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UNVR.N - Q2 2020 Univar Solutions Inc Earnings Call

EVENT DATE/TIME: AUGUST 07, 2020 / 1:00PM GMT

OVERVIEW:

Co. reported 2Q20 constant-currency net sales of $2b, net income of $1.8m and EPS of $0.01.

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Univar Solutions' Second Quarter 2020 Earnings Conference Call. My name is Carol, and I will be your host operator on this call. (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 Anne Kos - *Univar Solutions Inc. - VP of IR*

Thank you, and good morning. Welcome to Univar Solutions' Second Quarter 2020 Earnings Call and Webcast. Joining our call today are David Jukes, President and Chief Executive Officer; and Nick Alexos, Executive Vice President and Chief Financial Officer.

Last night, we released our financial results for the second quarter ended June 30, 2020, and posted to our corporate website at univarsolutions.com a supplemental slide presentation to go with today's call. The slide presentation should be viewed along with the earnings release, which has also been posted on our website.

During this call, as summarized on Slide 2, we will refer to certain non-GAAP financial measures for which you can find the reconciliations 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 and/or expectations for the future. All statements are forward-looking, and while they reflect our current estimates, 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 and our expectations for the future.

On Slide 3, you will see the agenda for the call. David will start with second quarter highlights and end market trends. Nick will walk you through our financial update, and then David will close with progress on our Nexeo integration and our business strategy. Following that, we will take your questions. With that, I'll now turn the call over to David for his opening remarks.

David C. Jukes - *Univar Solutions Inc. - President, CEO & Director*

Thank you, Heather. And good morning, good afternoon, and good evening to everyone, and thanks for joining our call. Our mission at Univar Solutions is to streamline, innovate and grow. And I'm pleased to see our progress reflected in our Q2 performance, which remains solid as we continue to adapt during these challenging times and deliver results. As a company that is always serious about safety, this remains our highest priority for our employees, our suppliers and our customers.

Key highlights from the quarter are: We delivered solid earnings beyond the upper end of our expectations in a challenged environment. Although sales were down versus the prior year, we were able to partially mitigate the COVID and economic headwinds by selling to new customers, disciplined margin management and cost reduction. We continue to monitor changing markets and meet new demand patterns for critical products. I'll speak more on trends in a moment.

We had strong cash provided from operations of $152 million, ending the quarter with liquidity of $815 million, above the $750 million to $800 million guidance range.

With all our sites fully operational and the strength of our supplier relationships, we were able to serve customers and met the high demand for household cleaning and sanitization products that were in short supply as well as improve our product mix, enabling margin lift.

Our Nexeo integration remains on track. As you saw in our release last night, we've accelerated our strategy to streamline operations and put digital firmly at our core with a program we are calling Streamline 2022 or S22 for short, which Nick will speak to in greater detail. A key enabler of this program is a range of senior organizational alignments, providing me direct functional reporting of the North American segment. We continue to advance our digital capabilities and made progress on our sales force effectiveness, attracting more new customers, and we continue to streamline our business with the disposal of some nonstrategic assets.

And before I speak more on trends, I want to provide a brief update on our COVID-19 go-forward plans. For our employees that are working remotely, return to our work site remains a voluntary process. Currently, we have return-to-office-site pilots at our global headquarters and a few other sites around the world. We're closely following WHO and CDC guidelines, whilst having PPE on site, new safety protocols and continued robust cleaning practices.

We also continue to monitor our customer and supplier closures as well as reduced production schedules in each region on a daily basis. As compared to the prior year, excluding the Environmental Sciences divestiture, April sales were down mid-teens, May sales were down mid-20s and June sales, down low teens, with a pickup occurring in the back half of the month, but still down year-over-year.

Our end market displayed a wide range of demand patterns by region. Globally, we saw strong demand in Consumer Solutions, particularly products to essential end markets related to health care needs. Personal care started to see an uptick in demand during June as salons and shopping centers reopened. Our general industrial market was softest in May, but saw improvement sequentially during the back half of the month. Refining and chemical processing markets were down significantly in the U.S.A. and Canada, affected by both demand and pricing in our energy business. And although we are not reinstating full year guidance, I can say the sequential sales improvement we saw through the quarter has continued into July. The actions we've taken to date and the steps we plan to take going forward, including through our S22 program, are designed to position our business for sustainable success as the pandemic evolves and into the future.

Looking ahead, we believe that our industry vertical focus, global network of solution centers along with our digital platform will continue to deliver comprehensive solutions to our customers and capture new business and market share despite this complicated macroeconomic environment.

Now let me turn the call over to our CFO, Nick. He'll walk you through our second quarter results and our outlook, then I will close with an update on our Nexeo integration progress and highlight our key business strategies.

Nicholas William Alexos - *Univar Solutions Inc. - Executive VP, CFO & Principal Accounting Officer*

Thank you, David. Hello, and good morning to all on the call. Univar Solutions delivered solid performance in the quarter, ahead of our expectations. Our operational agility, the diversity of our product portfolio and end markets, our digital investments and cost reductions significantly offset demand decline.

Constant currency net sales of $2 billion were down 20.6%. Excluding results of Environmental Sciences from last year's financials and FX, we estimate net sales were down approximately 16.5%. Gross profit, exclusive of depreciation, was lower by 15.3%, $489 million or 13.5% on a constant currency basis. Our gross margin expanded by 200 basis points to 24.3%, driven by the favorable product and end market mix. When excluding results of Environmental Sciences from last year's financials, we estimate gross profit, exclusive of depreciation, was down 8.8% on a constant currency basis.

