Seeking Alpha

Transcripts

FMC Corporation (FMC) Q3 2023 Earnings Call Transcript

Oct. 31, 2023 1:18 PM ET | **FMC Corporation (FMC) Stock**

SA Transcripts
142.73K Followers

Q3: 2023-10-30 Earnings Summary

Play Call | Slides | Press Release | 10-Q

EPS of $0.44 misses by $0.01 | Revenue of $981.90M (-28.70% Y/Y) beats by $1.41M

FMC Corporation (NYSE:FMC) Q3 2023 Earnings Conference Call October 31, 2023 9:00 AM ET

Company Participants

Zack Zaki - Director, Investor Relations

Mark Douglas - President and Chief Executive Officer

Andrew Sandifer - Executive Vice President, Chief Financial Officer and Treasurer

Conference Call Participants

Joel Jackson - BMO Capital Markets

Laurent Favre - Exane BNP Paribas

Aleksey Yefremov - KeyBanc

Kevin McCarthy - Vertical Research Partners

Laurence Alexander - Jefferies

Mike Harrison - Seaport Research Partners

Vincent Andrews - Morgan Stanley

Arun Viswanathan - RBC Capital Markets

Adam Samuelson - Goldman Sachs

Operator

Good morning, and welcome to the Third Quarter 2023 Earnings Call for the FMC Corporation. This event is being recorded and all participants are in a listen-only mode. [Operator Instructions]

I would now like to turn the conference over to Mr. Zack Zaki, Director of Investor Relations for FMC Corporation. Please go ahead.

Zack Zaki

Thank you, Ledia, and good morning, everyone. Welcome to FMC Corporation's third quarter earnings call.

Joining me today are Mark Douglas, President and Chief Executive Officer; and Andrew Sandifer, Executive Vice President and Chief Financial Officer. Mark will review our third quarter performance as well as provide an outlook for fourth quarter and full year performance. Followed by an update on FMC, Diamides franchise. Andrew will provide an overview of select financial results. Following the prepared remarks, we will take questions.

Our earnings release and today's slide presentation are available on our website, and the prepared remarks from today's discussion will be made available after the call.

Let me remind you that today's presentation and discussion will include forward-looking statements that are subject to various risks and uncertainties concerning certain factors, including, but not limited to, those factors identified in our earnings release and in our filings with the Securities and Exchange Commission. Information presented represents our best judgment based on today's understanding. Actual results may vary based upon these risks and uncertainties.

Today's discussion and the supporting materials will include references to adjusted EPS, adjusted EBITDA, adjusted cash from operations, free cash flow and organic revenue growth, all of which are non-GAAP financial measures. Please note that, as used in today's discussion, earnings mean adjusted earnings and EBITDA means adjusted EBITDA. A reconciliation and definition of these terms as well as other non-GAAP financial terms to which we may refer during today's conference call are provided on our website.

With that, I will now turn the call over to Mark.

Mark Douglas

Thank you, Zack. And good morning, everyone. During Q3, we observed a continuation of industrywide destocking activity as the value chain resets inventory levels in response to increased security and supply and high interest rates. This led to significantly lower volumes versus the prior year and in the case of Latin America, the decline was much more severe than we had estimated at our last earnings call. As a reminder, due to the timing of its growing season Latin America is typically the strongest contributor to our Q3 results which amplifies the region's impact on our overall Q3 numbers. We had assumed that the destocking we observed in Latin America during Q2 would be sufficient to allow for our normal order patterns to resume. As Latin America entered its main growing season in September, it became clear that we underestimated the debt and duration of the destocking to come. It is our view that when the global destocking ends and channel inventories have been reset, there will not be a snapback restocking period. Rather, we expect the crop protection market will grow from that reset inventory base at a more historical growth rate. As a result, and as we noted in our pre-release, we are taking significant actions with regards to our company's cost structure, with an announced restructuring of our Brazilian operations, as well as a review and adjustment of our total company cost base. We are right-sizing our cost base to better reflect market conditions, protect our margins, and position us for future success. We will provide more details about our restructuring programs at our Investor Day.

Our Q3 results are detailed on slides 3, 4 and 5. Q3 revenue was 29% lower than the prior year, both including and excluding FX, driven primarily by lower volumes from channel destocking and, to a lesser extent, dry weather conditions in some countries. We had price increases in North America, EMEA, and Asia, which were more than offset by price decreases in Latin America. While our sales were down significantly versus prior year, we need to be clear that the grower application of crop protection products has been steady, and even trend in higher than the prior year in some key countries such as Brazil and the US. In addition, sales of our newer and more differentiated products, including Branded Diamides and Plant Health, outperformed the overall portfolio. Products launched in the last five years grew 4% and represented 10% of total sales in the quarter, demonstrating robustness in the current environment. New product launches accounted for more than 4% of total company sales in the quarter.

Looking at our revenue by region, North America sales were lower than the prior year by 34% as anticipated destocking activity was the main driver of lower volumes. Dry weather in Canada was a smaller volume headwind. Sales in EMEA were relatively flat with a revenue decline of only 1% and 4% excluding FX. We encountered volume pressure from channel destocking as expected particularly in Germany. This was mostly offset by a combination of higher prices, strong diamide sales that outperformed the overall portfolio and a modest FX tailwind.

