Q3 2022 results webcast transcript

Company participants

- Peter Vanneste, Chief Financial Officer & Executive Vice President of Finance & IT
- Geoffroy Raskin, Vice President of Investor Relations

Other participants

- Karine Elias, Barclays (credit)
- Wim Hoste, KBC Securities
- Charles Eden, UBS
- Othmane Bricha, Bank of America
- Patrick Folan, Barclays
- Karel Zoete, Kepler Cheuvreux
- Daan Schelfaut, Nerisa
- Peter Testa, One Invest
- Fernand De Boer, Degroof Petercam
- Eric Wilmer, ABN-AmRo – Oddo-BHF

Presentation

Geoffroy Raskin, IR

(Slide 1)

Good afternoon, everyone, and thank you for joining us today. I'm Geoff Raskin from Investor Relations.

(Slide 2)

Before I pass over to our CFO, let me remind you of the safe harbor (and) regarding forward-looking statements, which I will not read aloud with which I assume you will have duly noted. I would also like to repeat that since 2022, following the strategic review end of last year and our subsequent plans to divest our Emerging Markets business, we now present these as assets held for sale and discontinued operations. Our P&L thereby only encompasses our Core Markets as continuing operations, and in the meantime, we will continue to provide you with business information for both continuing Core Markets and discontinued Emerging Markets. And we'll make clear throughout the presentation when we covered towards. Peter, with that, I leave it up to you.

Peter Vanneste, CFO

(Slide 3)

Good afternoon, everyone, and thank you for joining us today. As you know we have a new CEO with Gustavo as from next week, and that change has been explained in the press release this morning. I will obviously be focusing on the Q3 results in this call. These Q3 results show that we are turning the corner in our performance recovery with sequential EBITDA and margin improvements. We have been ramping up actions to deliver on our strategic priorities over the past 18 months and each is now contributing to the recovery and outperformance. This achievement is of course against the backdrop of a continued challenging external environment, which high raw material costs, energy, and wage inflation. Ontex's revenues in Q3 grow up 17% like-for-like driven by volume, mix and pricing. We have now consistently seen this mid-single digit year-on-year volume and mix growth every quarter this year. Prices are up 13% in Q3 and counter the huge increase in raw material inflation that cannot be offset by our cost reduction programs alone. We have now begun to turn the quarter with an EBITDA at EUR35 million, up from the EUR25 million in Q2, and this will further increase in Q4. The Group's financial structure has touched a low point in Q3, but with the improvement in EBITDA, the leverage will steadily come down starting in Q4. And the net debt be significantly reduced with the EUR250 million proceeds from the divestment in Mexico early next year.

(Slide 4)

So, let's look first at the revenue growth on Slide 4. Ontex has now returned to strong revenue growth and this is driven by, as I said, volumes, product mix and by pricing. The momentum we're now building in the turnaround of our top line is clearly visible in the chart. This swing has been built on six quarters of sequential growth with Q3 2022 revenues up at a record high level. The role our strategic decisions have had in these chains, have been vital, which I will illustrate in the following slides.

(Slide 5)

So turning to Slide 5, on volume and mix. Ontex has been driving consumer dement shifts to retail brands where market share has increased in Europe, notably in baby pants and fem care. In this context, we have outperformed the market, posting mid-single digits volume mix growth in both Q3 and year to date and so we even did 2 percentage points better in Core Markets only. This growth has been driven by our strategic growth priorities, which you can see in the middle graph, showing the last 12 months of volume and mix growth impact on revenue. The blue line is Ontex in total, where volume and mix impact turned positive this year and stands at 4% today. The growth drivers combined are in red, (where) and they were positive since the second half of 2022 and stand at 7% today. Baby pants continues to be a big driver in Q3. Our outperformance shows the effectiveness of our strategy to return Ontex to its influential role in Europe. As a direct consequence, we are gaining share in retail baby pants, which are winning in the market. In North America, we continue to ramp up our footprint. In Q3 and year to date, we have generated consistent double-digit volume and mix growth and this momentum will be supported by the expansion in capacity of our new U.S. plant and the performance improvement being ruled out in Tijuana. Adult care volumes were somewhat lower, but driven by outperformance in retail channels, where we also see higher growth in line with the trend for more home nursing.

(Slide 6)

Cost reduction on Page 6: In parallel to restoring top-line growth, bringing down the Group's structural cost basis, key to the turnaround. In Q3, we maintain the momentum with a further EUR23 million gross operating savings of which EUR15 million in Core Markets, bringing their total so far at EUR60 million for the Group. Most recently, the small U.S. production facility acquired a few years ago was closed, with capacity being absorbed into our other plants on the continent. In Europe, scrap rates and operational efficiencies are better than the year before and our service levels have continued to improve throughout the year. We expect to achieve around EUR80 million of gross operating cost savings for the full

Group this year and while wage inflation driven by increased cost of living has pushed salary cost higher, SG&A costs are remaining at 10% or below.

