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Ingevity Corp. (NGVT)

Q3 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning [indiscernible] (00:00:06) and welcome to the Ingevity Third Quarter 2024 Earnings Call and Webcast. My name is Adam, and I'll be your operator today. [Operator Instructions] I will now hand the floor to John Nypaver to begin. So, John, please go ahead when you're ready.

John E. Nypaver, Jr.

Vice President, Treasurer & Investor Relations, Ingevity Corp.

Thank you, Adam. Good morning and welcome to Ingevity's third quarter 2024 earnings call. Earlier this morning, we posted a presentation on our investor site that you can use to follow today's discussion. It can be found on ir.ingevity.com under Events & Presentations. Also throughout this call, we may refer to non-GAAP financial measures which are intended to supplement, not substitute for comparable GAAP measures. Definitions of these non-GAAP financial measures and reconciliations to comparable GAAP measures are included in our earnings release and are also in our most recent Form 10-K. We may also make forward-looking statements regarding future events and future financial performance of the company during this call and we caution you that these statements are just projections, and actual results or events may differ materially from those projections as further described in our earnings release.

Our agenda is on slide 3. Our speakers today are Luis Fernandez-Moreno, our Interim CEO, and Mary Dean Hall, our CFO. Our business leads, Ed Woodcock, President of Performance Materials; Rich White, President of Performance Chemicals; and Steve Hulme, President of Advanced Polymer Technologies are available for questions and comments. Luis will start us off with some highlights for the quarter. Mary will follow with a review of our consolidated financial performance and the business segment results for the third quarter. Luis will then provide closing comments and discuss 2024 guidance.

With that, over to you, Luis.

Luis Fernandez-Moreno

Interim President, Chief Executive Officer & Director, Ingevity Corp.

Thanks, John, and good morning, everyone. Please turn to slide 5. Let me begin by saying how excited I am to be here to help Ingevity continue to execute on our business strategies to maximize profitability, including the repositioning of our Performance Chemicals segment. The team has done much of the heavy lifting to set this segment up for success. We've exited lower margin cyclical end markets. We've reduced our physical footprint to optimize costs and diversified our raw material stream. And we have exited long-term supply contracts which have hindered our ability to manage the cost and timing of key raw material purchases. These efforts have not been easy. I have been a member of the Ingevity board since the day we became public, and I can say that the board has been and continues to be supportive of this strategic direction.

I know that many of you have been keenly focused on our actions in the Performance Chemicals segment the last several quarters, understandably so. At the same time, I want to ensure our other segments, Performance Materials and Advanced Polymer Technologies, get the attention and focus they deserve. Together, these three segments give us scale and diversity around geographies and end markets. In addition to my focus on executing the business strategies underway, one of my first tasks will be to review our portfolio of businesses to bring a fresh look to our overall corporate strategy.

Ingevity has many things to be proud of and you see this in our third quarter results, which Mary will go over in detail. Performance Materials continues to deliver profitable sales growth and top quartile margins in what some consider a soft order production environment. APT maintained solid EBITDA margins despite mix changes and pricing pressures as inflation began to cool down while global industrial demand remained weak.

And our Performance Chemicals segment saw margin improvement even as we worked through high cost CTO inventory and were negatively impacted by adverse weather conditions in North America – in the key North America regions of our Road Technologies product line. This quarter gives you a glimpse of what this company can do even in the face of headwinds like slow industrial demand, weather impacts and consuming high cost CTO inventory. My focus in the upcoming quarters will be on execution to ensure our efforts and resources are focused on delivering the improved results we all expect. Although it has only been four weeks, I am even more excited now about the future of Ingevity.

With that, I'll turn it over to Mary to review the financials for the quarter.

Mary Dean Hall

Executive Vice President & Chief Financial Officer, Ingevity Corp.

Thanks, Luis, and good morning, all. Please turn to slide 5. Third quarter sales of \$376.9 million were down 16% due primarily to our repositioning actions in Performance Chemicals that resulted in the exit of lower margin end markets in our Industrial Specialties product line and lower sales in the Road Technologies product line due to unfavorable weather conditions in key parts of North America as Luis mentioned. During the quarter, we incurred before tax restructuring charges of \$86.9 million, primarily related to the closure of our Crossett, Arkansas facility, and \$100 million charge for the termination of a long-term CTO supply contract, which led to a GAAP net loss of \$107.2 million. We have excluded the impact of these charges in our non-GAAP disclosure and our discussion for the remainder of this presentation. A reconciliation of our non-GAAP measures to GAAP is in the appendix to this deck and also in our earnings release and Form 10-Q, which will be filed this evening.

