. As we go into the third quarter, we think that the dis-synergies are going to be larger as we burn down the inventories of suppliers that have left us. And they become more impactful in the third, but still, we should have mid-single-digit millions of dollars net gain or incremental gain in the third quarter sequentially. And then as you go into the fourth quarter, we should get into the low-teens in net millions of dollars of net synergies.

James Sheehan
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Very helpful. Thank you so much.

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.

A

Okay.

Operator: Mike Leithead from Barclays. Your line is open.

Michael Leithead
Analyst, Barclays Capital, Inc.
Q

Thanks. Good morning, guys. If I...

Carl J. Lukach
Executive Vice President & Chief Financial Officer, Univar, Inc.
A

Hey. Good morning, Mike.

Michael Leithead
Analyst, Barclays Capital, Inc.
Q

Good morning. If I look at your slide 11 on synergies, I just wanted to follow up on Bob's question a bit earlier. It looks like you were originally expecting $100 million return on $150 million cash spend. Now that's about $120 million return on $225 million cash spend. So, I guess, can you talk about what areas or projects in the integration process are now costing you more than you originally thought, or maybe perhaps lower return than you originally thought?

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.
A

So, as I tried to explain, what we have is the ability to capture more synergy. And we're delivering on that and we're taking that and I think that's very exciting that we can do that. What we're also doing though, and about half of that additional $75 million is spend on technology which we're advancing, which we're bringing ahead, and that doesn't contribute to the $20 million additional savings. That's more savings which we think we can deliver as yet and [ph] un-numerated (01:01:02) but more said is that we believe we can deliver through systemically transfer, reducing our transaction costs.

So as Carl said, 20 basis points on that is $15 million. So think about in those terms. About half of the extra $75 million is there advancing ERP and digitization to get more benefit over and above the net $120 million. The extra $20 million comes from increasing the one-time integration cost from $150 million to ,whatever it is, $180-ish million, something in that order.

Carl J. Lukach
Executive Vice President & Chief Financial Officer, Univar, Inc.
A

And Mike, it's Carl. Let me just add to that. With this new estimate of one-time costs, we're crossing the line from pure integration of the two companies. We're crossing that line now into optimization of the consolidated enterprise. And what our work stream teams are coming back to us with is, hey, if we do this, it wasn't in the scope at the beginning. If we add this money, we'll add this functionality and there is a real payoff, and the lens that we're looking through on those requests is return on investment. So those look very attractive to us. It looks like very smart business to do that.

And then, I just want to remind you, Mike, that we also have another workstream going very actively on monetizing excess assets in the footprint and also optimizing the working capital level of the combined enterprise. Both of those workstreams are very active and looking very promising. We stick with what we said back in

September of 2018 that we expect to largely offset these one-time costs, certainly, the pure integration costs with the monetization gains from selling excess assets and also the working capital optimization.

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.

A

And I just want to clarify, I just want to add on one thing. I've said it in the narrative earlier on. As we look to invest in digital and in IT and this extra spend on this to advance opportunities that we saw in future years, we're doing against a very, very rigid structure that says it cannot disturb or put at risk the base integration. So, I don't want any concerns that we're trying to run away with ourselves. No. There's a very rigorous and disciplined process of integration. We'll do nothing which disturbs or puts at risk that integration program.

Michael Leithead
Analyst, Barclays Capital, Inc.

Q

No, that's helpful. I guess I was just trying to make sure I was grading fairly on the ROI that you guys are trying to measure against. So, to be clear, the $35 million to $40-ish million of broad and digital scope investment, none of – any potential return on that is in that $20 million of updated synergies that would be incremental at, I guess that's the TBD box on the right there, am I understanding that correctly?

David C. Jukes
President, Chief Executive Officer & Director, Univar, Inc.

A

So, you're absolutely right. None of that is in the net $120 million. That would be additional in the TBD box.

Carl J. Lukach
Executive Vice President & Chief Financial Officer, Univar, Inc.

A

Yeah. You're right. On slide 11, that's it. Yes.

Michael Leithead
Analyst, Barclays Capital, Inc.

Q

Okay. Thank you, guys.

Carl J. Lukach
Executive Vice President & Chief Financial Officer, Univar, Inc.

A

Great. Great, Mike. Thanks.

Operator: We have now reached the end of our Q&A session. I will turn the call back over to Heather for closing comments.

Heather Kos
Vice President-Investor Relations, Univar, Inc.

Thank you, ladies and gentlemen, for your interest in Univar Solutions. Given this is my first quarter here, I haven't got the chance to meet everyone yet, but I'm looking forward to it. If you have any follow-up questions, please reach out to the Investor Relations team. This does conclude today's call.

Operator: This does conclude today's conference call and you may now disconnect.