(Slide 7)

Turning now to raw material and input cost inflation on Slide 7. Raw material costs were up close to 30% year to date, reflecting the delayed impact of rising indices in the previous quarters. Some raw material indices continued to climb mainly for fluff and super-absorbent-polymers. And while other see some stabilization they remain at significantly higher level compared to 2020. Energy, transport and wage inflation also play a role in the raw material price increase as it does for our own transformation costs, which are up about 30% for energy year to date, and 15% for transport. Overall, we're seeing a 20% year-to-date cost increase and close to 25% in Q3. Cost inflation is not over or behind us and margins have only partially recovered. So pricing remains key over the next quarters.

(Slide 8)

With pricing on Slide 8. As with volumes, pricing has been positive since the second half of last year, with momentum steadily building throughout (the last) the past nine months to reach 13% in Q3 for the whole Group. In Core Markets we see a strong acceleration in the last quarter with a 6 percentage points sequential increase from Q2 to Q3. With our still low margins we will continue to rollout further price increases to help offset the unprecedented raw material cost inflation.

(Slide 9)

So to bring all these various drivers I presented in the previous pages together, let's turn to Slide 9. And this slide gives us a summary of how the year-on-year evolution of volumes, cost reductions, cost inflation and pricing impact our adjusted EBITDA since the start of 2021. On the right in green, you can see how consistent delivery of cost reduction measures, since the start of 2021, plus volume and mix growth, turning positive from 2022, are now contributing about EUR30 million to the EBITDA every quarter since the start of the year. And we intend to keep this pace going forward. The left hand side in red, shows how we manage to price against the unprecedented cost inflation. You see that we have steadily increased prices in phase of higher and higher inflation, and although we are not fully compensating cost inflation yet, Q3 is the first quarter where our additional pricing exceeds the further increase in costs. In the middle, you have the overall picture of how adjusted EBITDA has evolved over the last seven quarters. The dark line represents the net impact on adjusted EBITDA, adding the impact of growth and efficiencies in green and the net cost inflation in red. Whilst clearly the net impact remains negative, the GAAP is narrowing significantly in Q3, with EBITDA improving versus Q2. We expect this to further improve in Q4, with EBITDA step-up year on year.

(Slide 10)

Now doing a deeper dive in reported Core Markets figures. We break out the Q3 revenue on Slide 10. You can see here how the 17% like-for-like revenue growth is based on a solid contribution of volume, mix and growing price components. Ontex's volume and mix growth of 6% clearly continues to outperform the markets, based on recent contract wins, positioning in higher value categories, and retailer brands gaining share in the recessionary environment. Pricing is clearly the main game changer with an 11% increase, up from 2% in Q1 and 5% in Q2. The momentum of this pricing is going well across categories, growing month-after-month, and with further price increases planned in the coming months. And we also benefit from a foreign exchange tailwind of 6%.

(Slide 11)

Turning to Slide 11. We can see the impact of revenue growth on adjusted EBITDA contributing EUR48 million year on year of which most is from the pricing of course. Note that this EUR48 million marks a 50% increase compared to the revenue impact in Q2. Relentless focus on cost reduction delivered EUR15 million bringing the total for continuing operations at EUR41 million in the year. However, these strong measures were not yet enough to compensate cost inflation, which is still sequentially up and amounted to an EUR81 million year-on-year. Wage inflation also led to higher SG&A expenses, but strong cost-containment allowed to keep those costs below 10% of sales as indicated before. Finally, we had a positive impact from forex, (which mainly) with mainly the ruble appreciation more than offsetting the adverse impact of the U.S. dollar appreciation on our costs. All this let to adjusted EBITDA down 41% year-on-year, but marks a sequential improvement of 28% versus Q2, and that's also reflected in the adjusted EBITDA margin with a 0.8 percentage point improvement versus Q2.

(Slide 12)

Returning to Group numbers on Slide 12. Net debt totaled EUR895 million at the end of September. The increase versus EUR826 million at the end of June is mainly due to the lower EBITDA and increasing working capital needs, as revenue grows through volume, mix and pricing, and raw material prices are still up sequentially. We continue to work on our DSO, which improved, and we remain cautious with inventory levels for now, as we keep them relatively high to secure supply in the current volatile environment. With higher net debt and especially the last 12 months adjusted EBITDA still lower than the previous quarter, the leverage peaks at 7.7 times. This is temporary as from the next quarter onward, the last 12 months of adjusted EBITDA is expected to increase again. The debt will come down significantly after the closing of the Mexican divestment foreseen by end Q1 2023 with a EUR220 million loan as a priority. This is the debts that entails the covenants, for which the next test is foreseen mid-2023. The remaining debt after that is largely secure with the main components being the EUR580 million bond with a fixed rate of 3.5% and maturing in 2026 and not wearing any covenants.