Our adjusted gross profit of \$146 million was flat to last year, while gross margin was higher by 610 basis points. The gross margin gains were largely driven by our Performance Chemicals repositioning actions, which have

reduced our exposure to lower margin end markets and Industrial Specialties product line and enabled our higher margin businesses such as Performance Materials and Road Technologies to represent a larger portion of our total company results. In addition, the repositioning actions generated cost savings of \$14 million, which benefited gross profit in the quarter. Adjusted SG&A dollars and percent of sales increased year-over-year, despite repositioning savings of about \$4 million, primarily due to credits to variable incentive compensation recorded in the third quarter last year versus a normalized run rate this quarter.

Adjusted EBITDA dollars were down about \$4 million in the current quarter versus last year. This quarter's results were negatively impacted by approximately \$5 million in CEO severance charges and almost \$4 million in Crossett restructuring-related inventory charges. Adjusted EBITDA margin improved 340 basis points to 28.2%, primarily due to a strong quarter from Performance Materials and the positive impact we're beginning to see of our repositioning actions in Performance Chemicals. In fact, we realized a total of \$18 million of savings in Q3, which puts us on track to realize our 2024 target of \$65 million to \$75 million in savings from the restructuring actions we have taken. We continue to expect that our full year 2024 effective tax rate will be between 23% and 25%.

Please turn to slide 6. We generated free cash flow of \$28.5 million in Q3, which includes the first \$50 million payment to terminate a long-term CTO supply contract, as well as \$21 million of cash restructuring charges. Clearly, we had a very good quarter from a cash generation standpoint. Also, we've been very disciplined on CapEx this year as we managed free cash flow while ensuring appropriate safety and maintenance spend at the plants. Leverage was slightly lower than last quarter, still around 4 times, but we expect this to move closer to 3.5 times by year end. Our bank calculated leverage was about 3 times at the end of Q3, and we are comfortably in compliance with all of our bank covenants. As we've stated in recent quarters, our capital allocation priority for the near term is to focus on debt reduction.

Turning to slide 7, you'll find results for Performance Materials. The segment delivered solid sales growth of 3% to \$151.1 million. Not included in this number are approximately \$4 million of sales that were scheduled to be shipped out in the third quarter but were delayed into Q4 due to the port strike on the East Coast. EBITDA was up 8% to \$80.6 million, with an EBITDA margin of 53.3%. The segment continues to benefit from lower input costs as a result of investments made at the plants to improve operational efficiency, primarily by reducing natural gas usage. Because of these improvements, it is possible that segment will maintain margins in the high 40s to low 50s over the next few quarters. But over the long term, we continue to expect EBITDA margins in this segment to be in the mid to high 40s as the geographic and automotive sales mix changes over time.

Turning to slide 8. Revenue in APT was \$48.8 million, up 14% as volumes increased versus last year's lows. We believe Q3 last year was the peak of destocking for APT customers. China especially had a nice uptick this quarter as sales for paint protective film for autos increased, which may indicate market demand in China is beginning to show some signs of improvement. EBITDA margins were a solid 20.1%, although down compared to last year. The increased volumes also improved our plant utilization, but these gains were more than offset by pricing pressure, unfavorable product mix and a negative impact from movements in foreign exchange rates, primarily the strengthening of the British pound versus the US dollar. We've also noted that APT is exposed to several end markets affected by the continued weakness in industrial demand. Not only does this slowdown affect current markets in which we participate, but it also dampens customer momentum to adopt new products such as bioplastics, which is where our Capa technology brings many unique benefits.

Please turn to slide 9 for Performance Chemicals results. Sales of \$177 million were down 31%, primarily due to the repositioning actions affecting the Industrial Specialties product line where sales declined 54%. This reflects our intentional actions to exit lower margin cyclical end markets. However, we're also still experiencing lackluster industrial demand in our remaining Industrial Specialties end markets, which include our fatty acids that go into

mining and lubricants, dispersants that go into ad chem for crop protection and rosin that goes into rubber and certain molten adhesive applications.

