Univar, Inc.

Second Quarter 2016 Earnings Conference Call

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PRESENTATION

Operator:

Good morning. My name is Carol and I will be your conference Operator today. At this time, I would like to welcome everyone to the Univar Second Quarter 2016 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be question-and-answer. If you would like to ask a question at this time, simply press star, then the number one on your telephone keypad. If you would like to withdraw your question, please press the pound key.

I would now like to turn the call over to David Lim, Vice President of Corporate Development and Investor Relations at Univar.

David Lim:

Thank you. Good morning. Welcome to Univar's Second Quarter 2016 Conference Call and Webcast. With me today are, Steve Newlin, President and Chief Executive Officer; and Carl Lukach, Executive Vice President and Chief Financial Officer. This morning, we released our financial results for the quarter ended June 30, 2016, along with a supplemental slide presentation. The slide presentation should be viewed along with the earnings release, both of which have been posted on our website at Univar.com.

During this call, we will refer to certain non-GAAP financial measures for which you can find the reconciliation to the comparable GAAP financial measures in our earnings release and the supplemental

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slide presentation. As referenced on Slide 2, we may make statements about our estimates, projections, outlook, forecasts or expectations for the future. All such statements are forward-looking, and while they reflect our current estimate, they involve risks and uncertainties and are not guarantees of future performance. Please see our SEC filings for a more complete listing of the risks and uncertainties inherent in our business.

With that, I will now turn the call over to Steve for his opening remarks.

Stephen Newlin:

Thank you, David. Good morning, everyone. Let me start by saying it's a privilege to be here leading the Univar Team. As a member of the Board since late 2014, I've had the opportunity to interact with many people across the organization. Today, I look forward to leading our team's focus on driving profitable growth and growing the value of our Company. I spent my first several weeks as CEO meeting with the team and conducting consensus, strategy and business plan reviews to address our current state and to pinpoint opportunities for improvement.

Before Carl walks you through our second quarter performance, let me give you a few of my initial observations. We have a strong record on safety. It's at the core of everything we do. Our suppliers and customers value this and it's a key differentiator for Univar in the marketplace. We have the broadest product and service offering in the industry. Our delivery rates are among the industry's best. We offer our customers a full array of chemical products and services to help them reduce the number of distributors they use and in turn create value for them. Our supplier base is very strong. We carry terrific, renowned brands and have relationships that span decades. Large distributors like Univar give chemical producers the opportunity to simplify by consolidating their distribution channel. The supplier can trust one or two distributors of scale, makes sense to consolidate and our reach enables them to do this.

With our tremendous global scale, as the number one chemical distributor in North America and number two in Europe, we can leverage our costs through global networks to provide value to our customers and to our supplier-partners. We have great people at Univar. We have several key leaders in place and a high energy team, strong commitment and work ethic. We're in an industry whose fundamentals for growth are excellent toward (phon) an opportunity for superior earnings growth. Those growth fundamentals include output in trends, opportunity to lower unit transaction cost through operational excellence and digitization and consolidation opportunities. I expect our team to deliver industry leading growth. Our balance sheet is improving and I firmly believe our strategy is enriching our business mix, driving operational excellence, (inaudible) bolt-on acquisitions, is the right strategy. However, we have many opportunities to improve our culture, one that focuses on execution, accountability and profitability growth. We need to shift from a culture that prioritizes volume over value, but the immediate priority is on improving our execution, drive commercial greatness and operational excellence.

Let me talk for a moment about what I call commercial greatness, sales execution. We create a lot of value in the supply chain for our customers and for our supplier-partners (inaudible) will improve our abilities to sell and capture the value that it creates. We'll need to make some investments in talent and training to make sure we have got the right people and the right approach to sell our value proposition. We'll instill additional discipline and accountability into our sales management and for that matter, across our Company. We'll also modify our sales incentive program to ensure our rewards are aligned with our strategy and goals. Sometimes in business you can turn one dial and the impact is leveraged. Sales execution, the biggest lever we have, by improving our sales execution, we're going to become more valuable to our customers and our supplier-partners as we support their goal. We'll also become more strategic in how we approach markets. We will soon be conducting a comprehensive review of our product portfolio and market verticals, focus resources on the highest value growth opportunities. We've got some very talented people and we want to ensure they're deployed in the right areas.