In Latin America sales were down 33%, 36% excluding FX due to lower volumes and to a lesser degree pricing pressure. Destocking particularly in Brazil and Argentina was the driver of the results in the region. At the same time, we had a very successful launch of our patent pending diamide insecticide Premio Star in Brazil. The strength of that launch was one reason branded diamide strongly outperformed the rest of the region's portfolio. Shifting to Asia, sales were down 28% and 23% organically. As expected, from like the other regions, volumes were negatively impacted by destocking behavior, particularly in India, where elevated channel inventory continues to be actively managed. Pricing was up slightly with an FX headwind. Products launched in the last five years showed greater resilience than the rest of the portfolio and grew 16% versus the prior year, driven by sales of Isoflex herbicide. The outperformance of new products in most regions demonstrates how our technology differentiates FMC in the marketplace and why our new product pipeline is a key contributor to our growth at consistently superior margins.

We reported EBITDA of $175 million in the quarter, down 33% compared to the prior year period, due to the volume decline along with a smaller pricing headwind partially offset by lower costs. Sales of new products included launches and sales of differentiated products such as our branded diamide and biologicals positively impacted mix. Costs were $137 million tailwind, with contribution from inputs and to a lesser degree operating costs. Input cost benefits were especially pronounced compared to the prior year period that represented the peak of inflationary headwinds. Combined SG&A and R&D costs were favorable to prior year, and we are on track to deliver our commitment of $60 million to $70 million cost control in the second half, keeping those operating costs in line with the prior year.

Shifting to our outlook, slide 6 shows our latest expectations for Q4 and full year. We are expecting revenue in Q4 to be 22% lower than the prior year, driven by a high teens percentage volume decline, as destocking continues. Similar to Q3, we expect a low to mid-single-digit pricing headwind in Q4, driven by Latin America. FX impact is forecasted to be minimal. Adjusted EBITDA in Q4 is expected to be between $246 million and $306 million, which is a 36% year-over-year decline at the midpoint, primarily due to lower volumes. We expect positive mix impact as sales of new products, including launches, continue to show growth. Operating costs are expected to be in line with the prior year as cost controls remain in place.

I'll now turn the call over to Andrew, who will cover cash flow and other financial topics.

Andrew Sandifer

Thanks, Mark. I'll start this morning with a review of some key income statement items. FX had essentially no impact on revenue in Q3, with headwinds among Asian currencies, particularly the Pakistani Rupee and the Indian Rupee, offset by tailwinds in Latin American and European currencies, particularly the Brazilian Real, the Mexican Peso, and the Euro. EBITDA margin in the quarter was down 120 basis points versus the prior year period. While favorable input costs and positive mix led to a gross margin percent that was over 400 basis points higher than the prior year period, the severity of the volume decline resulted in a decline in EBITDA margin. EBITDA margins in Q4 are expected to be meaningfully below prior year and prior guidance. Gross margin is anticipated to be challenged by pricing pressures in Latin American, Asia due to current market conditions. Despite continued operating cost discipline, the expected decline in volume is anticipated to further pressure EBITDA margin, as SG&A and R&D expenses are supported by a lower revenue base. Interest expense for Q3 was $65 million, up $23 million from the prior year period. The significant increase in US interest rates year-over-year with the main driver. Higher overall debt levels also contributed to increased interest expense as working capital remains elevated.

Relative to guidance, elevated interest expense was entirely attributable to higher debt balances. We now expect full-year interest expense to be in the range of $240 million to $245 million, with the increased versus prior guidance due to elevated working capital levels resulting in higher debt balances. Our effective tax rate on adjusted earnings for Q3 was 15%, in line with the midpoint of our full-year expectation for a tax rate of 14% to 16%.

Moving next to balance sheet and liquidity. As of September 30th, gross debt-to-EBITDA was 3.6x, while net debt-to-EBITDA was 3.3x, reflecting the sudden deceleration of our earnings beginning in Q2 and elevated debt levels due to higher working capital resulting from this deceleration. The covenant of our revolving credit facility evaluated our leverage using a metric that includes adjustments to both EBITDA and debt as reported. With these adjustments, covenant leverage was 3.8x as of September 30th, relative to a maximum allowable of 4.0x. We do not view this as an acceptable leverage level relative to our covenant. In light of this and the reduced outlook for Q4, we are currently in advanced discussions with our bank group to further amend our covenant to provide additional headroom for the company as we adjust our cost structure and debt levels to current market realities. Our bank group continues to be highly supportive of the company and recognizes the transitory nature of the current industrywide channel inventory correction. We expect to complete this amendment in the next 7 to 10 days and will provide further updates at time.

Moving on to cash flow generation and deployment on slide 7. FMC generated free cash flow of $32 million in Q3, down from $360 million in the prior year period. Cash from operations declined $316 million with lower EBITDA and substantially lower payables as we adjust our operations to match current demand. Capital additions and other investing activities were slightly lower than the prior year period while legacy spending increased $14 million due to timing of expenses. Year-to-date cash flow through September 30th was negative $790 million, $651 million lower than the prior year period. Nearly all of the reduction stems from lower cash from operations, which was down substantially due to lower EBITDA and lower payables. We returned $73 million to shareholders in the quarter via dividends. There were no share repurchases in Q3. We expect full-year weighted average diluted shares outstanding to be $125.7 million. We've reduced our free cash flow guidance for 2023 to negative $750 million at the midpoint. Down from breakeven in our previous guidance. The reduction in full-year cash flow outlook is a direct result of lower than expected second half EBITDA and the impact of reduced volume on working capital. Compared to prior year, the decline in free cash flow is almost entirely due to lower EBITDA and payables. With lower use of cash for inventory, largely offsetting other items including higher cash interest, cash taxes and capital investment. Adjusted cash from operations is now expected to be between negative $635 million and negative $435 million, down substantially from prior guidance.