Road Technologies sales were down 8%, primarily due to weather-related delays in road construction projects during the current quarter. Since weather caused a number of road projects to be delayed in both the second and third quarters and we're entering the winter months, we expect many of those projects will shift into next year's paving season. Recognizing the challenges in getting resources to complete road projects, it is unlikely the shift will result in a significant increase in projects next year since there are only so many projects that can be completed in any given year.

EBITDA for the segment was \$19.8 million, down 20%, due primarily to higher CTO costs, continued weak industrial demand and the weather-related delays impacting Road Technologies. These headwinds were partially offset by savings from our repositioning actions. EBITDA margins improved 160 basis points to 11.2%. This is primarily a result of the exit of lower margin end markets in the Industrial Specialties product line, which is a key element of our repositioning strategy. As we indicated last quarter, we expect to run through our remaining high cost CTO inventory by the end of the first quarter next year.

And I'll now turn the call back to Luis for an update on guidance and closing comments.

Luis Fernandez-Moreno

Interim President, Chief Executive Officer & Director, Ingevity Corp.

Thanks, Mary. Please turn to slide 10. As you've heard today and seen in our release, we had a good quarter. As you know, the fourth quarter is a seasonally low quarter for our Road Technologies product line and we are still consuming high cost CTO inventory in our Performance Chemicals segment as Mary mentioned. Also, as you heard from many other companies, there are few, if any, signs of industrial demand improving and auto production forecasts appear to be softening. In light of this headwinds, we expect to deliver toward the lower end of our guidance of sales between \$1.4 billion and \$1.5 billion with adjusted EBITDA of between \$350 million and \$360 million.

As I look at the next few months, I see three key priorities for me, improved execution and focus, reducing our leverage through improved free cash flow and complete a fresh look at our business portfolio and corporate strategy. Based on these priorities, while it is too early to provide guidance on 2025, with the actions we have taken and our continued focus on improving growth and profitability, I have challenged the team to deliver a plan approaching \$400 million of EBITDA for 2025 and return our leverage to around 3 times by year end 2025. I will be able to provide more details of these initiatives and our progress in our February earnings call. Let me say again how excited I am to be in this position to drive the execution of our strategy. I look forward to speaking with you all again next quarter when we will also share more details on our outlook for 2025.

With that, I'll turn it over for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And our first question today comes from Jon Tanwanteng from CJS Securities. John, your line is open. Please go ahead.

Lee Jagoda

Analyst, CJS Securities, Inc.

Hi. Good morning. It's actually Lee Jagoda for John this morning. If we could just start with the CTO sales in Q3, can you speak to the volume of CTO sales you had in Q3, how much inventory you have remaining? And I think prior expectations were that you should be done with all the high cost inventory sometime during Q1 of 2025. Is there any update to that?

Mary Dean Hall

Executive Vice President & Chief Financial Officer, Ingevity Corp.

So I believe the CTO resales were very nominal in Q3, and as I – I think we said last quarter, we expect that we have completed essentially the resales. Your comment about the CTO inventory, we continue to have high cost inventory that runs through our production as we're actually consuming CTO to make product and that's the CTO – the high cost CTO that is actually impacting the EBITDA margins, for example, and profitability and that's what we've said that we expect to finish with that high cost inventory, consume it essentially all by the end of first quarter of next year.

Lee Jagoda

Analyst, CJS Securities, Inc.

Okay. Great. And then just another question on CTO, where is the underlying price of CTO today in the spot market? And how does that compare to your expectations from prior quarters in terms of when you need to go back to the market, the spread versus the high cost stuff that you're burning through today?

Mary Dean Hall

Executive Vice President & Chief Financial Officer, Ingevity Corp.

So what we have talked about is how the spot price of CTO has continued – did continue to come down largely throughout the year, I would say plateaued in the last few months. And I think the last Argus price I saw was in the \$700 – \$650, \$750, call it, range. So again, significantly below where we had indicated our CTO contract costs had been previously, although not back to the levels that we had seen in prior years before the dynamic of biofuels began to impact CTO prices.