Second quarter adjusted EBITDA of $163 million was lower by 18.8% and 16.6% on a constant currency basis. Adjusted EBITDA was unfavorable due to lower demand in markets globally, the Environmental Sciences divestiture and price deflation affecting certain product margins. The decrease was partially offset by favorable product mix, interim cost reduction measures and the realization of Nexeo synergies. Excluding Environmental Sciences businesses from last year's results, adjusted EBITDA was approximately 11.3% lower on a constant currency basis.

During the second quarter, we captured net cost synergies related to the Nexeo integration of approximately $13 million, which cumulative year-to-date is $30 million of the planned $35 million for 2020. Based on internal estimates on a global basis versus the Q2 adjusted EBITDA of $163 million, we believe we benefited by $20 million from nonrecurring product mix margin in the quarter. We also believe the COVID recession impact on demand was approximately $55 million versus prior year, which was partially offset by $17 million of non-Nexeo cost reductions. Absent these unique COVID impacts collectively, we would have had an adjusted EBITDA of approximately $180 million for Q2.

With continued uncertainty in the economy, we estimate for Q3 and Q4 of 2020 a net $20 million per quarter of COVID-related headwinds versus the prior year results. Q2 net income is $1.8 million or $0.01 per share compared to net income of $16.3 million or $0.10 per share in the prior year quarter. The decrease in EPS was primarily due to the lower gross profit, the impairment charges and fair value adjustments on warrants issued in connection with the Nexeo acquisition. These were partially offset by lower warehousing, selling and administrative expenses as a result of cost-reduction measures and lower integration-related expenses and stock-based compensation.

Adjusted earnings per share for the quarter was $0.33 compared to $0.42 in the prior year period. Working capital was our biggest source of cash during the quarter, reflecting the countercyclical and seasonal nature of our business model. Net cash from operations versus the last year was partially offset by the lower net income and, the prior year second quarter did include the payment of a large onetime legal settlement.

Capital expenditures for this quarter were $20.9 million and integration-related expenses were around $14 million. We ended the quarter with cash on hand of $547 million for a total liquidity, including availability under our asset-based credit lines of $815 million. This is in excess of our guidance, principally due to the timing of net working capital.

Our ROIC was 9.4% for the quarter versus 9.9% last year. We expect these figures to improve as we continue to capture the synergies from integration as well as grow the business. We ended the quarter at a 3.6x leverage ratio, down from 4.1 the previous year.

Moving on to Slide 8. We have aggregated the key metrics across our 4 reporting segments and provided detail in the appendix. Across our 3 largest regions, we saw a top line decline due primarily to lower global demand and partially offset by higher demand for products in essential end markets.

Latin America continued to benefit by growth in its range of markets. In the U.S., excluding the impact of the Environmental Sciences divestiture, sales would have been down approximately 22%. The higher demand in certain central end markets also had a significant impact on gross margins as more higher-margin products were sold. Univar Solutions benefited by its advantaged supply and operational position across all its geographies to serve these essential markets.

Going forward, if some of the supply lines have freed up, we'll continue to service the marketplace but at a more normalized return. All reporting segments showed a positive impact on the delivered gross margins, except for Canada, where the mix impact was not significant enough to offset deflationary headwinds in some commodities. Adjusted EBITDA margin also expanded with strong performance in EMEA and Latin America. U.S.A. adjusted EBITDA margin expanded by only 20 basis points as the results were further impacted by the contraction of the energy market. In Canada, planned cost reductions were not sufficient to offset the delivered gross profit decline.

Moving on to Slide 9 for an outlook update. Despite a good Q1 and Q2 and relative stability in our end markets today, our guidance remains withdrawn for the full year 2020, given the uncertain economic environment. As David mentioned, sales trends in Q3 so far are comparable with the latter part of Q2, with some signs of continued demand recovery. However, keep in mind, Q3 typically involves seasonal lows given the holiday period in EMEA.

Full year Nexeo net synergies are expected at $35 million, taking into account the delays in some of the SAP implementations. We also continue to expect over $40 million of incremental cost savings for the full year, of which about half are reductions versus the prior year cost. Our S22 actions should also benefit margins in the second half of 2020.

We are diligently managing our working capital and expect it to remain between 13% to 14% of annualized net sales of Q4 by year-end. As we noted, while Q2 generated strong cash inflow from net working capital, we expect Q3 to be a seasonal use of working capital with a positive reversal in Q4 as it historically does with our year-end seasonality.

CapEx is expected to be approximately $115 million, which is in line with prior guidance, while Nexeo integration costs may come in lower, now in the range of $60 million to $70 million. Cash use in 2020 of other expenses and timing of accruals should be around $90 million, within our prior guidance, of which $32 million has already been spent year-to-date. The full year estimate also includes Q3 and Q4 S22 cash costs of up to $20 million.

As discussed earlier, we exceeded our liquidity guidance in Q2, although Q3 will be a use of cash due to the seasonal effect on working capital and other cash needs. We continue to target liquidity to be in the range of $750 million to $800 million by year-end. And versus our last guidance, we now expect to end the year with approximately $100 million more cash available for debt paydown before the impact of any divestitures, asset sales or any acquisitions.

Beyond 2020, our only significant other use of cash will be approximately $65 million in 2021 as the final portion of our Nexeo integration plan that totaled $225 million. And we still expect to achieve the targeted net Nexeo synergies of $120 million by Q1 2022.