In regards to operational excellence, we made progress improving the productivity of our operation through the introduction of Lean Six Sigma 18 months ago. We're managing our business better in areas

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that were in need of improvement, such as on time delivery, but there are many other opportunities to simplify, automate and (inaudible) processes.

We will reinvest a portion of our savings into initiatives to drive growth and efficiency. In addition to our sales force and marketing initiative, we will invest in technology. For example, we have opportunities to build and implement tools to reduce transaction cost with our customers and suppliers. We have many processes that are done manually today that can be automated. We'll look for ways to drive down cost to create more value in the chain.

Finally, let me just comment briefly on capital allocation. We plan to continue to pursue bolt-on on acquisitions to broaden our product and service offering. However, we do not intend to do anything that will make us more highly leveraged. We'll balance our M&A activities with debt paydown.

With that backdrop, I'll now turn the call over to our CFO, Carl Lukach, who will walk you through our second quarter results. Carl?

Carl Lukach:

Thanks, Steve. Welcome to your first Univar investor call as CEO. For everyone's benefit on the call, Steve, as he mentioned, has spent his first 10 weeks out at our branches and terminals, meeting with our employees and senior leaders and customers and suppliers assessing our performance, especially here in the United States. His experience in the chemical industry and distribution and in maximizing sales force execution is enabling us to rapidly identify new opportunities to create and capture value. We're all looking forward to working with Steve to actualize what we see as tremendous opportunities in front of us.

With that, let me review with you our second quarter results and our outlook for the remainder of the year, beginning on Slide 3. For the second quarter, our GAAP earnings per share improved from a loss of $0.12 last year to earnings of $0.29 this year. This was largely due to lower interest expense and the absence of one-time charges associated with our initial public offering last year and the debt refinancing that we also did last year, partially offset by a 34% increase in shares outstanding. Adjusted EBITDA in the quarter declined $20 million or 12% from $168 million to $148 million, as 8% growth outside the US was more than offset by lower USA EBITDA. On a currency neutral basis, EBITDA declined 10%.

Moving then to Slide 4, on a consolidated basis, our net sales were down 10%, that's 3% from lower volumes; 7% from lower average selling prices; and 2% from foreign currency translation; partially offset by a 2% benefit from acquisitions. The 3% volume decrease was from a combination of lower demand from oil and gas and from our EMEA restructuring. Excluding these two factors, global volumes grew 3%. Average selling prices globally were 7% below last year. While our growth profit percentage increased 110 basis points to 19.7%, our gross profit dollars declined $22 million from last year or 5%. Adjusted EBITDA margins declined 10 basis points to 6.6%, as lower costs were more than offset by the decline in gross profit dollars. As a result, our conversion ratio slipped to 33% on a consolidated basis.

Turning now to Slide 5, in our USA segment, Adjusted EBITDA declined 24% to $83 million, due to the decline in upstream oil and gas and lower growth profit dollars. Twenty one million dollars or a 7% decline in gross profit dollars versus last year, reflects margin compression from 9% lower average selling prices and 4% lower average gross profit per pound. USA volumes were down 4%, which was comprised of a 44% decline in our upstream oil and gas business and a 2% increase in our industrial chemicals and services businesses. Demand from our oil service industry customers declined each month sequentially in the second quarter and is now running at about a third below first quarter volumes, despite the slight increase in rig count that has recently occurred.

Prices are also down substantially. As a result, the upstream oil and gas market has become a very small contributor to our delivered gross profit in EBITDA each month. We are not including any improvement in 2016 market conditions in our guidance and continue to reduce our direct operating cost in this area. Revenue from our US-centric services businesses was up 11% in the quarter reflecting the acquisitions

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Of Weavertown and Bodine. Excluding acquisitions organic top line growth was 3% led by ChemPoint and its new product authorizations. Delivered gross profit was likewise up low double-digits in the quarter and year-to-date. In aggregate, these three service businesses now comprise 13% of our USA sales versus 10% last year.

We continue to invest in the future potential growth these businesses offer us. Our total USA operating expenses including delivery costs were about flat versus last year, excluding the impact of acquisitions. EBITDA margins declined 100 basis points to 6.9% in the quarter as a result of the lower gross profit dollars.

Let's move then to Canada on Slide 6. The underlying performance of our business in Canada was strong despite the impact of the Fort McMurray wildfires and a weak economy, especially weak in Western Canada energy markets. Volumes declined 7%, and sales declined 9%; however, Adjusted EBITDA increased 4% on a more favorable product mix and lower operating costs. On a currency neutral basis, Adjusted EBITDA grew 10%.

