Diversification and flexibility, Ercros' tools to mitigate the effects of covid-19

- **Despite the stoppage of activity and the fall in prices, demand was resilient in the first quarter.**
- **Raw materials fell 22%.**
- **The contribution margin to sales ratio increased 3 percentage points compared to Q1 2019.**
- **Ercros renewed the syndicated facility agreement.**

General framework

Ercros is showing significant resilience to the effects the covid-19 pandemic is having on economic activity in the industrialised world. Since the start, the company has taken measures of a hygienic, organisational, operational, supply and logistical nature, for the dual purpose of mitigating possible consequences on people's health and maintaining its productive activity.

The measures taken by Ercros –in its capacity as a critical operator and provider of essential services– have helped to ensure that the incidence of the disease among staff has not been significant and to guarantee the supply of the products required by its customers at all times.

The demand for chemical products involved in the manufacture of disinfectants, detergents and pharmaceutical products has increased by sector, while demand for products related to the automotive, construction, furniture or swimming pool water treatment industries has weakened due to the temporary reduction or discontinuation of activity by some customers.

The investments made over the last four years –within the framework of the industrial modernisation and production capacity expansion plan– have given Ercros greater agility and flexibility to adjust its production and adapt it more easily and efficiently to fluctuations in demand.

Profit for Q1 2020

Throughout the first quarter of the year, the prices of Ercros' main products maintained the downward trend that began in mid-2019, under pressure from the price reduction of the main procurements and supplies. However, the greater relative fall in the price of raw materials and energy compared to the fall in the price of end products has allowed the unit contribution margin to improve.

Between the first quarter of 2019 and the first quarter of 2020, the decrease in sales was 13.5%, a difference of EUR 23.4 million. 76% of this difference was due to the drop in the price of the products sold. This is particularly relevant in the case of caustic soda; while the remaining 24% was the result of the lower volume of products directly affected by covid-19 sold. These include PVC, swimming pool water treatment tablets and glues and resins, the tonnage of which has fallen by around 20%.

In the case of PVC, due to the scheduled maintenance shutdown of the VCM plant, carried out between February and March, less product was available during the quarter, which also contributed to the reduction in the volume of sales.

The strengthening of the dollar has benefited exports, the greatest impact of which is seen in the intermediate chemicals and pharmaceuticals divisions, which sell 66% and 92% of their products abroad, respectively.

The 22.1% reduction in the cost of procurements and supplies –equivalent to a decrease of EUR 25.9 million– is mainly attributable to the continued downward trend in the prices of raw materials and energy, but also –although to a lesser extent– to the lower quantity required to adjust production to the lower demand. In the case of Ercros, the reduction in the price of electricity, gas, methanol, ethylene and EDC has been particularly relevant due to its impact on improving the unit contribution.

Under "Expenses", it is also worth noting the trend in staff costs, which increased by 1.9% –less than the wage increase set in the collective agreement for 2020, which is 2.5%– due to staffing adjustments.

The overall result of these changes is that, between the first quarter of 2019 and the first quarter of 2020, the contribution margin –calculated as the difference between revenue (product sales and revenue from the provision of services) and variable expenses (procurements, supplies and inventory reduction)– rose from 32% to 35% of sales, an improvement of 3 percentage points.

This improvement is also reflected in ebitda –which excludes extraordinary items from revenue and expenses– which stood at EUR 11.3 million compared to EUR 13.6 million for the same period in 2019. Despite the increase in fixed expenses, adjusted ebitda remains at 8% of sales.

The provisions recognised, amounting to EUR 1.2 million, relate almost entirely to the higher cost of dismantling the old mercury electrolysis facilities at the Flix factory.

If we take into account this extraordinary expense and a small, also atypical, income of EUR 0.1 million, ebitda for the first quarter of 2020 was EUR 10.2 million, 22.8% lower than that for the first quarter of 2019.

Depreciation and amortisation increased by 6.9% as a result of the investments made, and finance costs rose by 4.1%, mainly due to provisions made for potential customer insolvencies, although the Ercros nonperforming loan ratio continues to be very low.

After income tax, profit for the period was EUR 0.8 million, EUR 2.8 million less than the EUR 3.7 million obtained in the first three months of 2019.

By business, the chlorine derivatives division experienced a drop in sales of 18.2% and in ebitda of 55.8%, due to the decline in demand for several of its products and the reduction in the price of caustic soda. The intermediate chemicals division, despite the reduction in the prices of its end products, has held firm and in some cases improved its margins as a result of lower raw material and energy costs. This explains why the ebitda of this business has increased by 59.7% despite the 10.5% reduction in its sales. The pharmaceuticals division also performed well, with sales up by 8.6% due to increased demand for several of the active pharmaceutical ingredients it produces, and ebitda up by 2.1%.

Balance sheet

With regard to the balance sheet, between 31 December 2019 and 31 March 2020, non-current assets increased by EUR 3.2 million (0.9%), mainly due to the investments made, and working capital also increased by EUR 3.2 million (4.9%).

The change in equity of EUR -6.2 million is mainly due to the repurchase of treasury shares for retirement for EUR 7 million. This is one of the elements of shareholder remuneration with a charge to 2019 profit and that, on this occasion, was concentrated in the first quarter of the year. The amount paid for this purchase, together with the payment of investments and the changes in working capital, explain the 12.8% increase in net financial debt.