As David mentioned, with the onset of COVID and the subsequent recession, we have accelerated certain actions to reduce costs, streamline our operations and improve business performance, particularly in North America. For our press release yesterday announcing our S22 program, we are targeting an EBITDA margin run rate of 9% by the end of 2022 and a net leverage of 3.0x by year-end 2021. Other elements of our program are as follows: We have just signed this week a binding agreement to divest 2 nonstrategic industrial emergency response and cleaning businesses. We expect this transaction to close in Q3.

During Q2, we recorded a $16 million impairment charge related to these assets and expect to now record a further loss of approximately $15 million in Q3. Although we view these businesses as nonstrategic, we are committed to growing our nationwide chemical waste services business, ChemCare, as we believe it holds great promise for synergistic growth and is also supportive of our sustainability ambition.

We have targeted other portfolio management and business alignment actions that may result in additional $35 million of charges yet yield positive cash flow, assist with working capital management and would be accretive to our margins going forward. Of these charges, we expect up to $20 million to be cash expense, which we have already reflected this -- in our year-end liquidity outlook. We expect these and additional portfolio activities could yield greater than $200 million in pretax cash proceeds with timing through 2021.

As we focus on creating long-term value for all our stakeholders, we have aligned our management to drive growth and operating efficiencies. And through our S22 program, we are confident in achieving the target EBITDA margin of a 9% run rate by the end of 2022, with more details to be provided on our 2021 guidance call.

It is clear in many ways that our company has operated very well during this challenging period, while keeping our Nexeo integration and strategic plans on track and initiating additional measures designed to accelerate our market share growth and improve the cash flow profile of the business. We also continue to target free cash flow in a more normalized economic environment of $325 million to $375 million. With that, I'll turn it back to you, David.

David C. Jukes - *Univar Solutions Inc. - President, CEO & Director*

Thanks, Nick. Moving to our integration progress. Despite the COVID-19 obstacles, we successfully delivered on several significant integration milestones, realizing $13 million of net synergies during the quarter. I'd like to highlight a few of those milestones now.

We successfully kicked off the third wave of our ERP implementation, and we're continuing to successfully service our customers while optimizing our processes. Our site consolidation plan continued, closing 6 branches in the quarter, bringing total closures to 19. We finalized the sale of 6 further sites with cash proceeds of approximately $6 million and remain on schedule to close 15 branches in total during the year.

Our SAP migration plans and time line remain the same as we communicated last quarter, which is 6 smaller, more agile ways, adopting the hybrid approach that includes much more remote training and support. The U.S.A. time line to completion is Q2 2021, with Canada and Mexico rollouts moving to the second half of 2021. We're in the early stages of realizing the full benefits of optimizing our scale but remain true to our strategy of having a strong local presence for our customers.

Moving to our business strategy progress. Sales force effectiveness remains a key driver of business improvements as we leverage our advantaged network of sellers in combination with our digital platforms. We continue to track our levels of pipeline growth, transactional activity, customer retention, margin management and affected activity at a local business level. Even with the obstacles of COVID-19, we've maintained momentum and continue to see good progress in the leading indicators.

Our U.S. average customer contacts were up 37% sequentially from Q2 despite customer closures. And just like we saw in the first quarter, we welcomed hundreds of new and returning customers in the second quarter, defined as customers with no activity in the past 12 months. And equally in importance, of the new customers we welcomed back in Q1, 40% purchased again in Q2. I am though impatient to see the leading indicators feed through to the financials, which is why I've made certain changes to the organization, which will particularly impact North America and allow me to be closer to that business.

Jen McIntyre's leadership of the S22 program will allow us to drive process efficiency and structural cost improvements uninhibited by regional entropy. She will also take responsibility as Head of North American operations.

As Chief Commercial Officer, Brian Herington has already made significant progress in establishing common global practices for pricing, sales force execution and digital disruption. By taking a direct control of the largely local chemical distribution business in North America, he can more readily drive these to execution through the local management team.

And by globalizing our consumer and industrial solutions industry verticals, under the leadership of Nick Powell, I expect us to deliver faster growth through an ability to perform consistently for supplier partners in whatever geography we operate, something they told us they want.

The expansion of this largely differentiated set of chemistries and ingredients is an important driver of our mix-enrichment goals. Our supplier partnerships remain a bedrock for our business and a source of competitive advantage, especially in times like these. You may have seen our announcements over the last few months regarding new or expanded product authorizations from supplier partners such as Dow, Vink Chemicals, Biosynthetic Technologies, [Jet's Products] and Valio. These partnerships, along with the leading chemical and ingredient products they bring are a recognition of how our partners recognize the value of our end market expertise and digital capabilities to support their growth.

We continue to build and expand our robust portfolio of products and solution capabilities. And as we go forward, we've developed a customer-centric approach to drive growth. In addition, we believe connecting our industry verticals globally and increased use of our digital tools will allow for both greater cross productivity and deeper customer intimacy throughout the end markets we serve. We've conducted an in-depth survey of our customers who've told us how they want to interact and purchase in the COVID-19 world. Not surprisingly, in-person meetings as the primary tool of engagement ranked low with our customers in each region, and a mix of more virtual and less in-person interactions than previously will be the preferred norm. This has confirmed our strategic decision to accelerate our omnichannel approach, which has allowed us to open up or expand sales channels to better address customers' current preferences.

Just as one example, during the second quarter, we held 31 customer webinars to promote the technical capabilities and stimulate demand for certain chemicals and ingredients in North America, EMEA and Lat Am, reaching approximately 1,500 customers while engaging our supplier partners. As our investments to expand our digital footprint continue to deliver results, this presents another source of competitive advantage for us as customers adopt and use our e-commerce platforms to search, select, source and self-serve in growing numbers. These platforms create multiple entry points for customers and new ways for us to connect with them and gain share. Our Univar Solutions website provides customers with products and formulation information, and we've improved the ratio of website traffic to sales leads.