Our Canada results benefited from strength in the personal care, pharma, food and ag markets, partially offset by volume declines in our energy focused Western Canada business. We continue to see the benefits of productivity initiatives in Canada, with a 23% decline in outbound freight. Operating expenses overall declined 5% over flat on a currency neutral basis. The deflation in US dollar price chemicals was muted by the strengthening of the US dollar against the Canadian dollar versus last year. Average selling prices declined in Canada just 3% in the quarter compared to the 9% decline in the USA.

Moving then to Slide 7 and our results in Europe, Middle East and Africa, we had strong 22% growth in Adjusted EBITDA in EMEA, despite overall stagnant demand from industrial markets. Sales declined 2%, while overall volumes increased 3%. Our gross margin percentage increased 130 basis points to 22% reflecting the benefits of our mix enrichment strategy and the facility shutdowns we completed in 2015. Increased gross profit dollars was attributable to growth in our focus industries which includes personal care, coatings and adhesives, food and pharmaceuticals as well as strong margin management. Overall, our Adjusted EBITDA margin increased 140 basis points to 7% due to gross margin improvements and operating expense reductions from our productivity initiatives and facility shutdowns.

Moving then to Slide 8 and our rest of the world segment, of which approximately 85% of our revenues are from Latin America markets. Sales declined 12% on a reported basis, but increased 1% on a currency neutral basis, reflecting the sharp drop in value of the Mexican peso in the quarter versus last year and to a lesser extent, the Brazilian real. Reported EBITDA declined 32% but on a currency neutral basis, it was down 21%. Our business in Latin America was negatively impacted by the continued recession in Brazil, as well as foreign currency translations. Lower operating expenses were not enough to offset the decline in gross profit dollars.

We remain cautious on the weak macroeconomic environment in Brazil and the impact that it's having on slower industrial production there. In Mexico, however, despite the weak economy, sales volume increased 4% from market share gains and was the primary driver of strong double-digit EBITDA growth on a currency neutral basis.

To sum up then, for our three segments outside the US in aggregate, we grew Adjusted EBITDA 8% on a reported basis and 12% on a currency neutral basis, in line with the double-digit currency neutral growth we reported last quarter.

Moving then to Slide 9, like the first quarter, our cash flow was again strong in the second quarter. Adjusted operating cash flow was $112 million, that's Adjusted EBITDA less change in net working capital, less cap ex. This equates with a 76% after cap ex cash conversion rate and a 5% operating cash margin. Our cap ex of $22 million was down $9 million as planned or 29% lower. For the full year, we continue to expect cap ex to be less than $100 million, down more than $45 million from last year. Cash

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taxes were $1 million in the quarter versus $6 million last year. This is due to a higher mix of earnings in geographies where we are able to utilize our tax loss carry-forwards.

In 2016, we expect our full-year cash taxes to be under $5 million compared to the $38 million we paid in 2015. As a result of the higher mix of projected earnings in tax loss carry-forward jurisdictions, our effective tax rate for the quarter was 2%, considerably lower than last quarter and our guidance. We expect our full-year effective tax rate to be approximately 15%, down from the 30% guidance we provided last quarter. Cash interest expense of $30 million was down $25 million or 46% from last year and down $14 million from the first quarter, due to the timing of interest payments. We continue to expect full-year cash interest to be about $150 million which would be $11 million lower than last year, again reflecting the timing of interest payments.

Pension contributions of $8 million were down 34% from last year. We continue to expect full-year contributions to be down about $30 million from the $60 million we paid into the funds last year. Lastly, our cash non-operating expenses of $10 million in the quarter were down about 73%. Our priorities for use of cash continue to be: to reinvest for growth in our asset light business model, including digital projects, that will lower our transaction cost per unit; make targeted attractively priced, value-creating bolt-on acquisitions and to pay down debt. Given the sluggish growth in demand from global markets, we think it's prudent to allocate more of our cash flow this year to debt reduction.

As a reminder, we have $40 million of scheduled debt amortization payments this year. Last quarter, we indicated to you that we would aim to pay down double that amount. We are on track to meet or exceed that goal. Slide 10 details our debt profile. Net debt at quarter end was $2.9 billion, down $25 million from year end, but up $23 million from a year ago. Our leverage ratio of 5.1 times is in line with last quarter. Our current total liquidity improved from $761 million in Q1 to $825 million at the end of Q2.