Capital additions are expected to be between $135 million and $145 million including spending to support new product introductions, which is our most recent results illustrate, drive high value for our business even in challenging industry conditions. Legacy and transformation cash spending of $70 million to $80 million is expected to remain essentially flat to midpoint after adjusting for the benefit from the disposal of an inactive site in 2022. This guidance implies a rolling three year average free cash flow conversion of 21%, substantially below our targeted 70 plus percent. This is due entirely to the cash flow and books impacts from the inventory reset in 2023.

I'll reiterate Mark's earlier point that end market demand for our products is solid. The quality of our receivables is solid with good performance on collections in key countries including Brazil. Once this industrywide channel inventory reset is finished and more normal order patterns resume, we expect a significant rebound in cash flow as EBITDA improves, inventory is converted to receivables which are subsequently collected and critically as we rebuild payables ramping back up production. Our near term cash deployment priorities have not changed with the dividend and debt reduction including the redemption in Q4 of the $400 million in notes due in 2024, still the top priorities. Share of purchases will remain suspended until leverage returns sustainably to targeted level.

And with that, I'll hand the call back to Mark.

Mark Douglas

Thanks, Andrew. I mentioned earlier that our more differentiated products were showing resilience in the current market environment. This includes the Diamides, a very successful product franchise, which has received renewed attention over the last couple of months. Today, I'll give you an update on the progress of our Diamides growth strategy. This will be supplemented by our forward-looking view of the robust growth plans we have for the Diamides at our Investor Day. We have owned the Diamides for the past six years. Over this timeframe, we have delivered on every target we've set, including growing the size of the business, expanding our partner base, accelerating registrations, expanding our geographic footprint, and finally, introducing brand new patented formulations that allow us to explore and expand the new market segments. All of these results should provide confidence that we can continue to profitably grow the franchise into the future.

Turning to slide 9 for some basic data on the insecticides market, which was valued at over $20 billion in 2022. Insecticides have grown at roughly 5% per year over the current time frame. FMC's Diamides, Rynaxypyr and Cyazypyr, make up more than 80% of the entire Diamides class, which includes a few other smaller active ingredients. FMC's Diamides have grown at about 12% of the total insecticide market. And as you can see, Diamides outperformed every other leading chemistry class in the insecticide market by growing at 11% compound annual growth rate and gained 5% market share as a result. High value technologies such as the Diamides continue to take share from older insecticides, some of them being phased out by regulators.

Turning to slide 10, we showed a breakdown of our $2.1 billion of Diamides sales in 2022. Cyazypyr has grown more rapidly than Rynaxypyr since our acquisition of the assets and made up more than 20% of total sales. This year, we estimate that this trend will continue, with Cyazypyr making up roughly 22% of total Diamides sales. Partner sales are a key element of our lifecycle management strategy. FMC sells either technical active ingredient or formulated products to our partners under these arrangements. We have long-term supply agreements with five key global companies and over 60 local agreements in various countries with the potential to add more partners in the future. Many of these agreements go through the end of the decade. The partnership model has helped to expand the market for our Diamides since our partners have access to customers, crops and segments that we do not currently serve. Moreover, partner sales are not margin dilutive and these sales made up roughly one-third of our Diamides revenue in 2022. While the remaining two-thirds came from our own commercial activities, which we refer to as branded sales.

In 2023, we've seen our partners actively manage their inventories, resulting in lower sales. Branded sales have continued to outperform the overall company. We've also shown the geographic breakdown of our branded sales as of 2022. Asia made up more than 40% of our branded sales, followed by Latin America at 28%, EMEA at 17%, and North America at 12%. This year, we expect branded sales to outperform total sales in Latin America, driven by new products' introductions. Branded Diamides in the other regions are expected to perform in line with, or better than, respective regional sales. On the right to the crop breakdown of our overall Diamides revenue, which includes branded and partner sales. The diversity of crops reflects the broad market potential, as well as market access required to sell these products. This is an important fact to note, as we have numerous products selling in more than 90 countries across dozens of crops. Our Diamides are not a single monolithic product, and as such are defendable through various mechanisms, including, most importantly, newly patented formulations, branding, value selling, agronomic support, and grower education. Our precision ag offering, Arc farm intelligence, now helps support and defend over $700 million of revenue from our branded Diamides, a unique and powerful tool in our Diamides growth strategy.

Turning to Slide 11, you can see that managing the Diamides life cycle has multiple strategic components. We will provide more color on these pillars at Investor Day in November, but I wanted to start framing the innovation and IP pillars today. Turning to slide 12, FMC has continued to significantly grow the Diamides to innovation, since acquiring them in late 2017. At acquisition, sales were already segmented across dozens of formulations and brands, spread across more than 80 countries. Since acquisition, FMC has increased the segmentation by developing new partner sales, launching new patented formulations and brands, obtaining new registrations and expanding existing labels which have resulted in a diverse portfolio. This diversity minimized reliance on any single formulation and instead relies on innovation to drive future growth.

We have already started to see the benefits of recent innovation in Diamides. This is evident from the increase in total sales of Branded Diamides from ‘21 to ‘22, even though some of the core Rynaxypyr products decline modestly in the same time frame. Coragen MaX insecticide powered by Rynaxypyr is one example of innovation that did not exist when we acquired the Diamides. Coragen MaX is a patent pending higher concentration formulation of Coragen that provides targeted insect control in canola, pulses and cereals. Premio Star is another example of new technology that was developed primarily for applications on Brazilian soy, corn and citrus crops and receive priority approval from Brazilian authorities. The patent-pending combination of Rynaxypyr and bifenthrin provides a differentiated formulation with extremely high performance for chewing and sucking insects. Premio Star has a dual mode of action, its broad spectrum, with both immediate and extended control.