We expanded our shop.univarsolutions.com to offer self-serve capabilities 24/7 to improve our customer experience. Customers in the U.S., they can now browse the entire product catalog, request quotes and quickly purchase products. They can download a variety of documentation, including invoices and safety data sheets as well as track their shipments to the recently launched "where's my stuff?" feature.

We continue to expand our reach on chempoint.com, increasing the number of products and markets served through this digital channel. As we told you last quarter, we launched chemcentral.com, a new no-frills retail channel for those transactional customers who don't require the high-touch service available through more regular Univar Solutions channels. This has been a really exciting start-up platform that we are rapidly expanding and is attracting many new buying customers.

Altogether, our digital foundation and committed sales force strategy is aimed to maximize the effectiveness and scale of our operations as well as make it easier for customers and suppliers to do business with us and deliver market share growth. We're confident that we're investing in the right tools to streamline the supply chain, innovate with customers and accelerate growth. They are in step with customers' changing preferences.

And before concluding, I'd like to mention a few other highlights. In June, we released our sustainability report. This report is a more useful, comparable and comprehensive tool for our stakeholders than ever before, with improvements that include new dashboard, which shows our progress against the company's 2021 sustainability goals.

Additionally, the report references the latest version of the Global Reporting Initiative, GRI standards, integrating Univar Solutions' sustainability performance data, representing the combined impacts and aspects of the entirety of our new company, making our reporting more transparent and complete; reporting in accordance with the Sustainability Accounting Standards Board, SASB, for the chemical sector, increasing the ability for stakeholders to access key information; expanding the toolkit of monitoring and managing our global impacts through the introduction of scope 3 emissions reporting; integrating the material contributions that our business makes to the United Nations Sustainable Development Goals; achieving external assurance on our global sustainability reporting claims as well as assurance in our scope 1 and 2 emissions safety and release metrics.

This significant milestone is a marked development as we move to demonstrate our robust and honest approach to better business. 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 a better stewards of Earth's resources.

Also, we're pleased to announce that Univar Solutions joined as a signatory of the CEO action commitment, pledging to take action and foster safe, collaborative, supportive and respectful environment that values diverse perspectives, mitigate some conscious bias and enables a culture where employees are able to bring their authentic self to work.

Before we come to your questions, to summarize, we delivered solid financial results during these challenging times. We had $815 million of liquidity at June quarter end. We're maintaining firm control of our working capital and other cash needs and expect to end the year with $750 million to $800 million of liquidity. We maintained momentum on our Nexeo integration program and expect to achieve our $120 million net synergies. We delivered $17 million of cost reductions in the quarter against the greater than $40 million of additional cost savings we identified this year. We're investing in furthering our digital advantage, which is becoming increasingly attractive to our customers. We've launched S22 as a program to deliver growth in revenue and 9% EBITDA margins through global and functional excellence. We continue to see an opportunity to capture new business even in a challenged economy as we target growth through sales force effectiveness and omnichannel approach and digital capabilities to better serve customers. Through S22, we're focused on delivering the agility and decisive actions to enhance our competitiveness and increase our operational and financial flexibility as we work to position the company to capture greater value from the anticipated market recovery and growth opportunities ahead. We believe these collective efforts provide a path to deliver greater shareholder value.

Thank you for your attention. Please stay healthy and safe. And with that, we'll open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question this morning comes from Bob Koort from Goldman Sachs.

Robert Andrew Koort - *Goldman Sachs Group, Inc., Research Division - MD*

David, I was wondering if you could maybe give us some granularity on getting to that 9% EBITDA margin target. How much of that is volume-dependent? How much of it is internal cost-outs or rather self help? And can you give us a sense of the bridge to that 9% margin? And do you need to get back to 2019 demand levels to do it?

David C. Jukes - *Univar Solutions Inc. - President, CEO & Director*

Yes. I mean, I think, Bob -- I mean thanks for the question. I mean we've got enough confidence in our line of sight to announce that 9% margin target. And it is a combination of portfolio management, of cost management productivity and the growth of share growth. And we'll give much further guidance on that at our year-end earnings call. But that's how we're seeing things. It's a very clear path that we have and a very clear program that we have.

Robert Andrew Koort - *Goldman Sachs Group, Inc., Research Division - MD*

And I'm trying to understand a little bit about the change in management and responsibility. Can you maybe give us some specifics on how you'll do things differently going forward with this changed structure?

David C. Jukes - *Univar Solutions Inc. - President, CEO & Director*

Sure. What the plan really is, is to accelerate the optimization of our processes and speed up decision-making and accelerate the -- some of the digital benefits and integrate our digital benefits into our operating model. So it's really about accelerating the strategy that we're on and then enhancing the different pieces of the business that we have. So our focused global industries has been -- we've been successful in our approach to our focused industries, now segmenting those as Consumer Solutions and Industrial Solutions and giving those to Nick Powell to run globally and to give that global consistent performance.

We expect to see good growth from that because that is something our customers and suppliers say that we want. And if we can do that on a global basis and not get bogged down in some of the regional entropy that slows down decision-making and actions, and then we believe that we can accelerate much faster. Certainly, having Jen's role is a single focus on the program and a single focus on optimization of our business processes. We'll have the virtuous effect of probably reducing our costs, certainly improving our cost productivity, but also making it easier to buy from, which is a key part of our growth strategy.