Our cash interest coverage is 4.5 times, that's up 4 times in the first quarter and 2.8 times a year ago. Our weighted average interest rate at quarter end was 4.5% pre-tax. While our interest rate flowed (phon) through the market, we have hedged our interest rate risk to achieve approximately a 70%/30% fixed floating ratio. Our return on assets deployed in the quarter was a solid 20.1%, well above our cost of capital, but down from last year mainly due to a decline in oil and gas business.

Turning now to Slide 11, as we look ahead into the second half of 2016 and take into account the changing dynamics in the global markets, we expect continued sluggish industrial demand, lower chemical prices than last year and negative foreign currency translation impact related to Brexit. These headwinds we partially offset by the benefits of our organic growth initiative, growth and services businesses, acquisitions and savings initiatives.

As a reminder, we have three separate savings programs underway: our upstream oil and gas; cost reduction; our recurring Lean Six Sigma project savings, which are primarily in our supply chain area and the streamlining actions that we announced in the fourth quarter of 2015 which targeted a 3% reduction in our global workforce and the closure of several smaller sites in the USA, resulting in at least $10 million of annualized cost savings by the end of this year.

Taking into account these pluses and minuses, we expect second-half Adjusted EBITDA to be slightly below the $282 million Adjusted EBITDA we reported in the first half of the year, with second-half Adjusted EBITDA split about equally between the third and fourth quarter. As a result, we expect full-year Adjusted EBITDA to be between $550 million and $565 million. We have not included in our outlook any further softening in the European or global economy from Brexit and we are not counting on any increase in demand from chemicals from the upstream oil and gas market.

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

Stephen Newlin:

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Thanks, Carl. Let me just wrap this up with a few additional comments. There's no doubt we faced some challenges both internal and external. But we also have a golden opportunity in front of us. We have the right strategies, solid teams, broad products and services offerings, outsourcing trends in our favor and tremendous assets. Our businesses outside the US has been performing respectively, despite a difficult economic environment. In the first half of the year, our EBITDA outside the US grew modest double-digits currency neutral. EMEA and Canada are growing double digits. Latin America is holding up in an extremely challenging environment.

We will continue to refine and build on our businesses in those regions, but our largest business, US, which represented 65% of our EBITDA in 2015, is significantly under-performing. So getting that right is our highest priority. We're already implementing several of the changes in improvements I mentioned earlier. I'm very pleased David Jukes has moved in at the leadership role in our US business. David was the architect behind our EMEA turnaround. He and I are completely aligned on the changes we need to make and his leadership is already having an impact. However, altered change takes time.

Our sales force has been highly empowered (inaudible) the accountability that should be expected from that degree of autonomy. We need to invest in training, adjust our incentive structure and instill rigor and discipline across the organization. We also need to invest in market segmentation and technology tools to drive growth. Our market share is only in the teens, and more than 80% of the potential customers in other hands. We need to go after that. I expect it will take us a few quarters to see the real impact of our changes, but I have no doubt we'll drive above market profit growth. If there's one thing I have learned in my 37 years in the chemical industry, is that with the right mindset and skill sets, growth can be achieved in all market conditions by focusing on commercial greatness and operational excellence. Those are our clear priorities.

While we have much work ahead of us, I'm excited about the passion and commitment shown by our team members. We have a tremendous opportunity to be truly great at what we do as a Company, basically deliver chemicals and chemistry solutions to customers. We absolutely intend to make the most of it.

With that, I'd like to now open it up for questions.

Operator:

As a reminder, if you would like to ask a question at this time, please press star, followed by the number one on your telephone keypad.

Our first question this morning is from Bob Koort from Goldman Sachs. Your line is open.

Bob Koort:

Thanks, good morning.

Stephen Newlin:

Hey Bob.

Carl Lukach:

Hey Bob.

Bob Koort:

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Steve, you made the comment you thought the US was significantly underperforming. I'm just wondering if you could give us some metrics you judge that by and maybe benchmark where you stand relative to those metrics or to competitors and how you draw that conclusion.

Stephen Newlin:

Sure. Let me try and spell that out a little bit further for you, Bob. First of all, when you compare us to other public companies and there are not a lot of them in the space, I look at our productivity levels, and we're not at the top of the list. So we have a lot of room for improvement. Whether that is based on dollar carried per person in terms of profitability or growth productivity in terms of new accounts flowing in, gross contribution, all those metrics say we have a lot of opportunities for improvement, looking head to head in our space or looking backward in my past experiences.