Lee Jagoda

Analyst, CJS Securities, Inc.

Got it. And one more for me and I'll hop back in. Just in terms of the CEO search process, can you kind of give us the criteria for some of the things that a new CEO might have, you might want in a new CEO and any update on when the process might be completed?

Luis Fernandez-Moreno

Interim President, Chief Executive Officer & Director, Ingevity Corp.

Hi. This is Luis. Yeah, couple of comments regarding that. The board has a committee that is conducting the search, and obviously, they have the criteria that is needed for that search. The thing that I always highlight is that while that happens, I'm committed to stay here for as long as it takes to find the right leader for the company. And I will be acting as a full-fledged CEO, I don't expect to be just being a gatekeeper. So my focus and the focus of the organization continues to be to deliver based on my leadership, and again, the board is diligently acting on it, but they're going to take the time required to find the right leader for the company.

Lee Jagoda

Analyst, CJS Securities, Inc.

Sounds great. I will hop back in queue. Thanks very much.

Operator: The next question comes from Daniel Rizzo from Jefferies. Daniel, your line is open. Please go ahead.

Daniel Rizzo

Analyst, Jefferies LLC

Good morning. Thank you for taking my questions. You mentioned during your prepared remarks the reviewing portfolio businesses. Does this suggest that you won't be selling or divesting the PC or APT segments? Is that a possibility?

Luis Fernandez-Moreno

Interim President, Chief Executive Officer & Director, Ingevity Corp.

Hi, Dan. How are you? Yeah. It means that we are looking at the portfolio, I will be looking at it. The comments talk about the fact that the three segments that we have today provide scale and a geography and market diversity. Having said that, with me coming on the board, I think it's a good time to revisit and check if this is the right composition, the right corporate strategy, the right portfolio composition. So I cannot and will not speculate on what that may mean in terms of specific businesses other than indeed myself, the team and the board will continue to review the composition and the strategy. But again, recognizing that the current composition provides scale and diversity.

Daniel Rizzo

Analyst, Jefferies LLC

Thank you for the clarification. And then with Industrial Specialties, is there a percentage [ph] of your base (00:22:39) at this point or is the transition still kind of in [indiscernible] (00:22:41)?

Luis Fernandez-Moreno

Interim President, Chief Executive Officer & Director, Ingevity Corp.

So the strategy around Industrial Specialties is to diversify our raw material capability, so we are not tied to one or the other and being able to optimize the raw material mix to maximize both quality, profitability but also again, the ability to move from one to the other. So at this time, that's not something that we're focusing on in terms of what percentages, because the percentages may change quarter-to-quarter depending on the specific economics of each of the raw materials. And again, that provides flexibility that it's very important to us moving forward.

Daniel Rizzo

Analyst, Jefferies LLC

All right. Thank you very much.

Operator: The next question comes from John McNulty from BMO Capital Markets. John, your line is open. Please go ahead.

John McNulty

Analyst, BMO Capital Markets Corp.

Yeah. Good morning. Thanks for taking my question. So I guess the first one is in Performance Chemicals. So when I look at the improvement from 2Q to 3Q and the margins doubled and yet, sales in some of your higher margin business on the paving side was actually down a little bit. So I guess can you help us to understand what drove that improvement from quarter-to-quarter?

Mary Dean Hall

Executive Vice President & Chief Financial Officer, Ingevity Corp.

Yeah. It's primarily two things, John, and good catch there. So clearly, we're seeing the benefit of the mix shift as we're, again, progressively exiting those lower margin products and we're seeing that mix shift to the higher margin products in that segment. And also, frankly, in Q2, we were still operating Crossett, the Crossett facility. We announced the shutdown of that at the very end of Q2, and are seeing some – the benefit of not having the drag. If you recall, we talked about earlier the drag from the Crossett facility. So we would have had that drag in Q2. We don't have it in Q3. So both those things really are benefiting and showing up in that margin improvement.

John McNulty

Analyst, BMO Capital Markets Corp.

