FMC An Agricultural Sciences Company

FMC Corporation

Second Quarter 2020 Earnings Call Script

August 5, 2020

As Prepared for Delivery

Introduction – Michael Wherley

Thank you and good morning everyone. Welcome to FMC Corporation's second 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 second quarter performance and the outlook for the rest of the year. Andrew will provide an overview of select financial results and discuss the sustainability of FMC's tax structure. 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 specific 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" means "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.

<u>Business Review – Mark Douglas</u>

Thank you, Michael, and good morning everyone.

At our last earnings call, we forecasted Q2 would be a challenging quarter. Despite this outlook, we delivered solid financial performance and navigated the challenges posed by COVID-19, severe headwinds from foreign currency, very dry weather in Europe, and an industry-leading comparison from Q2 2019. Our proactive cost control actions, along with price and volume increases, delivered earnings growth in the quarter.

Our confidence in the outlook for the second half of the year has increased, which is why we are raising the midpoints of our EBITDA and EPS guidance and tightening those ranges. Underlying demand for our products remains healthy, and we expect double-digit organic revenue growth in the second half of the year, driven by volume, market access expansion, and the full effect of our pricing actions.

We also continue to invest in innovation to support and enhance the long-term sustainable growth model we have built at FMC. In the past few months, we announced the launch of our Arc™ farm intelligence platform and a related agreement with Nutrien to increase the adoption of this technology; we launched FMC Ventures with an initial investment in Trace Genomics; and we announced a partnership with Cyclica that will enhance our R&D discovery engine.

Let me now turn to the impact of the COVID-19 pandemic on our business. As we said last quarter, we have avoided significant plant closures and all our manufacturing facilities remain operational. The wellbeing of our employees is FMC's top priority. Although most FMC employees around the world have been working from home during these last few months, we are slowly bringing employees back to offices and laboratories in locations where local health officials have deemed this to be safe. In addition, we have thousands of employees who continue operating our manufacturing sites and distribution warehouses. In all our facilities, we are using a variety of best practices to address COVID-19 risks and following the protocols and procedures recommended by leading health authorities.

In Q2, sourcing of raw materials and intermediates was not a significant issue, although we continued to see some logistics challenges and related higher costs. We are seeing some pockets of reduced demand, as expected, due to food chain dislocations and labor availability.

As we commented in May, we implemented cost-saving measures across the company and price increases to offset the impact of COVID-19 and the related FX headwinds caused by a stronger U.S. dollar.

FMC Reported Financial Results ***(Slide 3)***

Turning to our Q2 results on slide 3. FMC's strong financial performance the past several quarters continued in the second quarter, despite a robust prior-period performance. Last year, our business grew 9 percent organically in Q2. This year, we reported approximately $1.16 billion in second-quarter revenue, which reflects a 4 percent decrease on a reported basis but 3 percent growth organically. After removing the FX impact, our business saw double-digit growth in Argentina, Brazil, Australia, Pakistan, and Canada.

Adjusted EBITDA was $341 million, an increase of 1 percent compared to the prior-year period. EBITDA margins were 29.5 percent, an increase of 150 basis points compared to the prior year, driven by significant cost-containment measures and pricing actions.

Adjusted EPS was $1.72 in the quarter, an increase of 4 percent versus Q2 2019. This year-over-year performance was driven equally by the increase in EBITDA, reduced share count and the benefit of a lower tax rate. Relative to our Q2 *guidance*, however, the 6-cent beat was driven almost entirely by our $9 million EBITDA outperformance versus the midpoint.

Q2 2020 Revenue Down 4% due to 7% FX Headwind, Up 3% Organically ***(Slide 4)***

Moving now to slide 4. Q2 revenue declined by 4 percent versus prior year, as a 7-percent FX headwind more than offset growth contributions of 2 percent from volume and 1 percent from price. We overcame a 3-percent volume impact from products that were discontinued either because of registration cancellations or rationalizations that we had planned for and forecasted earlier this year. We should note that 2020 has a higher than normal level of product discontinuations.

Latin America sales grew 2 percent year over year and 24 percent excluding FX. Pricing actions across the region offset some of the currency headwind, while the underlying volume gains were very strong in Argentina and Brazil.

Sales grew fastest in Argentina, driven by herbicides sales for wheat and soybean applications, including Finesse® herbicide. In Brazil, sales grew double digits organically, led by continued robust demand for our products on sugarcane, including Boral® herbicide and Altacor® insecticide. Our channel inventories in Brazil continue to be at normal levels as we head into the new season. Mexico sales grew organically but were impacted somewhat by COVID-19 related pressures on the growers that export fruit & vegetables.