So, it looks like we have made some errors in how we reward the folks. I think they've been doing much of what we thought we wanted them to do but we're redirecting them right now and we'll make—and they've been alerted to some changes that we'll be making in the compensation side of things. The first of the year, we didn't feel it was appropriate to change things now, but all these metrics where we seem to have opportunities, we're going to make adjustments to the comp plan to create the right behaviors.

Bob Koort:

Then what lessons can you take from what's pretty impressive results in Europe? How much of what's been done there can be replicated in the US operations, or is it fairly unique to what you've done in Europe?

Stephen Newlin:

No, I think it's a great question. While I haven't spent as much time in Europe because two-thirds of the Company last year was based right here in the US and that's where our challenges are, David Jukes was brought here for a reason. This was of course a decision made at the Board level. What he has done there can certainly be replicated here in the US. He is, I think, following a similar approach. We recognize that there are some cultural differences, but in context I think much of the work that he has done is reproducible.

The productivity of all of our assets will be explored, the way we go to market, the market verticals that they've had good success in, in Europe have very strong similarities to the US. I'll mention one other thing here, Bob, that David did a super job of in Europe and that is working with our producer-partners. We need to do a better job with that here in the US. David has relationships that I think can be leveraged (inaudible). So, I think we'll continue to gain some benefit from his experience there and sort of doing much of what he had completed over in EMEA.

Bob Koort:

Got it. If I could just for clarification, Carl, I wasn't sure if I missed it. Did you give an energy run rate comparison because I thought I recalled last call you guys thought maybe it was bottoming but I thought maybe I heard something different on your remarks this morning. Can you tell us?

Carl Lukach:

Good to hear, Bob. It is different. We started out this year assuming that the Q4 volumes in upstream would continue with that depressed rate for the year. What we've actually experienced was in the first quarter they were running volumes into that market space and were running about 25% below the fourth quarter. That decline continued and increased in the second quarter. Sequentially each month, our volumes now are running about 35% below the depressed fourth quarter levels in upstream. So the headline there is that in that market space, it's definitely worse than we forecast. We've got more to do on

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the cost side. As I mentioned on the call, it's representing just a trickle of gross profit contribution and EBITDA contribution.

Bob Koort:

Got it. Thank you.

Operator:

Your next question comes from Roger Spitz from Bank of America Merrill Lynch.

Chris Ryan:

Hi yes. This is Chris Ryan on for Roger. Thanks for taking my questions. The first question is within upstream oil and gas, are the main drivers there, caustic soda, ACL and perhaps guar? Was it lower caustic soda prices that was the principal driver?

Carl Lukach:

Chris, it's lower volumes of all those products and especially lower prices of hydrochloric acid which has really felt the brunt of the drop in demand from ACL into the fracking industry. So you've got it right, but it's largely the volume drivers.

Chris Ryan:

Okay. The US upstream oil and gas volumes were down sequentially each quarter in Q2 2016. Have you seen that decline stop in July? If not, when do you expect that to bottom out?

Carl Lukach:

Well, July was very much like June. We're running it at these low depressed rates. When that's going to bottom, there's a lot written out there in the media about that. We'll continue to follow that and look for your consensus view on that.

Chris Ryan:

Okay. Then EMEA's Q2 '16 volumes were up 3% year-over-year. In the introductory remarks, you called out 3% volume growth, excluding upstream oil and gas and EMEA restructuring. What was the EMEA volume growth excluding the restructuring?

Carl Lukach:

Our oil and gas business in Europe is quite small, so it's right around that 3% volume growth. But I don't want to get a misunderstanding there. We still see very sluggish absence of growth from almost all of the vertical markets in Europe, as we have here in the United States, the industrial markets. The 3% volume growth was very customer product specific and is not a change in that overall market view that we have.

Operator:

Your next question comes from the line of Allison Poliniak from Wells Fargo. Your line is open.

Allison Poliniak:

Hi guys. Good morning. Could you just talk a little bit about the competitive environment right now with the challenges? I know on the industrial distribution side, just because this length of the weakness has

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been ongoing that some of the smaller competitors are starting to really struggle. Are you guys seeing that in your area as well?