FMC has developed and launched four new patented or patent-pending formulations across 10 countries in the past few years. These new technologies are expected to make up 17% of branded Diamides sales in 2023. Contributions from new products will further accelerate over the next few years, removing FMC's portfolio away from older and less differentiated products. Slides 13 and 14 show an updated view of our patent and regulatory timelines. FMC has a patented state of over 1,000 granted and pending patents filed in over 75 countries for the Diamides. While we have not changed our overall outlook, we have included additional commentary to reflect developments since we last shared these timelines. One addition from our last version of this slide is the inclusion of patented mixtures and patent-pending formulations that can extend patent coverage once granted to 2040 and beyond in some cases. Patents are regulated by different government entities than the ones that issue crop protection registrations. Approvals of registrations does not have any bearing on patent validity. Generally speaking, legal actions must be initiated by the patent holder and can only start after registration is received and a generic product enters into commercialization. Moreover, patent judgments in one country do not change FMC's patent rights in other countries. Nor do these judgments give companies the freedom to operate in other countries with valid patents in place. FMC will continue to enforce our patents and we view any infringing parties as a seller of illegal product. In addition to our legal strategy, we also have a regulatory advocacy strategy that includes the enforcement of our data protection rights and notifying regulators about companies that do not have permission to produce or have unknown or different impurities in their products, or otherwise do not comply with applicable regulatory law. This has been and continues to be a successful strategy. Numerous regulatory authorities have declined to approve registrations from such companies.

In other instances, companies have voluntarily cancelled or withdrawn applications as a result of our efforts. Hopefully this overview has provided a more comprehensive understanding of the current state of FMC's Diamides. At or Investor Day, we will provide a view of the next phase of growth for this franchise, driven by innovation and other strategic levers.

Finally, let me wrap up by saying that 2023 has clearly not turned out how we or the broader industry thought it would. However, we firmly believe the current channel destocking will run its course, and I believe we have taken the right actions to reflect what is happening from a channel demand standpoint. Our new products, Plant Health products, and Branded Diamides all continue to outperform the rest of the portfolio, which shows the benefit of our technology investments. We look forward to seeing many of you at our Investor Day where we will lay out our new strategic plan and provide an outlook for FMC's growth over both a near and long term.

We can now open the line for questions.

Question-and-Answer Session

[Operator Instructions]

Operator

Our first question today comes from Joel Jackson of BMO.

Joel Jackson

Hey, good morning, everyone. There are a lot of questions in FMC, obviously, the last weeks, last months on the near term outlook and then, of course, the midterm outlook with the diamides and other products. Maybe we could start with next year. I realize it's early, but it's a key question. We had a lot of volatility around the different numbers. When you think about 2024, can you help anchor us on what it might look like? I don't know if you want to use your 7% to 9% EBITDA placeholder target as a starting point and as granular as possible around volumes, costs, price, where do you think earnings growth can shake out next year? What do you have to do to get the inventory out of the system? Do you have to lower prices? Whatever you can do to help us, get an early look on 2024. Be appreciative.

Mark Douglas

Yes, thanks, Joel. Listen, you are right, it is a little early to be giving specific details and we will talk more about this at our Investor Day as you can imagine. But let me try and frame ‘24 in the context of where we are today, give you some idea of how we're thinking. We have gone through obviously since sort of mid-year a very significant inventory reset and I'll keep reiterating the point that we see this as destocking inventory reset, whatever you want to call it, it does not reflect on the ground demand. We see strong on the ground demand pretty much everywhere in the world which is the backdrop for how the business really recovers and comes out of this period. The resetting is occurring now, obviously we started in Q2, we entered Q3 and here we are in Q4 and it's still ongoing. I would say next year Q1 is going to be more difficult because the inventory had not reset so Q1, 2023 was a pretty good quarter kind of flattish to 2022. That's not going to be the case. We're going to see that inventory reset continue in Latin America, likely in Europe as well, and maybe even a little bit in the US. We'll see how we go through Q4. I think things will start to change in Q2 as we start to lack the industry reset. And then I expect the industry to move forward in the second half of the year.

I know some people will say it's going to be a first half, second half story. It is just because of the way the seasons are moving and the inventory is resetting. From our perspective, I see revenue growth next year for FMC, and I see higher than revenue, EBITDA growth and revenue for next year. Why do I say that? I think the second half of next year is going to be much better. I think the industry will be in a much more balanced shape. As I've said, we're not expecting a snapback. I just don't see with the current economic environment where I see supply and where I see interest rates. I don't see people going and building a significant inventory again. That's not necessarily a bad thing. The industry typically grows at 3 plus percent a year. I expect you're going to see something like that number in the second half of the year.

For us, new products continue to be a major driver. One reason why we're very excited about next year is we have more products coming. And right now, when you look at what we call our NPI data, we're having something like $630 million this year of new business from those products launched in the last five years. I expect that number to be higher next year, adding more revenue to the company. So we see the new products paying off as we go over the next few years. From a cost perspective, I'll let Andrew comment a little bit on costs. We do have a couple of elements flowing through the P&L and balance sheet right now. Not only do we have cost savings, but we have unabsorbed variances coming out of our manufacturing plants as we think about the length of time that those manufacturing plants are either shut or idle and until they come back. So you've got to factor that in as we go next year. Having said that, we are putting in place significant restructuring plans. That will benefit EBITDA next year, as well as the product mix benefits EBITDA and gross margin. Andrew, do you want to say anything on the cost side?