So think of it as a kind of "front of the house, back of the house" split, where Nick Powell and Brian Herington with the local business have front of the house, Jen has back of the house, very clearly able then to leverage the benefits that we're getting through SAP and our digital investments to drive process improvements. And then it allows me to lean in much more into the U.S. business to make sure that we are doing the things that we know we ought to be doing at the time we ought to be doing them.

Operator

Your next question comes from Laurent Favre from Exane BNP.

Laurent Guy Favre - *Exane BNP Paribas, Research Division - Research Analyst*

I've got 2 questions, please. The first one, David, is on ChemCare. It sounds now that this business is actually core. So I was wondering if you could share with us some KPIs of how this business is doing and fiscally what do you want to do with it, how you intend to grow it, anything that can help us understand how perhaps misunderstood these business is within Univar right now. That's the first question.

And then the second one, I'm just trying to understand, to get my head around Q3, sorry, I'm bamboozled by all the numbers you provided. So can you perhaps repeat how we should be thinking about the, I guess, the difference in mix going into Q3? And then how we think about the difference in the COVID costs between what happened in Q2 and what you would expect in Q3?

David C. Jukes - *Univar Solutions Inc. - President, CEO & Director*

Sure. And I'm sorry if we bamboozled, we'll try and un-bamboozle it, if that's such a word. Let's look at ChemCare, first and foremost. I mean the businesses we've divested were small businesses which are businesses to do with emergency response, emergency cleanup. And they're really just not core to chemical ingredient distribution.

ChemCare is more core to our chemical and ingredient distribution business because it provides a value-added service for chemical waste processes. So our customers, our existing customers are requiring those services, and we can integrate that within our distribution network to backhaul products, clean up or dispose of chemical waste. It supports our sustainability goals as well. So it kind of fits much more as an integral part of our chemical and ingredient distribution business. It's a value-add business. It's performing okay at the moment. It's performed well the last few years. It's impacted right now as we note on the end market slide. I mean, the activity, the number of cleanups, number of transitions for manufacturing plants where ChemCare will support haven't been taking place in the second quarter. It is now improving its performance into the third quarter. So we have great expectations and a clear plan to grow that business.

In terms of Q3, let me let Nick un-bamboozle you with the numbers.

Nicholas William Alexos - *Univar Solutions Inc. - Executive VP, CFO & Principal Accounting Officer*

Yes. Thanks for your notes last night. If we look at Q2, obviously, we performed very well, and we're quite pleased by that. We are very much tracking key components of the Q2 performance, and we've called out 3 pieces of those that we thought would be informative to all of you in terms of the performance, which is the product mix benefit, which we thought might have been unique to the quarter; a pure COVID impact, i.e., the recessionary impact on demand; and then the cost savings that we targeted going into the quarter as we spoke on our last earnings call.

And when you adjust for those, if we would try to adjust for those, we get to that $180 million number that one could look at as "earnings power of a business pre-COVID." Obviously, we are continuing in a recessionary and perhaps COVID environment, and what we tried to do is give context in terms of what the numbers would have otherwise been further impacted versus prior year. And we've detailed a number that we think is roundly $20 million for each of Q3, Q4.

So I would take a step back and say, what would one would have thought those numbers would have been earlier in the year pre the COVID recession, and there's roundly a $20 million impact. As you know, Laurent, there are other factors year-over-year. We have the divestment of the Environmental Sciences businesses, which needs to be backed out. But we're also seeing growth in certain parts of our market, which would offset that. But what we tried to do is give you some sense of year-over-year continuing impact of COVID through the end of this year.

Operator

Our next question comes from Jim Sheehan from Truist Securities.

James Michael Sheehan - *Truist Securities, Inc., Research Division - Research Analyst*

Under 9% margin target, could you give some more color on where the cost savings are likely to occur by region? And what regions do you expect to drive more of the margin expansion?

David C. Jukes - *Univar Solutions Inc. - President, CEO & Director*

Jim, thanks for the question. I mean I think that, firstly, S22 is a global program, so we do see the opportunity for improvement right across our business. It is about process improvement. It is about streamlining operations, and we do see opportunity to do that, particularly as you bring digital at our core and roll those digital solutions across the whole business. I mean clearly, the U.S. is the largest part of our business, so clearly, the U.S. is where we expect to see the bigger improvement -- or the biggest improvements, but we have opportunities right throughout the business.

James Michael Sheehan - *Truist Securities, Inc., Research Division - Research Analyst*

And on your free cash flow outlook. Could you maybe talk about your early views on free cash flow for 2021? I know you mentioned your normalized free cash flow being around $350 million. What are the major puts and takes that we should be aware of for 2021? For example, is working capital going to be a large hurdle?

Nicholas William Alexos - *Univar Solutions Inc. - Executive VP, CFO & Principal Accounting Officer*

Jim, thanks. There are obviously a lot of pieces, and we're not at a stage of giving further guidance on 2021 other than highlighting that we think the one other factor that will continue to be in use will be the finalization of the Nexeo integration of roughly $65 million into next year. We very much feel that we can operate within the bandwidth of 13% to 14% working capital through 2021, much as we're trying to do for this year. So if we have growth versus 2020, certainly, there'll be a use of cash, but that will be a positive outcome for all of us, given that we will be in a growth environment. If the year is flat, then we would not have a significant use of cash. It's -- clearly, we also have to be cognizant of where we end up at the end of the year. And certainly, we'll talk about that in early 2021 when we give our full year guidance.