Got it. Okay. No, that's helpful and it definitely was – obviously was a big one. So I guess the other question that I had also on PC, I know it's a little bit early in terms of a guide for 2025, but I guess, look, there's a lot of kind of big buckets of improvement to come with CTO lower, Crossett gone. I guess, can you help to quantify the buckets as we go from 2024 to 2025? Let's just say the macros, everything's flat. Like, let's make a no-comp case from what's going on in the rest of the world. But on the savings, on the lower CTO, et cetera, can you help us to think about what that year-over-year bridge might look like for 2025?

Mary Dean Hall

Executive Vice President & Chief Financial Officer, Ingevity Corp.

I'll point to some information that we did talk about end of Q2 when we talked about Crossett, for example. We said that we expected the savings from closing Crossett to be – Crossett alone to be between \$20 million and \$25 million with an additional \$10 million of savings coming from corporate actions taken to rightsize the company as a result. On the CTO, again, what we've done is moved from long-term contractual arrangements at much higher cost to more of a spot purchase. And you heard – so we are obviously looking at the spot prices and again, as I mentioned, those have come down. Also recognized, though, I believe as we talked about last quarter in Industrial Specialties, because our raw material costs were so high, we were less competitive in pricing and selling of certain products in the market. So now with those CTO costs coming down as we move forward, we would expect that pricing will adjust as well. And again, we'll be more competitive in the market. We should see volume improvement as a result of that. But I think for modeling purposes, to just take the delta and CTO costs without any price movement would not be a fair apples to apples comparison.

John McNulty

Analyst, BMO Capital Markets Corp.

Got it. Okay. No, that's helpful. Thanks very much for the time.

Operator: The next question comes from Mike Sison from Wells Fargo. Mike, your line is open. Please go ahead.

Michael Sison

Analyst, Wells Fargo Securities LLC

Hey. Good morning. Nice quarter and outlook. Luis, I guess, when I think about 2025, so the last two quarters are running above that run rate. I understand the seasonality for the first and fourth quarter being a little bit lower. But when you think about building that bridge to next year that you're sort of walking your team through, just off the cuff, how much of that bridge from this year could be kind of just what you do on your own, and how much help do you think you need from auto builds or the economy?

Luis Fernandez-Moreno

Interim President, Chief Executive Officer & Director, Ingevity Corp.

Yeah. Hi, Mike. How are you? Very good question. I think that the reason I'm challenging the team to deliver a plan that is, again, approaching \$400 million, at this time, obviously, we understand that there's a fair amount of uncertainties on the things that you mentioned around auto production, industrial demand, but I'm definitely focusing on the self-help that we've done, say, company, including the fact that we got out of the CTO contract that will allow us to benefit from lower CTO costs in the last three quarters of the year. The benefits that Mary was just referring to when it comes to the PC repositioning. And the third element are the benefits of the enhanced focus or accelerated focus on execution by, again, making sure the teams are focused on the right things that allow us to improve profitability and growth. I think those are the key elements, while we understand that there are dynamics in the markets that are still uncertain. But definitely, we will be able to provide way more clarity in the February call in – in February 2025.

Michael Sison

Analyst, Wells Fargo Securities LLC

Understood. And then you kind of gave a little bit of color on what each of the segments you'd like to see. But can you maybe give us, I mean, just on general, when you think about what type of businesses that you or Ingevity's should own or want to own? Any sort of metrics behind that versus what type of growth, what type of return to capital, [indiscernible] (00:30:10) cash flow, any color of what is a good business you think that should be kept in the portfolio?

Luis Fernandez-Moreno

Interim President, Chief Executive Officer & Director, Ingevity Corp.

Yeah. That's a great question, Mike. And the only I can tell you is obviously I'm starting to look together with the team at the portfolio, but it would be too early for me to tell even with four weeks on the job and even as we're looking at the board, it will be very early for me to tell you what we're thinking. Clearly, we have some thoughts, but I think we'll be early to share some of those.

Michael Sison

Analyst, Wells Fargo Securities LLC

Okay. Great. Thank you.

Operator: We have no further questions, so I'll hand the call back to John Nypaver for some closing remarks.

John E. Nypaver, Jr.

Vice President, Treasurer & Investor Relations, Ingevity Corp.

Great. Thanks, Adam. Well, that concludes our call. Thank you for your interest in Ingevity and we'll talk with you again next quarter.

Operator: This concludes today's call. Thank you very much for your attendance. You may now disconnect your lines.

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