Andrew Sandifer

Yes, just echo comments you made, Mark, I think, as we look forward to input cost for next year. The cost of what limited buying we're doing right now, but the cost of things that we're buying are in a positive comparison to prior year. We do expect that input cost will be a modest tailwind next year. The challenge is, unfortunately, that carried forward of unabsorbed fixed costs from reduced production and then the latter part of this year and into early next year. So at gross margin, we're not expecting a lot of help either way at the gross margin line from input cost. Being offset again by unabsorbed fixed costs. It really would be the impact of the cost savings programs we're in the process of launching that will impact every line of the P&L from COGS to SG&A and R&D. We'll detail this more, additional detail at our Investor Day in a few weeks, but that will be a big part of driving profit growth next year.

Mark Douglas

So Joel, to wrap up for you, expect to see revenue growth, expect to see EBITDA growth above revenue growth next year from FMC.

Joel Jackson

Great. That's helpful. And then you reiterated a lot of your plan to defend the Diamides across the decade. As you've started doing some of these moves, can you talk about what's going well, what's not going as well as you've thought in some of these strategies and how you're thinking about changing them? And if you can be as granular as possible, what's working and not working in the different countries like India, Brazil, wherever else it'd be helpful.

Mark Douglas

Yes, sure. I mean, first of all, our main strategy, I think it's on slide 12, which shows the sediment chart. You can see on that slide how we're altering the profile of the portfolio of the Diamides. The new products are growing rapidly. The one we mentioned in the script, Premio Star in Brazil, that has already contributed in Q3, tens of millions of dollars of new growth. And we expect to see the same in Q4 and as we go forward in the rest of the season. That's the type of activity that changes the face of the Diamides. First of all, they give you tremendous pattern extension because these are very sophisticated formulations, whether it's the blend of different active ingredients or something like Coragen MaX, which is a very high concentration formulation. It means you can use less; it means you're carrying less water, less packaging. So from a sustainability perspective, it's a great product and it also has superb efficacy.

So it's those types of innovations, not only change what we sell, it may move us away from any generic products that will come into the market, either legally or illegally in different countries. It changes the shape and it adds more value to the company. So I think from a product innovation standpoint, that's one aspect that we've been heavily focused on. The second piece is the continued geographic expansion, registration, label expansion. You can see by the chart that we showed where Diamides sits in the whole spectrum of insecticides. There are some very old chemistries out there that are going to be removed over the next 10 years. Our target is those older chemistries. So we need to make sure we have the products in the right registrations and the right geographies on those crops to take away those older chemistries.

So for me, it's innovation, it's geographic expansion and the innovation is really driving the next generation of patent support that we have for these products. So we feel very good about where we are. We'll give you more details on November the 16th about that growth profile. But think of it in terms of innovation and geographic expansion.

Operator

Our next question today comes from Laurent Favre of BNP Paribas.

Laurent Favre

Thank you. Good morning, guys. First question. The business is back roughly to the size of 2019 or 2020. The working capital that I think you're implying for the end of this year is about $1.5 billion higher than it was back then. And I guess my question related to the framework that you've given us Mark, how much of that $1 billion, $1.5 billion you think you can get back not just next year but also maybe in the following years? Should we assume that working capital is significantly higher now structurally compared to what it was or what it has been over the last few years?

Mark Douglas

Yes, Laurent. I'll let Andrew give you some details on the working capital side. My view is when we think about restructuring the company, we're not only talking about our cost base but we're absolutely talking about the other metrics that we look at the performance of the company. Working capital be one of them. The different elements of working capital move at different speeds. Obviously, payables are a lot lower than it should be given the fact that we're not manufacturing a lot right now so therefore we're not buying a lot. That will change inventory. We are working our way through inventory right now. Obviously, selling out of inventory reduces inventory and then we'll collect the receivables at the normal rate. I expect the metrics to get back in line through ‘24 and ‘25 in terms of as a percent of revenue, how much working capital do we carry. But Andrew, if you want to give any more details on that.

Andrew Sandifer

Yes, certainly, Laurent, I think you're on to the right theme which is we do expect normalization of working capital over the next 12 to 18 months. I do think it's important to remember in the ag input space that working capital cycles different than other chemical or materials businesses. Now we buy on reasonable terms, industrial terms from our suppliers. Then we hold manufacturer product hold an inventory for to meet seasonal demand. Then have inventory ready when needed when pest pressure shows up. Then we sell often on crop terms or longer terms certainly than what we pay for materials we purchase. So it's a bit of a long cash cycle that's becoming elongated particularly as inventory levels have gotten out of line with the go forward sales pace. So I think right now the focus is really on, as I mentioned in my prepared comments, on taking inventory, converting it to sales, converting it to receivable and collecting it. But there can be a good six to 12 month lag in that process due to the seasonal nature of the business to be able to really clear through that inventory and turn it to a good to receivable and collect it. So certainly a good reference point, looking back a couple of years where trade working capital in 2021 at 9/30 was about $700 million lighter than where we are today. That's not a bad dimension. And certainly we would think that those working capital metrics would come back in line that to more historical norms. It's just going to take 12 to 18 months to really adjust to all of the whiplash we've had in the supply chain with both the rapid growth in 2022 and now the rapid deceleration in 2023. But I think my fundamental message to you is, yes, we fully anticipate a robust working capital release in 2024 and bleeding into 2025.

Laurent Favre

Thank you. And the second question, having seen sharp normalization of pricing in LATAM, what makes you think that prices are not going to be sharply down in the northern hemisphere when you start the ‘24 season?