Operator

Your next question comes from Kevin McCarthy from Vertical Research.

Kevin William McCarthy - *Vertical Research Partners, LLC - Partner*

You've divested your pest elimination business and now an industrial emergency response business in the third quarter. Aside from ChemCare, which you've addressed, what other businesses do you have in the portfolio that are not classic chemical distribution businesses?

David C. Jukes - *Univar Solutions Inc. - President, CEO & Director*

Yes. I mean thanks for the question. I mean firstly, portfolio management remains a priority for us. And obviously, it's one of the elements which will support the S22 goal of getting below 3x levered by the end of 2021. I mean we do have a number of other profitable and attractive businesses that, like Nexeo's legacy -- legacy Nexeo plastics business, don't fit into the core of what we would view chemical and ingredient distribution. So we're looking at those and we'll work on some of those. And there are a couple of those, nothing we can share today, nothing we can announce today. But portfolio management and cleaning up our business to focus on our core ingredient and chemical distribution business is a strategic priority for us.

Kevin William McCarthy - *Vertical Research Partners, LLC - Partner*

Okay. And then it sounds like digital will be part of your new S22 program. Can you help us understand how big that business is today, what your vision is for the future and how profitability compares with your nondigital businesses?

David C. Jukes - *Univar Solutions Inc. - President, CEO & Director*

Sure. I mean I don't necessarily think of businesses as digital or nondigital. What we think about is we are -- what we're digitizing these processes -- what we're -- I mean SAP roll out, the business system migration is a form of digitization that allows us data, which we can then put in a structured format to improve our processes, to reduce touches and make us easier to buy from. So we think about it as what we have is this big shopping mall and rather than just have one front door for people to come through, I want lots and lots of doors for people to come through, whether it's coming into our specialty store for food or our specialty store for solvents or coming into the general store through the front door. So we're building multiple entry points and multiple touch points for our customers.

We also talked about customers changing how they operate, changing how they want to interact. I think certainly at the moment when people are working from home, I suspect if you're working from home, you're not getting up at 9 and finishing your 5, you're operating -- you're getting your work done, but whenever timescale suits you best, if you want to walk the dog at 1, you walk-in the dog at 1, you come back and get the work done. Customers are no different. So we're seeing more customers interacting with us over our digital channels at 2 in the morning or on July 4 or whenever. We need to be open and accessible however customers choose to interact with us and build as many doors to our business as we possibly can do, and then give them a streamlined way through our organization, so we don't disappoint them when they do, do that. And that's really what the focus of our digital capabilities are about.

Kevin William McCarthy - *Vertical Research Partners, LLC - Partner*

That makes perfect sense to me. I guess what I was trying to get at is when customers enter a digital door, are you indifferent in economic terms as to whether they do that or use the telephone to call up a salesperson, for example? Just trying to get a sense of what the margin implications may be from digital as you're moving towards that 9% goal, if it's straight up or if you go lower before you go higher, that kind of thing.

David C. Jukes - *Univar Solutions Inc. - President, CEO & Director*

Well, just think about it in terms of -- think about it sort of in 2 ways. One, the price. And then secondly, the cost. So clearly it costs me more to process an order if I'm getting on the phone and I've got inefficient processes, which means I have to touch it 10 times before it gets out of the

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door rather than if it comes in, seamlessly go through the digital set of channels and then hops onto a truck and off it goes. So I can enhance my margin without changing my selling price, but just being much more cost productive, just focusing on that transaction cost. And so there's a -- the pricing strategy will depend on the channel that we have. But I don't think this gives us the opportunity to change overall market prices, it does give us the opportunity though to reduce our transaction costs to make our processes more effective and therefore, more profitable.

Operator

Your next question comes from Steve Byrne from Bank of America.

Steve Byrne - *BofA Merrill Lynch, Research Division - Director of Equity Research*

Yes. Regarding your management changes within the North American operations, our hunch on this one, David, is that a key driver of this is likely a view from you that the pace of progress and the sales force effectiveness has just not been as fast as you would have liked to have seen. We'd welcome your comments on that, but maybe more specifically, you commented on touch points, that you're tracking with the reps. What other metrics do you look at that you're monitoring that, the sales force effectiveness? And how would you rate the overall level of effectiveness compared to what you think they should be accomplishing right now? What percent of optimum would you put it at right now?

David C. Jukes - *Univar Solutions Inc. - President, CEO & Director*

Yes. Steve, thanks for the question. Look, I mean I think we're reporting good Q2 results, and we are progressing well on our integration plan and our cost reductions and so I think the business is performing reasonably well. But as I said in my prepared remarks, I'm impatient. I'm impatient to see some of the really good leading indicators turn into the really good lagging indicators of share growth and sales growth. And so that's really what I want to try and do. I want to try and remove some of the organizational entropy that stops those 2 things connecting.

As a metaphor, I think we're building muscle. We need to improve the ligaments that connect the muscles together so they can operate effectively together rather than just try and kind of focus on just building the muscle in one area like touch points. I rated our sales organization 7 out of 10 when I was asked this question last time. I was asked what would cause me to get into an 8 or 9 or a 10, and the answer was time executing well. I think they're still at the 7 out of 10. I think it's -- what we recognize is the strategy we were on needs to be adjusted slightly because a strategy that said, "I want more sellers in front of more customers more often," is probably not the best one to have when customers say, "I don't want to or can't see you right now." So we have to look at how we have an omnichannel approach and different ways of touching them and different ways of approaching them. And we need to do that in a very, very agile and flexible way. So Streamline '22 is really about improving our agility, improving our organization agility, so we can then better connect the leading indicators, which are all trending the right way, with the lagging indicators, which are not where I would want them to be, hence my impatience.