Stephen Newlin:

For us, it's a day-to-day process of being out there and showing the value that we bring to the customers. I think that really it's on us to influence and shape the marketplace. So we haven't noticed any differences. It's sort of just ongoing. You've got regionals out there that may not have the breadth, but they may do some things quite well, but they aren't going to have the breadth of offering. They're not going to have the assets that we have. I think it's on us to go collect that and win that business and earn it from the customers by selling our value proposition. We haven't seen any real behavioral changes in the marketplace in the 2.5 months that I've been here. I haven't heard about it at the Board level before that. So, I think it's pretty steady state on that front.

Allison Poliniak:

Okay, great. Then, Steve, you talked about your focus obviously on above market growth. As we look over the next five years, what would be a realistic goal or targeting in your view? Is it 100 basis points, 200, 300? How can we think about that as we go forward over the next few years?

Stephen Newlin:

I've had a history of 35 out of 37 years of double-digit growth going back to days as a seller, that's an expectation and mindset that I have. I'm not going to change that. I'm too old to change my view on that at this point, because I think a lot of it is more up in your head and in the execution than it is in any other exogenous conditions that might exist out there. So, I think that the growth fundamentals here are outstanding. We have these regionals that I think we can pursue and capture business from. We have the multi-nationals that give us opportunities where I think we have some competitive advantage that we need to take full advantage of. There's a trend toward this sort of outsourcing, if you will. There's a trend toward supplier-partner consolidation. So, there are a lot of good things that are working in our favour and if we—when we get our execution to the point of optimization, I think we'll have strong solid double-digit growth for a long time in the future. On top of that, we have, I don't know, 16% to 18% of the market, a small percentage of the market, a solid position but it is still a great opportunity for us to grow—plenty of opportunity (inaudible). We aren't calling on but a small percentage of the potential that exists out there. So, we have to find ways to get more productivity out of our sales organization, to make more calls, to make better calls and execute better on all fronts.

Allison Poliniak:

That's great. Thanks so much.

Operator:

Your next question comes from Karen Lau from Deutsche Bank. Your line is open.

Karen Lau:

Thank you. Good morning. Carl, I think you mentioned US GP per pound was down 4% in the quarter. Could you remind me what was the number last quarter and what are you expecting in the second half?

Carl Lukach:

Karen, I'm going to have to get back to you on last quarter. It was not down as much as we had in the second quarter. Then as far as going forward goes, we're not real bullish but we're taking actions to stop

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that decline and turn that up. So we don't have a number to put out as a forecast for the third quarter, but certainly the pressure is up.

We are seeing some green shoots, if you will, on price increases for certain products out there that will help. As we said last quarter, our sense is that chemical price is fully adjusted to lower oil sometime early in the year and have been bouncing around there for a while and now we think that there's a general sense of price increase in the marketplace that we're attempting at. We do see that with a few products, green shoots, early stages, but we'll see if it goes positive there.

Karen Lau:

Okay, sounds great. Steve, so just along the lines of growing the GP, I think you mentioned focusing more on capturing value instead of volume, changing the mindset. I think that implies driving higher GP dollar per pound. Is that something that you can drive meaningful improvement if the pricing environment kind of remain where it is and the demand level remain low? I'm assuming a lot of the GP improvement has more to do with pricing as opposed to costs. Is that something you can drive if the demand level remains pretty muted?

Stephen Newlin:

So, I want to build our Company to perform well no matter what economic climate that we're in. So if we get a little tailwind, we'll do even better, but I want us to build an organization that succeeds and has well above market growth under any conditions. To do that, we're going to have to work on all those levers.

On the cost side, we've got a lot of assets and this is a pennies business. We need to ensure that those assets are optimized. We're working on that but we still have tremendous opportunities on that front. Certainly pricing is important. By pricing, I don't want to mislead anyone here, pricing is a lot more than how much it is per pound. Pricing is, what do you do in terms of freight? What do you do in terms of giveaways? Do you add service in or not? So there are a lot of aspects. The terms are another aspect of pricing that we need to manage. For us, it's more about building a discipline into the organization that as someone ships something back because it's a mistake on their part, that's sort of their responsibility, not ours. If we make a mistake, we accept the full responsibility for that, so little things like that.