Mark Douglas

Yes, I wouldn't describe what we've seen in Latin America is sharp. And also, Laurent, it's not broad pricing. It's more a reflection of how we account for customer inventory and how we're managing price with customer inventory going forward. It shows up in price. Obviously, our customers, some of our customers are holding higher cost inventory. We're working that through as we go through this season. So it's not broad based price pressure. And as we indicated in the other three regions of the world, we actually had price increases over the year, over the period. We will continue to look at price increases next year. People should not forget there is still inflationary pressures moving through many economies and certainly companies like us. We have labor cost increases as many companies do. So we will not be shy from raising prices as we go through the next 12 months cycle.

Operator

Our next question today comes from Aleksey Yefremov of KeyBanc.

Aleksey Yefremov

Thanks and good morning. Continuing on the working capital theme, could you give us some idea how your working capital would strengthen the next few quarters? I mean, typically you'll have a build-in if you want, but given the current situation, would you expect maybe no build and release of working capital in the first quarter or something else perhaps?

Andrew Sandifer

Sure. Hey, I'll take, this as Andrew. Look, I think the traditional working capital build you see in Q1 should be significantly lower. From an inventory perspective, we're already sitting on a substantial inventory, so our traditional end of year, beginning of year inventory builds in advance of the Northern Hemisphere seasons will be much less subdued, if at all. I think from a receivables perspective because we do have significant advance payments in Q4 against sales in Q1. You don't see as much relief on the receivable side in Q1. And then the question mark is going to be how rapidly we start ramping back up production. We significantly reduced production levels, step down in Q3 and further step down in Q4. So our payables are quite depressed. How quickly we rebuild those payables in the first half of next year will have a lot of impact on it. But certainly I would say the biggest factor that should limit the traditional big working capital pump in Q1 is there is no need to build up a significant pool of inventory going into the new year.

Aleksey Yefremov

Thanks, Andrew. And sticking with working capital, your inventory is an absolute dollar basis. I mean, they decline sequentially, but given that you've shut down many of your production lines, maybe you would have expected a bigger drop. Could you just talk about that? Am I wrong here? And what's going on with inventory? Would you expect that number to come down more sharply in Q4 and Q1?

Mark Douglas

Yes, Alek, let me just make a comment up front and then Andrew can give you some other details. You've got to think carefully about how the inventory is and where it is. We have a lot of work in progress. From the moment we place an order with either outdoor manufacturers or our own facilities, it can take six months for those products to hit the warehouses to sell to customers. So once you start slowing that engine down, it takes a while for that to actually stop dead. We're out of that period now. So we do expect that inventories in Q4 will come down considerably. But Andrew, do you want to make any comments?

Andrew Sandifer

Yes, I think just building on that in Q3, look, sales were $250 million lower than what we'd expected in the quarter. And that's directly a big chunk of inventory reduction that we would have expected to achieve in Q3. And I think as Mark has commented, you can't stop a super tanker in one quarter, it does take time to slow things down. You should expect to see a more substantial drop in inventory from 9/30/23 to 12/31/23.

Operator

Our next question comes from Kevin McCarthy of Vertical Research Partners.

Kevin McCarthy

Yes, good morning. Andrew, it sounds like you've had at least some preliminary discussions with the banks regarding your covenants. Can you walk us through the path of deleveraging that you would foresee over the next several quarters and maybe talk through some of the more salient covenants and costs to amend those? Will be the first part of the question.

And then, longer term, I think you've been running the balance sheet with a goal of about 2.5x leverage. Are you tempted to reduce that goal on a structural basis given the volatility that we've seen in the market.

Andrew Sandifer

Thanks, Kevin. Look, I think the covenant discussions are well underway, going very positively. We'd expect to have something more concrete to disclose next week. So, some more to come there. Our most recent covenant amendment we did with 100% support of the bank group and at no cost. This covenant amendment may cost us a little bit, but it won't be a material expense. So I'll reserve comment until we have completed the discussions, but discussions are well advanced. We have gotten very positive feedback from the bank group. And just to reiterate, they see the need for us to adjust and go through this period of resetting our size of our business with this industrywide channel reset really is a transitory business condition. So the banks have been very supportive of the company. We will, again, adjust the covenant to give ourselves room as we're both reducing debt and allowing the trailing 12-month EBITDA to recover. So as Mark pointed to, certainly Q4, the guidance we have today is challenging, Q1 not likely to improve, and in Q2 we would expect to see an inflection point and start to see trailing 12-month EBITDA begin to recover. That will help with leverage. And then certainly any of the cash that we generate beyond paying the dividend at its current level, all of that cash flow will go to reducing debt. And including, I want to be very clear because there have been some questions about this. We have $400 million in senior notes that are due in February of 2024. We will be redeeming those notes this quarter. So, we'll have no near-term maturities to address. And that's a part of the whole conversation with the bank group on the covenant. So, we'll have some further information for you in the next week on the covenant.

In terms of longer-term financial policy, I'm going to reserve comment there to our Investor Day. I will state that 2.5 target leverage on average has been our long-standing policy. We've run north of that on average for the past several years. So that's something that we've had some very active discussions Mark and myself along with the board. So we'll bring some further comments in that in two weeks in the Investor Day.

Kevin McCarthy

That's helpful. And then secondly, Mark, to follow up on your prior comments regarding pricing and also the sales outlook for 2024. Would you expect price to trend flat up or down next year versus 2023?

Mark Douglas

A little early to tell, Kevin. We really not thinking through the volume price mix just yet. Generally speaking, price tends to be sticky for FMC over the years. We've seen that. We do tend to raise prices every year, even if it's only 1% to cover some form of inflation in different parts of the world. So a little early to say I'll give you more details on November the 16th when we talk about 2024. But volume, sorry Kevin just to finish that conversation, I would say just our new product introductions come through on volume for us not price. So that growth in new products would show up in volume expansion.