In Asia, revenue increased 2 percent year over year, and 8 percent excluding FX. Volume growth in India, Australia and Pakistan, as well as modest price increases across the region, were mostly offset by FX headwinds and some COVID-19 related impacts in India. Herbicides sales, including for the newly launched Authority® NXT, were robust for soybeans in India. We also continued to see a strong market recovery in Australia with the improved weather, and record demand for Hammer® and Affinity® Force herbicides due to a strong broadacre season.

In North America, sales decreased 6 percent year over year, driven by our continued focus on drawing down channel inventories of our pre-emergent herbicides following the wet spring last year. Coming out of this summer, we forecast our channel inventories will be in a much better position in this region, which should lead to good re-stocking at the end of the year. We also saw robust sales of Lucento® fungicide in our second U.S. season. Sales in Canada were strong, driven by herbicide blends from our PrecisionPac® systems for use on cereals and insecticides to control early season pests.

Sales in EMEA contracted 13 percent year over year and 10 percent excluding FX, due to hot, dry conditions across Northern and Eastern Europe and Ukraine, as well as the expected registration cancellations and product rationalizations. This was partially offset by insecticide growth in Southern Europe for specialty crops.

Q2 2020 Adj. EBITDA Increased 1% ***(Slide 5)***

Turning now to the second quarter EBITDA bridge on slide 5. We had strong operational performance, offsetting a $62 million FX headwind with a $46-million contribution from lower costs, a $16-million benefit from higher pricing, and modest volume growth.

H1 2020 Adj. EBITDA Increased 2% ***(Slide 6)***

Moving now to slide 6, where we have included first half results to highlight the overall performance we have delivered in a very challenging market. We posted organic revenue growth of 6 percent. On the EBITDA bridge, balanced contributions from volume growth, price increases and cost reductions more than offset the FX headwind.

I will now turn it over to Andrew.

Selected Financial Results – Andrew Sandifer

Thanks, Mark.

Let me start this morning with a few highlights from the income statement.

FX was a larger than anticipated headwind to revenue growth in Q2, at 7 percent vs. our expectations of a 5 percent impact. The Brazilian Real was more than half of this total, followed by the Indian Rupee, Pakistan Rupee, Australian Dollar, Euro, and a broad set of other European currencies. While we did take pricing actions in the quarter, we were intentionally less aggressive, particularly in countries hit hard by COVID. We continue to expect FX headwinds to remain at an elevated level throughout 2020, with pricing trailing FX impacts for the full year, but with prices increasing ahead of FX during the second half of the year.

Interest expense for the second quarter was $40.7 million, up slightly from the prior year period, primarily due to the impacts of our third quarter 2019 debt offering and higher foreign debt balances, partially offset by lower term loan and commercial paper balances. With the decrease in interest rates since the beginning of the year, we now anticipate interest expense between $150 and 160 million for the full year, somewhat better than our prior guidance.

Our effective tax rate on adjusted earnings for the second quarter was 13.5 percent, consistent with our expected full-year tax rate of 12.5 to 14.5 percent.

Before leaving the topic of tax rate, I think it is important to spend a few moments this morning on FMC's tax rate and its long-term sustainability, given tax rate's impact on our stock valuation on a Price-to-Earnings basis as opposed to an Enterprise Value-to-EBITDA basis. As many of you have noted, FMC currently trades at a premium to our peers on a EV-EBITDA basis, but at a discount on a P-E basis.

When we completed the DuPont Crop Protection transaction in 2017, we aligned the legal entity structure of

FMC in such a way that, in conjunction with our broad geographic dispersion of sales, led to the advantaged tax rate we now benefit from. We believe this will prove to be durable.

FMC operates our business through regional hubs, in which we have established Principal Operating Companies, or “POCs”. Our POCs own, operate, and protect business critical assets, particularly intellectual property, trade secrets, and other intangible assets.

As a result of this POC structure and our geographic mix of sales, approximately 40 percent of FMC’s overall profit stream flows through jurisdictions where we pay the statutory tax rate on corporate earnings, such as the U.S. The remaining roughly 60 percent of FMC’s profit stream flows through jurisdictions where we have made significant investments and commitments, and as such pay an effective tax rate that is below the statutory tax rate. These arrangements are formalized through what is commonly referred to as a ‘tax ruling’, which sets the specific rate that FMC pays over a defined time period, based on the commitments and investments FMC has made in the relevant jursidiction.