How much credit you issue for something that's returned, is all about the customer interface and the relationship. Same thing goes with the suppliers. Suppliers want us to succeed. They want us to help them succeed through our growth. So, developing better, stronger relationships with those producer-partners is another aspect of this that we've got to work on. So I wish I could say it's only one thing. Pricing is certainly front and center to that. There's no question about it. Again, pricing means all those things I just described and a few more, but we need to work both ends of this equation. At the customer interface as well as backward into the supplier and everything through the chain we certainly have some higher profile opportunities and we're going to be thoughtful about how we prioritize those. We've already I think launched some things to make improvements on all fronts, kind of cherry picking a bit, the easier ones first and some of these are going to be a lot longer in duration.

I'll give you one other aspect of this. There's a mix element of this that is really important. If I'm a seller and I'm going to spend my X amount of hours that I have out selling, I'd like them to be working on areas that are going to provide the greatest reward for our shareholders. That's not necessarily just in the bulk part of our business. Specialties offer some terrific margin opportunities for us and they're in our portfolio, but we really haven't distinguished what markets we prefer to be in or where we want our sellers to spend their precious little time.

Karen Lau:

Okay, that's great color. So if we follow the playbook in EMEA how they were able to very significantly improve the margins, I think you may have walked away from a lot of—some of the lower margin

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businesses. Should we expect that to happen in the US as well, as you take more actions to improve the productivity there?

Stephen Newlin:

Yes, that's a great question. I feel like it's a little bit of a trick question, but I'm going to answer it as honestly as I can. So, again, I have a history of this. I think that in business, you have to have a situation where it's mutually beneficial. Some customers are so transactional that there's no recognition of the differentiation or the value that you bring. In cases like that where we really can't do anything differently than anybody else, if someone is willing to take a negative margin or not earn money on an account, I would say that's where I'd rather have them deploy their resources than us deploy ours.

So there will be some cases where we're in arrangements that are losing arrangements for us and we're going to have to carefully and selectively and thoughtfully get out of those. We won't do it in an arrogant way but we'll do it in sort of a business manner that says look, this isn't making any sense for us. If this is the way you need to do business, there are probably others who can do this for you and use our time. This is about resources and where our time is. So, we've got to make sure that we're working on the right things and the opportunities that can reward us with a fair and appropriate return. I'd answer it that way.

Karen Lau:

Okay, that makes sense. Maybe the last one. You talked about some of the—taking on some digital projects and automating some of the processes. I recall you guys scrapped the SAP project a couple years ago. Do you need to ramp-up the investment on the IT side to implement some of these projects or are we talking about small incremental cap ex here?

Stephen Newlin:

Yes, don't have any plans for enterprise software platform. It would be nice if we had it, but we don't need it. Where we really want to spend our money and we're going to be careful in how we allocate it, are on things that can help us grow or things that can help our productivity. We have really a manual process. If you go through our warehouses and they do an excellent job but there's so much manual there. We need to understand where those assets are from when they get to that plant until they get to our customer's site.

This is not expensive or difficult to do. So, we're going to invest in that front. We see some eCommerce opportunities to make some modest investment, to make sure we're capturing some business that's relatively easy to gain by customers that aren't looking for as much technical support or the service component that we add to our core business. So those would be the two areas that I wouldn't expect a significant ramp-up in spend on those fronts.

Karen Lau:

Okay. Thanks guys. Thanks very much.

Operator:

As a reminder, if you would like to ask a question over the phone, please press star, followed by the number one on your telephone keypad.

Your next question comes from Ryan Merkel from William Blair. Your line is open.

Ryan Merkel:

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Thanks. Good morning everyone. So just stepping back for a minute, just given the challenges in the industry, are you still seeing the OEMs willing to shift more business to distribution versus direct because I know that was a trend that you guys have discussed.

Stephen Newlin:

Yes, I think it's case by case, but I think this is something that we can influence and shape based upon the strength of our relationships with our suppliers. One thing I learned in the distribution business some time ago is, those suppliers and that relationship with those partners is every bit as important as with your customers and maybe even more so. We need to be a little more straightforward and nurturing on that front and give our supplier-partners reason to want us to do more for them. So this trend has occurred, we simplify their lives, when they can consolidate down to one or two major suppliers, it's a lot less activity and risk on their part. We operate with this incredible safety record and that's very important to these potent brands. I would put our record on that front up against anyone. We have a lot going on. We have all these assets, this large footprint and the scale to get there. We have a knack for understanding in the middle-sized accounts that they wouldn't go direct in. Understanding where bad debt risk is and whether that can be taken on. We take that for these supplier-partners. We have this ability to provide a broader offering than they will selectively, so I think the fundamentals are outstanding here and we're going to continue to develop those relationships with our supplier-partners and continue to take advantage of this trend that has been emerging for the past several years on this front.