Operator

Our next question comes from Laurence Alexander of Jefferies.

Laurence Alexander

Good morning. Just two questions about framing. One is if you think about the loss sales this year, can you give us rough split between how much you think is order timing moved into the first half of next year? How much is permanently lost and how much you think you would recover by I don't know ’25 -‘26?

Mark Douglas

It's, Laurence, there is no push of sales into next year. This is all real inventory that's been held in distribution retail and it's been removed. It does not get pushed so I would say it's zero going into next year. It truly is a reset of bringing those inventories around the world down and then growing from that new point onwards.

Laurence Alexander

Okay. And secondly on Diamides just for context, can you give a sense for how many reformulations you're introducing? I don't know either annually or over the next three, five years and how that compares with the cadence across the rest of your portfolio. And then also just for context, there have been other large chemistry classes that have gone off patent. What has been the typical growth trajectory for those over 5, 10 years after they went off patent?

Mark Douglas

Yes, I'm going to give you those details on November the 16th because we have a section on Diamides and the overall growth of the portfolio so we'll put it all in context for you. Suffice to say that the number of formulations accelerates as we go over the next 5 to 10 years and those products are already in our pipeline that we'll talk about. Well documented in terms of what happens to molecules when they go off patent. Generally the market expands, pricing alleviates but volume goes up and the net-net is you have an expansion of the market itself plus an expansion in overall dollars of profitability. I don't think the Diamides will be any different. The difference may be the fact that they are so fragmented and different types of patents in different parts of the world. You may see that coming off in different regions and we kind of showed that in the slides that we put forward. We have our own examples, Sulfentrazone, Clomazone that have been off patent for many years. They continue to grow, they remain profitable. We don't see any difference for those Diamides, but we'll put all that in context for you on the 16th.

Laurence Alexander

So your bias is they're in line or better than average as opposed to worse than average?

Mark Douglas

You mean in terms of growth?

Laurence Alexander

Yes, in terms of what happens, in terms of that sort of typical trajectory. For historical example, do you think they're kind of at least in line with the average?

Mark Douglas

Yes, I would say the Diamides will be higher than the average just because of the attributes that they have.

Operator

Our next question today comes from Mike Harrison with Seaport Research Partners.

Mike Harrison

Hi, good morning. Just speaking with the Diamides discussion, you guys have worked pretty hard to enable potential competitors to work with you on licensing and other commercial arrangements. You gave some details in the slides there, but how should we think about potential competitors? You mentioned there were five large ones and more than 60 smaller ones who have taken that avenue and are working with you and they're now customers versus potential competitors out there who are looking to go with a load and create generic versions of your Diamides without working with you. And I guess how do you see that kind of evolving over the next several years?

Mark Douglas

Yes, I mean, this is -- that will obviously happen as patents roll off and jurisdictions change, generic products will come. I mean, that's normal in this industry, we see it every molecule that has ever existed. What we're doing about that, changing the formulations, bringing new technologies into the Diamides as we just talked about, expanding that geographic base, those are the things that we're doing. The branding of our products, we have extremely strong branding around the world. The brands that we sell are some of the best known brands in the pesticide industry. That is a very powerful tool in places like India, in places like Brazil. Brand matters, quality, assurance of performance. So all you bring all those things together, and we'll talk about that on the 16th, those are the types of activities that allow you to continue to grow your market share in an expanding market.

Mike Harrison

All right, thank you. And then in terms of the, where you see channel inventories today, and your visibility on normalizing order patterns. Can you maybe walk us around the world and talk about where you see those channel inventory levels? I guess are the challenges right now, mostly focused on Latin America, or is visibility still pretty limited in other regions as well?

Mark Douglas

Yes, it's not great right now, Mike. It's very difficult to walk around the world. You could tell by the types of results that FMC is putting out there, as well as our competitors, that everybody is having the same issues in judging where the market is. I think the focus is on Latin America, because Latin America is now at the beginning of its season, where we've had time in the Northern Hemisphere to work through some of this in US, Canada, obviously Europe. So I think Latin America has all the focus now, just because it's late to the game in terms of where its season is. That does not mean to say that there is not channel inventory elsewhere in the world. Hence my comments, I see this working through Q1, possibly into Q2, and then off we go. So I think that first half is where we're really focused on to make sure that we understand, as we come out of that period, exactly where are we and how is volume flowing.

Operator

Our next question comes from Vincent Andrews of Morgan Stanley.

Vincent Andrews

Thank you. Good morning, everyone. Mark, I wanted to try to square some of your preliminary comments on 2024. I recognize they're at a high level. I understand raw material costs can be down next year. I understand that you're going to have some restructuring cost savings, and that's going to help EBITDA grow year-over-year, where I would appreciate some more color. It's just on the top line. I think you said you expected FMC to have sales growth next year. And I'm just thinking through, like, if 1Q has to lap, what we've seen in 2Q through 4Q ‘23, which is kind of like a mid to high 20s sales decline. And I think you only had volume down about 3%, yes, 3% in 1Q ‘23. In my model, I just sort of assumed that the headwind from lapping things in 1Q ‘23 on the top line was kind of too much to overcome in the balance of the year to get growth. So, particularly if we assume that once the destocking is over, it's just sort of a reset of sales levels and we go back to the industry growing 3% and perhaps you guys doing a bit better than that. So is there something I'm not thinking about right that helps you get to the idea that you can overcome the 1Q and potentially even a little bit of a 2Q top line headwind to get full year sales growth next year?