We believe with our existing and planned investments, we can maintain or improve upon our current tax rulings at least through the year 2030, with further opportunities to extend them beyond that time horizon. As such, we are highly confident in maintaining a very competitive tax rate, particularly as compared to peers with different entity structures and larger earnings streams in statutory rate jurisdictions such as the U.S.

Over the 2030 horizon, we expect our tax rate to stay in the range of 13 to 16 percent, based on our expectations for geographic sales mix and the durability of our tax rulings.

Despite our competitive global effective tax rate, let me be clear – FMC pays substantial taxes in the U.S., particularly due to the "GILTI" or global minimum tax provisions of the 2018 Tax Bill.

Moving next to the balance sheet and liquidity.

Gross debt at quarter end was $3.5 billion, down by approximately $300 million from the prior quarter. Strong free cash flow led to lower short-term financing needs. We also reduced the amount of excess liquidity we maintained due to heightened uncertainty caused by the COVID pandemic. We fully repaid the revolver draw made late in the first quarter at the height of the pandemic's impact on short-term financing markets. We ended the quarter with over $200 million of surplus cash on the balance sheet. Considering this surplus cash, gross debt to trailing twelve month EBITDA was 2.7 times at the end of the second quarter, still somewhat above our targeted 2.5 times annual average leverage, reflecting the seasonality of working capital and free cash flow. We continue to expect leverage to be at or below 2.5 times at year-end.

<u>2020 Cash Flow Outlook</u> ***(Slide 7)***

Moving on to slide 7, and specifically cash flow and cash deployment.

Free cash flow for the second quarter was $205 million, up significantly from the prior year period, with very strong collections in the quarter and improved payables.

We are maintaining our full-year free cash flow guidance range of $425 to $525 million. With improving confidence in our outlook, we expect to revisit share repurchases at the end of the third quarter, and at present anticipate restarting share repurchases during the fourth quarter.

<u>FCF Growth Projections and Seasonality Trends</u> ***(Slide 8)***

Moving next to slide 8. FMC is making good progress in both improving our free cash flow conversion from earnings as well as growing the absolute amount of free cash flow. As you can see on the left-hand side of this slide, at the midpoint of our guidance range, we expect to improve cash conversion by 18 percentage points compared to last year while growing cash flow by nearly $175 million. We continue to believe we have substantial headroom to improve further on both free cash conversion and the absolute free cash flow we generate, particularly as we complete our SAP implementation and end the period of high cash spending on transformation efforts later this year.

On the right-hand side of this page you can also see the breakdown of free cash flow generation by semester for last year and this year. Note that the seasonality is very similar in both years, with negative free cash flow in the first half of the year and strongly positive free cash flow in the second half, but with improvement in both semesters in 2020 versus 2019.

Finally, a quick update on progress in implementing our new SAP S/4HANA ERP system. This was the second quarter-end close that we have completed with 60 percent of the company on the new system, and the close again went very smoothly. We continue to push forward to complete implementation of the new SAP system across the remainder of FMC by year-end, which will give us a thoroughly modern system across the entire company and will enable further efficiencies in our back-office processes. The most recent implementation phase has gone so well that we are accelerating some synergies planned for 2021 into 2020. We continue to expect total synergies of $60 to $80 million from implementing the new system, but we now forecast $40 million in synergies in 2020 – up $20 million from our prior forecast. We will capture most of the remaining $20 to $40 million in 2021.

And with that, I will turn the call over to Mark.

Market and FMC Outlook – Mark Douglas

Thank you, Andrew.

Turning to the market outlook for 2020, we now expect the overall global crop protection market will be flat to down slightly – on a U.S. dollar basis – slightly worse than our previous outlook. The change is driven by a reduced outlook for Europe, where we believe the market will be flat year over year, versus up low-single digits in our prior forecast. Our views on the other regions have not changed; we expect the North American market to be up low-single digits, the Asian market to be down slightly and the market in Latin America to contract by low- to mid-single digits. All these forecasts are for the markets – not FMC – and are in U.S. dollars. As such, the Latin American market is seeing the largest headwind from FX.

FY 2020 and Q3/Q4 Earnings Outlook ***(Slide 9)***

Moving to slide 9 and the review of FMC's full-year 2020 and Q3/Q4 earnings outlook.