Steve Byrne - *BofA Merrill Lynch, Research Division - Director of Equity Research*

And with respect to the sales force muscle that you're referring to, what is the head count of your sales force right now versus what it was prior to the Nexeo acquisition at legacy Univar and versus what it was on day 1 of that acquisition?

David C. Jukes - *Univar Solutions Inc. - President, CEO & Director*

Well, we haven't changed the size of the sales force since we combined the 2 businesses. We said at the time, it wasn't about reducing sales heads, it was about sizing the sales organization. The opportunity for growth that we saw there, we still see the opportunity for growth there. Therefore, cutting sales heads is probably not the most sensible thing to do. However, adjusting sales channels and thinking about how you touch customers in a different way and how you make sellers more productive so they can manage more customers and manage more transactions and how we can get to more people when they choose to do, does seem to me to be a sensible approach and sensible strategy.

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Operator

Our next question comes from Dave Begleiter from Deutsche Bank.

David L. Begleiter - *Deutsche Bank AG, Research Division - MD and Senior Research Analyst*

David, just back on S22 program, and thanks for your detail on that. Are there any specific cost savings attached to the program?

David C. Jukes - *Univar Solutions Inc. - President, CEO & Director*

Well, David, as we said, I mean I think firstly, we see a very clear path to that 9% operating margin, and we see that through growth, and we see that through cross productivity. So we'll share more details of that at our -- when we talk about 2021. But we're going to follow the same execution model that we followed with the [Unite] program. And you'll remember, we talked about the bloodstained documents. When people have to sign in blood, what they were going to deliver to enable us to execute that in the pace that we wanted to and the pace we committed to. And that's been a very successful program. We have delivered, in fact, over-delivered in certain cases, what we committed to by engaging our people and then having them commit to what they can do, not some kind of theoretical notion. We'll take the same approach with Streamline 2022, which is one of the reasons. Jen, having been so successful running the Unite program, will manage the and lead the Streamline program.

Nicholas William Alexos - *Univar Solutions Inc. - Executive VP, CFO & Principal Accounting Officer*

And Dave, if I could just add one point of emphasis. Clearly, the intention is not to announce as part of that a further significant restructuring. Streamline 2022 is about the portfolio rationalization that we highlighted as well as improving the processes that David has highlighted with the leadership in place to improve our cost structure over time through 2022.

David C. Jukes - *Univar Solutions Inc. - President, CEO & Director*

I think it is really -- cost productivity is a thing to look at.

Nicholas William Alexos - *Univar Solutions Inc. - Executive VP, CFO & Principal Accounting Officer*

And growth.

David C. Jukes - *Univar Solutions Inc. - President, CEO & Director*

And -- because that supports growth, yes.

David L. Begleiter - *Deutsche Bank AG, Research Division - MD and Senior Research Analyst*

Got it. And again -- and just on the noncore assets, I apologize if you mentioned this. What are the sales and EBITDA attached to the noncore assets identified for sale?

Nicholas William Alexos - *Univar Solutions Inc. - Executive VP, CFO & Principal Accounting Officer*

Yes. I would say we're not being specific for obvious reasons. Overall, they won't be material to the impact of the profile of the business. And we're going to work to try to achieve maximum value for those assets as we divest them.

Operator

Your next question comes from Duffy Fischer from Barclays.

Duffy Fischer

Maybe I missed it, but in your comment that July sales are comparable to June, what is that benchmark? What were June sales year-over-year that we can extrapolate that to?

David C. Jukes - *Univar Solutions Inc. - President, CEO & Director*

Duffy, I think we said in prepared remarks that June was down low teens year-on-year, although it accelerated as the month went on. And July is more like the end of June than the start of June. So that's how we're seeing things.

Duffy Fischer

Okay. And then the -- not really guidance, but directional guidance that Nick gave, that negative $20 million, just to be clear, basically, that's at the run rate of July, taking into account seasonal effects is indicative of the rest of the year, we should subtract roughly $20 million in EBITDA per quarter for each of the next 2 quarters. Is that the right way to read that?

Nicholas William Alexos - *Univar Solutions Inc. - Executive VP, CFO & Principal Accounting Officer*

Yes. I would say -- Duffy, Nick here. You could take that approach. Our approach on the '20 is basically, pre-COVID, is whatever your views might have been for Q3, Q4, you would layer into that a $20 million net COVID impact. Obviously, it's hard to determine exactly, but we are tracking the 3 pieces that we talked about, and we extrapolated that we thought those would be about $20 million a quarter versus prior year results.

You can take the seasonality into account, obviously, adjust for the Environmental Sciences businesses and maybe probably get to the same place, but our context was a year-over-year comparison.

Duffy Fischer

Fair enough. And then maybe I could just sneak in a third. When you look at sequentially from Q1 to Q2, your gross profit was down $44 million, but yet your EBITDA was up $1 million, which is terrific. Can you just walk through what it was you were able to kind of squeeze out in between the gross profit line and the EBITDA line? And how much of that we might be able to repeat? And how much of that was just kind of emergency measure as when we really didn't know what COVID was going to do to the world?

Nicholas William Alexos - *Univar Solutions Inc. - Executive VP, CFO & Principal Accounting Officer*

Yes. I mean we called out the $17 million of savings that we kind of pulled on for the quarter, that we said that, that's $40 million for the year. So that leaves my math $23 million plus for the rest of the year. So less than the $17 million run rate in Q3 and Q4. And I would highlight that those are numbers that are costs that we took out versus our plans going into 2020. About half of those costs are really savings versus prior year spending levels.