Provisions and other payables decreased by EUR 1.6 million, due to payments made for the dismantling of the mercury plants and compensation for the collective redundancy procedure in 2017.

On 6 May 2020, Ercros and a pool of banks renewed the syndicated facility agreement, for a period of 4 years, which can be extended to 5 years. This syndicated facility includes: (i) factoring, which consists of a recourse and non-recourse tranche, with an aggregate limit of EUR 102 million; (ii) a revolving tranche, amounting to EUR 30 million; and (iii) a new tranche for investments, amounting to EUR 15 million. These last two tranches include, for the first time, an ESG (Environment, Social and Governance) component.

Forecasts for 2020

The slowdown in global economic activity due to the spread of the coronavirus pandemic has been particularly noticeable since April, when many industrialised countries agreed to implement containment and discontinuation of activity measures. Together, these measures have caused a significant drop in demand for some of our products. We anticipate that this situation will continue in May and, if the plans for easing restrictions worldwide are successfully implemented, it will start to improve from June onwards. We expect the second quarter of 2020 to be the most affected by the covid-19 crisis. We estimate that the volume of sales will decline between 20-30%. Thanks to a recovery in activity in the second half of the year, we expect this drop for the year as a whole to be between 10-15%.

On a positive note, we should point out that in April the drop in the price of caustic soda that we had been observing since the beginning of 2018 was halted and an upward movement began. This change in trend is due to the temporary shortage of this product on the market, as a result of the sharp fall in demand for chlorine derivatives, particularly those intended for the automotive and construction industries. At the moment, the price increase is relatively moderate and we should wait a bit to see if this change in trend will be consolidated. Electricity and raw material prices are also expected to remain low, which will help to maintain unit margins.

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Consolidated income statement for Q1

Thousands of euros	Q1 2020	Q1 2019	Variation (%)
Income	**158,333**	**182,600**	**-13.3**
Sale of products	149,389	172,793	-13.5
Provision of services	5,325	7,668	-30.6
Other income	3,619	2,139	69.2
Expenses	**-148,116**	**-169,368**	**-12.5**
Procurements	-71,474	-91,113	-21.6
Inventory reduction	-9,033	-6,542	38.1
Supplies	-19,467	-25,684	-24.2
Staff costs	-21,712	-21,299	1.9
Other operating expenses	-25,259	-24,465	3.2
Provisions	-1,171	-265	341.9
Ebitda	**10,217**	**13,232**	**-22.8**
Amortisation and depreciation	-7,033	-6,577	6.9
Ebit	**3,184**	**6,655**	**-52.2**
Financial loss	-1,817	-1,746	4.1
Earnings before tax	**1,367**	**4,909**	**-72.2**
Income taxes	-543	-1,249	-56.5
Profit for the period	**824**	**3,660**	**-77.5**

Reconciliation of adjusted ebitda

Thousands of euros	Q1 2020	Q1 2019	Variation (%)
Ebitda	**10,217**	**13,232**	**-22.8**
Atypical income items	-136	-115	18.3
Atypical expense items	1,194	475	151.4
Adjusted ebitda	**11,275**	**13,592**	**-17.0**

Adjusted ebitda by business

Thousands of euros	Q1 2020	Q1 2019	Variation (%)
Chlorine derivatives	3,296	7,451	-55.8
Intermediate chemicals	4,742	2,969	59.7
Pharmaceuticals	3,237	3,172	2.1
Total adjusted ebitda	**11,275**	**13,592**	**-17.0**

Sales by business

Thousands of euros	Q1 2020	Q1 2019	Variation (%)
Chlorine derivatives	86,389	105,553	-18.2
Intermediate chemicals	46,909	52,420	-10.5
Pharmaceuticals	16,091	14,820	8.6
Total sales	**149,389**	**172,793**	**-13.5**

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Economic analysis of the balance sheet[1]

Thousands of euros	31-03-2020	31-12-2019	Variation (%)
Non-current assets	362,894	359,713	0.9
Working capital	68,077	64,870	4.9
Current assets	189,902	184,470	2.9
Current liabilities	-121,825	-119,600	1.9
Resources used	**430,971**	**424,583**	**1.5**
Equity	285,910	292,083	-2.1
Net financial debt[2]	124,327	110,171	12.8
Provisions and other payables	20,734	22,329	-7.1
Origin of funds	**430,971**	**424,583**	**1.5**

1. The Company uses as a management tool the economic analysis of the balance sheet, which is obtained from certain reclassifications of balance sheet items to reduce the number of operating aggregates for better analysis and comparison.

2. Net financial debt includes all debts of a financial nature with non-banking institutions and obligations under leases (at 31-03-2020: EUR 12,591 thousand and at 31-12-2019: EUR 13,378 thousand). Likewise, in addition to its cash and cash equivalents, deposits securing debt obligations have been subtracted from its financial debt (at 31-03-2020: EUR 9,444 thousand and at 31-12-2019: EUR 11,247 thousand).

Detail of net financial debt

Thousands of euros	31-03-2020	31-12-2019	Variation (%)
Loans	75,117	77,097	-2.6
Obligations under finance leases	12,591	13,378	-5.9
Working capital finance	83,930	92,060	-8.8
Gross financial debt	**171,638**	**182,535**	**-6.0**
Cash on hand	-37,867	-61,117	-38.0
Deposits	-9,444	-11,247	-16.0
Net financial debt	**124,327**	**110,171**	**12.8**

Barcelona, 14 May 2020