As I said earlier, we are expecting double-digit organic revenue growth in the second half of the year, driven by both volume and the full effect of our pricing actions.

We expect continued headwinds from FX, and to a lesser extent, from impacts related to the pandemic. At the onset of the pandemic, there were numerous contingencies to consider, but after several months of navigating in this environment, we are more confident in our ability to deliver on our 2020 forecast.

FMC full-year 2020 earnings are now expected to be in the range of $6.28 to $6.62 per diluted share, a year-over-year increase of 6 percent at the midpoint and 7 cents above prior guidance. EPS estimates do not include the benefit of any share repurchases in 2020.

2020 revenue is forecasted to be in the range of $4.68 to $4.82 billion, an increase of 3 percent at the midpoint versus 2019, and 9 percent organic growth. We believe the strength of our portfolio will allow us to deliver high single-digit organic growth, continuing a multi-year trend of above-market performance.

EBITDA is now expected to be in the range of $1.265 to $1.325 billion, which represents 6 percent year-over-year growth at the midpoint.

For the third quarter, we expect earnings to be in the range of $1.03 to $1.17 per diluted share, a year-over-year increase of 17 percent at the midpoint versus Q3 2019. We forecast Q3 revenue to grow 6 percent year-over-year at the midpoint. Excluding the significant FX headwinds, revenue is expected to increase 12 percent organically, driven primarily by robust growth in Asia following a good monsoon season, as well as improved market conditions in EMEA and a normal start to the Latin America season. EBITDA is forecasted to be in the range of $233 to $257 million, representing a 12-percent increase at the midpoint versus the prior-year period.

The third quarter is the seasonally smallest quarter for FMC, which is in-line with the quarterly pattern from the past two years, as Q3 is not a high season in any of our regions.

Guidance for Q4 implies a strong quarter with sales growth of 6 percent at the midpoint on a reported basis and 11 percent organically, as compared with Q4 2019. We are forecasting EBITDA growth of 10 percent year over year at the midpoint. EPS growth is forecast to be 3 percent, limited by the large tax adjustment in Q4 2019.

Projected FY 2020 Adj. EBITDA and Revenue Drivers (YOY) ***(Slide 10)***

Turning to slide 10, and full-year EBITDA and revenue drivers. Revenue is expected to benefit from 5-percent volume growth, with the largest growth in Asia and Latin America. New products are driving about 1.5 percent in total revenue growth, with the largest contribution coming from EMEA. FX is now forecasted to be a 6-percent top-line headwind versus 5 percent in our prior forecast. However, we expect to offset much of this with price increases totaling 4 percent.

Regarding EBITDA, we will deliver significant cost savings this year to offset the COVID-related impacts to supply chain costs, pockets of lower demand caused by food chain dislocations and labor availability, as well as a portion of the FX headwind. This includes the earlier realization of some SAP synergies Andrew referenced.

Foreign exchange remains a critical factor in our outlook. We now foresee an impact of $230 million for the full year, versus $170 million in our prior forecast.

We increased our full-year pricing actions to $177 million to cover over 75 percent of the full-year FX impact, but in the second half of the year, we expect to cover the full impact. Pricing will come from all regions, led by Latin America.

Projected Q3/Q4 2020 Adj. EBITDA and Revenue Drivers (YOY) *(Slide 11)*

Moving to slide 11, where you see the Q3 and Q4 drivers. On the revenue line, volume and price are expected to drive the top line strength in both quarters. We expect the second half volume growth to be driven primarily by Asia and EMEA, in addition to the overall strength of our diamides business. Regarding EBITDA drivers, pricing is certainly the largest positive factor, and volume contributions are also meaningfully higher than in the first half.

Concluding Remarks

As my first quarter as CEO, this was certainly an interesting time to start! Q2 was a quarter to focus on execution, cost management, the health of our employees, protecting the balance sheet, as well as setting the stage for a strong second half. It was not the time to chase volumes or significant price increases.

We are looking forward to the rest of the year, as we continue to launch new products, expand our market access and stay aligned with our customers as we collectively manage through these difficult times.

Before closing our prepared remarks, I would like to announce we will host an investor call on November 17 to provide an update on our R&D pipeline. This will cover some of the topics we had planned to discuss at our Investor Technology Day that was cancelled earlier this summer due to the pandemic. More details will be available in the coming weeks.

I will now turn the call back to the operator for questions.

Closing – Michael Wherley

That is all the time that we have for the call today. Thank you and have a good day.

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