Operator

Your next question comes from Laurence Alexander from Jefferies.

Laurence Alexander - *Jefferies LLC, Research Division - VP & Equity Research Analyst*

A couple of things. Can you give a sense for your experience with digitalization so far, the reductions in error rates and how you're seeing sort of your net cash cycle evolve with customers who have kind of fully migrated to digital channels?

David C. Jukes - *Univar Solutions Inc. - President, CEO & Director*

I can certainly try it for you. I mean I think, firstly, it's -- if you think about those channels as the storefront channels, then most of our customers using shops today will be using it to download information, download data and reorder. So we want to migrate as many of those to utilizing shop more often. We have a feature called "where's my stuff", which is exactly what it says, which we think is going to be a big driver of adoption for us because it will bring people back into the site to utilize the site rather than picking up the telephone to do other things.

If you look at something like ChemCentral, which we launched, which is a no-frills retail channel, their customers are swiping their credit card. So we have public pricing there. People are able to buy and swiping credit cards. So that's a pretty touch-free program. It is a pilot. It has been launched. It's been hugely successful so far. And it's bringing new customers in, bringing the massive data in. But the cash cycle on that is pretty good.

Laurence Alexander - *Jefferies LLC, Research Division - VP & Equity Research Analyst*

And then longer term, with your margin improvement, should your cash cycle get faster or slower as your margins improve?

Nicholas William Alexos - *Univar Solutions Inc. - Executive VP, CFO & Principal Accounting Officer*

I mean they might. I'm not sure that we'll factor that into any working capital guidance that we would provide. I think we look at the 13% to 14% working capital benchmark as being best-in-class, and we will plan to stay within that while serving our supply chain on both sides.

Operator

Your next question comes from Michael McGinn from Wells Fargo.

Michael Lawrence McGinn - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Good quarter. I just want to go back to the digital conversation really quick. Is this a scenario you see playing out as becoming more of like a drop-ship resellers' stud on marketplace where you don't have to take inventory? What percent of that business is that today? And maybe parlaying that into free cash flow, do you envision a scenario where you see steady growth for the business overall plus still positive working capital contributions given the nature of that low-touch sale?

David C. Jukes - *Univar Solutions Inc. - President, CEO & Director*

Sure. So I don't envisage in what we are doing that we become just a transaction engine. I do think -- I mean firstly, handling dangerous chemicals, handling hazardous chemicals is a core value of ours. It's something we do very, very well, and it's something that our supplier partners has come to rely on us on and it's something our customers come to rely on. So this is about digitizing the interaction of that, but that's a fundamental core competence that we have as well as the expertise we have in the application, in the development and use of certain differentiated chemicals and ingredients. So I think this is the value that we have rather than just a pure transaction cost. So I don't see us evolving to a marketplace model. I don't see us evolving into a kind of just an intermediary. I think the maybe place for us is on marketplace's potentially, but that's a more philosophical question about the evolution of marketplace is in this space, which over the last 20 years, so far haven't been successful. But the brick-and-mortar and safety and sustainability and compliance in a highly regulated industry, those functions that we perform are core to what suppliers and customers value from us, and we'll continue to invest in doing those incredibly well.

Michael Lawrence McGinn - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Okay. And then maybe switching gears to the management structure. I think there was some color earlier on the call, but I just wanted to get a sense of -- there seems to be a lot of -- there are regional focus, and there's an operational focus. Internally, is the regional the direct line and the operational the dotted line? Just trying to get a feel for how you're organizing that. And is that -- what the change is versus the prior structure?

David C. Jukes - *Univar Solutions Inc. - President, CEO & Director*

Sure. So what we have is we've globalized certain businesses and globalizing functional excellence. So the functional excellence will cross boundaries and cross barriers, and we'll do that in an uninterrupted way by any regional structure. However, our business is a local business. And so we have to operate regionally. We have to operate locally. So we'll still have very close local touch points with our customers, still global touch points with our suppliers. And we still have those local sites and facilities. But I think what we have and what we want to be able to do is to drive process excellence to enable better, faster local decision-making. So this is not centralization, per se, it's globalization of processes to have consistent effective processes so you can make faster decision-making locally and better decision-making locally. And that's where some of the operational agility comes in.

Michael Lawrence McGinn - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Okay. And in the past, you haven't been shy about changing the compensation structure of the organization. Is there -- are there any compensation structure changes now with this change? Or still the same?

David C. Jukes - *Univar Solutions Inc. - President, CEO & Director*

Well, there isn't for 2020. We'll honor all the arrangements that we made for 2020. We need to look at what we do for 2021 to make sure that fits for purpose. But what I will tell you is compensation will be based on gross margin growth. That's what it will be based on. That will be the largest component for our sales organization, gross margin growth. We won't flip it through to volume or anything more esoteric, driving gross volume growth, share growth is really important to us. So whilst the 2021 change of structure might be finessed and the fundamentals of it is based on growth and it's based on gross margin, it won't change.

Operator

This concludes the Q&A portion of our call. I'll turn the call back for any closing remarks.

Heather Anne Kos - *Univar Solutions Inc. - VP of IR*

Thank you, ladies and gentlemen, for your interest in Univar Solutions. If you have any follow-up questions, please reach out to the Investor Relations team. This does conclude today's call.

Operator

Ladies and gentlemen, this does indeed conclude today's conference call. Thank you once more for participating. You may now disconnect.