Ryan Merkel:

Okay, good. Thanks for that. Then secondly, Steve, you mentioned a goal to deliver consistent and superior growth. I'm wondering what is a reasonable range of sales and EBITDA growth in your mind when end market conditions get a little bit better here?

Stephen Newlin:

Sales growth, I'm really reluctant to mention, because we may have a little bit of pruning to do. I don't know enough yet to know—to put any scope around that. So I know that we have accounts where we lose money straight up and we're going to fix that one way or another. I don't want to be bound to a top line number that isn't helpful to our EBITDA and ultimately EPS number. But I've mentioned earlier, I've always been a double-digit growth expectation and deliverable guy and I'm not changing that now. So, give us a few quarters here to get the house fully in order. Again, some of you know me, I define double-digits as a range between 10 and 99. It's not going to be 99, but I hope it's better than 10 as well. So I would just say, leave it at the double-digit number.

Ryan Merkel:

Okay. Thank you.

Operator:

Your next question comes from Jim Sheehan from SunTrust Robinson Humphrey. Your line is open.

Jim Sheehan:

Good morning. Could you talk about specifically what impacts you are seeing or expect to see from Brexit? Also what is your FX headwinds currently? Can you just update us on what the specific EBITDA headwind from FX is in your guidance?

Carl Lukach:

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Okay, great. Hi Jim. Good morning. Well we went in to this quarter three months ago expecting FX translation headwinds to diminish. I guess everyone was in that boat. With Brexit though, we went in and added additional FX translation losses from the 15% devaluation of the pound and a little bit on the euro. There was a knock on effect on the euro. You add the two together. We have an additional $6 million of EBITDA headwind in the forecast for Brexit that we didn't have three months ago, so that's the quantification of it.

Now, I want to be clear to make sure that we're not dialing in any Brexit impact in terms of additional slowing of the UK economy or the European economy or the global economy for that matter. So we're continuing to just straight line sluggish industrial production growth, but that's it on the FX front. In the second quarter, Jim, it was as we predicted, a lot less. It was about $3 million in the second quarter.

So good news on FX translation and I emphasize, translation, it's come down from double-digit last year per quarter to I think it was $6 million in the first quarter back to $3 million in the second quarter. Now, it looks like we're going to go back up to those mid single-digits going forward in the second half.

Jim Sheehan:

Great. In EMEA, you talked about some product mix improvement and you've got more pharmaceutical finished goods in the mix there. How much is that mix improvement contributing to your margin benefit there? Is that type of product mix improvement something that you can replicate in the USA?

Carl Lukach:

It's pretty broad-based, the European verticals that were up. But food ingredients was up. Personal care was up. The Pharma was up, as you mentioned. We do expect that to continue, the Pharma. Now replicating that to the US, different dynamics region by region, but I wouldn't jump to that.

Stephen Newlin:

Those same markets exist in a greater degree of strength in the US than even in Europe. So I think that there are some approach and style differences, some executional differences that we need to make some adjustments on here to better penetrate those markets, but certainly the opportunities are, I would say, bigger here than they are in EMEA.

Jim Sheehan:

Great. Steve, can you comment on what your target leverage is for the Company? When would you expect to achieve that?

Stephen Newlin:

I'll give you a long term target of, I'd like to be 3 or sub-3. Two and a half to three, I think is a great range for a Company like this, allows us the freedom to do a lot of things without, you know, and still be able to sleep very well at night. So that's where we'll head. I think you'll see a lot of balance in how we approach getting there, whether it's debt takedown, growth of EBITDA which also helps drive that of course and continuing to make some appropriate and selective acquisitions, I think that part of our strategy doesn't change. I think that that was mapped out very well in the past and I love that part of what we're doing here.

Jim Sheehan:

Thank you.

Stephen Newlin:

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Okay. I appreciate all the questions and the input here today. I look forward to getting out there. It's been sort of a immersion (phon) here in the last 75 days or so. Come mid-September, we'll be spending some time out there getting to know those of you who I haven't had the privilege of meeting yet and reacquainting with those of you that I've worked with over the years in the industry. So thank you for your time and your questions today. Good luck with all of you and we'll be seeing you soon.

Operator:

This concludes today's conference. You may now disconnect.

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