Mark Douglas

Yes, I think there are. I'm not going to go into those details today because I actually, we're preparing for all of that as we go into our Invest Today. You've got to understand that the NPI, the growth of the new product is accelerating, so that gives you a tailwind. You do have a full season of LATAM in the second half of the year, which is also a positive tailwind. You take those big pieces together. We believe we'll have positive growth next year, Vincent.

Vincent Andrews

Okay. Well, I look forward to the detail on that in a couple of weeks, and maybe just as a follow-up, just trying to understand the inventory drawdown that we're seeing through the supply chain. Obviously, the numbers are quite incredible. Where would you have guessed a year ago or so that those levels were, and is it really just a function of sort of twin effect of, they overstocked a bit during the supply chain challenges, and then we've gotten the interest rate shock, which has sort of swung the pendulum 100% in the other direction. I'm just trying to understand how the channel was managing to hold, what incentivized them to hold all this inventory this whole time?

Mark Douglas

Yes, I think, listen, I think that your LATAM premise is absolutely right. In 2021 and 2022, clearly there was a lot of uncertainty around supply. There was a lot of price increases. I think the thing that caught the industry out is that growers around the world were holding inventory, and I don't think that was factored into people's calculations. That has obviously been much more than anybody thought, and that's one of the big catalysts that we saw starting to unwind in Q2. And here we are today. So I think it's not only, don't just focus on distribution and retail, the grower component here was much bigger than I think anybody thought.

Operator

Our next question comes from Arun Viswanathan of RBC.

Arun Viswanathan

Great, thanks for taking my question and good morning. So I guess you've addressed a lot of the issues around the Diamides franchise, but just so we're completely clear, two questions around this. So it sounded like the EBITDA contributions of the Diamides is relatively high, north of 40% of company EBITDA, or maybe around $500 million to $600 million annually. Are you saying that you don't necessarily see risk to that? Generally speaking, you would maintain that level of contribution, EBITDA contribution from that franchise. And if you do see any deterioration that the new product growth and maybe some of the other stools you've added, such as biologicals would fill that gap so there really isn't really any risk to losing large chunks of profitability within the company?

Mark Douglas

Yes, absolutely. We don't see that at all. November the 16th, I'm going to paint the picture for you as how we grow over the next 36 months and what we look like 10 years out. You'll see that there are a number of components that aid that growth. We are absolutely committed to continue to grow the value of the diamonds in terms of its contribution to the company. Now you will see there are other parts that we're introducing that are growing much faster than the Diamides. So don't think of FMC as being a Diamides story. Yes, the Diamides are incredibly important to us. It's a fantastic franchise. Anybody would give their right arm to have this franchise. What we're telling you is we have other things that are actually growing faster and will become more important to the company over the next 3 to 10 years. So I think that's the story that people are missing. You're assuming we're going to drop EBITDA in Diamides. That is not the case. EBITDA is going to grow with the Diamides. You also have the additive of all the new products and the new platforms that we're building. That's the total story and I think that's getting missed today.

Arun Viswanathan

All right, thanks for that clarification. And then just on the supply chain itself, what are some of the steps that you can take to get better intelligence of inventory levels, whether it be at the distributor level or even as maybe has happened in the last year at the farmer level? Is there further intelligence you can get through your grower network or distributor network? And do you feel like there's accurate communication about those inventory levels? So what's so different around this time that the magnitude of destocking is just so much more pronounced? Thanks.

Mark Douglas

Yes, listen, it's a very, very fragmented structure in this industry. It is very difficult at the grower level to understand what people are holding when you have millions of farmers around the world. We obviously talk to our big distributors and partners around the world and they were caught out by this. So I think the industry has a lot to learn in terms of how much inventory is set out there. We are going to be doing some things internally ourselves. I don't want to say what they are, to try and aid our demand forecast accuracy and understanding what inventory is out there. But I think we have to recognize it's never going to be 100% accurate. It is just too fragmented. But there are things that we've learned over the last 12 months that we can apply to our thinking, especially as we're planning our supply chain activities. So yes, there are learnings, some of them I want to keep for ourselves. But generally speaking, I think the industry does have to do a better job of. communicating where inventory sits at any point of that value chain.

Operator

Our final question today comes from Adam Samuelson of Goldman Sachs.

Adam Samuelson

Yes, thank you. Good morning, everyone. It's a lot of ground cover today. I know that there's going to be a lot more detail on some of these topics at the Investor Day. But let's hope and maybe just step back and I understand there's a lot of channel intelligence. Refresh, it's going to happen on your end as well. As you're thinking about 2024, do you think it's 2020, 2021 kind of shipments that are a more appropriate baseline for future growth or kind of cumulatively where do you think the inventory build both in your distribution channel and at your -- at the farm customers actually built up so that we can think about a proper base off which to grow longer term.

Mark Douglas

Yes. I think for us, as we just talked about, I think we reset as we go through Q4, Q1, much more balancing Q2. That's where you grow from, industry typically grows at 3%-ish can be zero can be a little more. Think of that as sort of the second half move. You're getting more normal growth patterns. You also have to remember that inventory doesn't sit still at any one point of this value chain. It can move from grow a back to retail and retail back to distribution. So any one point in time, inventory looks different. That's another complicating factor. Having said all of that, we expect this to reset as we go through the first half of next year predominantly Q1. Second half of the year will be much, should be much more normal in terms of growth and inventory management. That's how we see it.

Zack Zaki

Yes. All right. I'm sorry we don't have time for a follow up. I do appreciate the questions. Thank you. That's all the time we have for the call.

Operator

This concludes today's call. Thank you for joining. You may now disconnect your line.

Read more current FMC analysis and news

View all earnings call transcripts

Comments

Sort by Newest