(Slide 13)

So regarding the outlook on Slide 13 now, the uncertain geopolitical environment and the inflationary macroeconomic situation continues to be volatile. For the short term we have enough visibility to confirm our full-year outlook 2022. We have a positive view for Q4 and we expect the volume growth and pricing momentum to continue current trends. We now expect revenue in Core Markets to grow by about 15% like for like, an improvement on the above 10% we anticipated prudently previously. The adjusted EBITDA of Core Market is confirmed to be within EUR100 million to EUR110 million range. While for the total group, we expect it to land at the high end of the range of EUR125 million to EUR140 million. This implies that adjusted EBITDA of Q4 is expected significantly up quarter on quarter and year on year, confirming the start of the recovery. Cash flow discipline clearly remains the focus and while we want to ensure that we can continue to support our strategic growth initiatives with CapEx and working capital, nevertheless we expect leverage to reduce by year-end to below 6.5 times.

(Slide 14)

So I do believe our priorities are clear. We continue to drive the volume mix growth that we've seen in the previous quarters, and combined with the further step-up on pricing and the consistent cost saving delivery we will continue the EBITDA improvement. And to bring more than the cash discipline will bring leverage now. We're track to refocus our portfolio and the divestment of the Mexican business activities will allow to reduce net debt in 2023. And with that, let's pass over to Q&A.

Q&A

Geoffroy Raskin, IR

Now before we start the Q&A, can I ask all the participants to limit themselves two questions only please. And if you have more I invite to go back into the queue and if we have time we will address them. In case of time constraints, please contact the IR department afterwards. Operator, over to you.

Operator

(Operator Instructions)

Your first question comes from the line of Andre Philippides from Barclays. Please go ahead.

Q – Andre Philippides, Barclays (line of)

Hi. This is Karine Elias from Barclays. Thank you for taking my questions and thank you for the presentation. I had a couple please, and I'll come (back to the queue for) back in the queue for the rest. (On the) can you confirm your drawings on the RCF? I believe in Q2 you had drawn about EUR50 million on that. And then secondly if you could comment on the working capital movement Q3 and year to date as well? Thank you.

A – Peter Vanneste

Yeah. All right. Thank you Andre for your question. (On the) starting with your first question on the RCF. You know the RCF is providing working capital flexibility for us. So yes, we're still using it, as we speak right now. And we have been using it partly also because of some peaks that we've seen in Europe. As we changed our payment cycle, that has been leading to peaks, and, you know, we will tend to (continue it) continue using it as long as we need it because that's also (where) what it is for. So that's on the RCF.

On the working capital levels, (we have) they are above what they can be and they should be. I've mentioned already in previous calls that because of the supply disruption context, we are more prudent on our inventory levels. So, we keep higher levels of safety stock to make sure that we can absorb fluctuations we might have in this supply. Now, (the level of) the evolution of the working capital is essentially driven by what's happening with the raw material costs and our growth basically in our top line. So, the volume growth is leading to high receivables, pricing is leading to high receivables and then the inventory is impacted by the cost of inflation. On days we're doing well.

Q – Andre Philippides, Barclays (line of)

That's very helpful. Sorry, I may have missed. Have you mentioned the actual drawings on the RCF, the quantum drawn on the RCF for the quarter, please?

A – Peter Vanneste

No. It's -- we don't have the exact number right now, but it's still above the 50 that we have (that you quoted that we've been at the page) at the half year.

Q – Andre Philippides, Barclays (line of)

That's helpful. Thank you.

Operator

The next question comes from the line of Wim Hoste from KBC Securities. Please go ahead.

Q – Wim Hoste, KBC Securities

Yes. Thank you. Good afternoon. I also have two then, please. Can you first talk a little bit about the commercial momentum for Q4 and into '23? Net contract wins? For example, I understand from the press release that retail brands are doing relatively well (versus private label) giving the depressed consumer or the, let's say, the pressure on disposable income. But how is the kind of contract book looking for (Q2) Q4 and in 2023? That's the first question. And also a little bit by segment and geography, please?

And then the second question is on the guidance for the full year on the Core Markets suggesting significant jump in EBITDA margin in Q4, if you assume that there is not going to be a major deviation in revenue, for example. So, can you maybe talk about the key drivers? Is it mainly the inflationary context that will calm down? Is it mainly further pricing? Is it a combination of those together with cost savings? Can you maybe offer a little bit of additional kind of quantification or insights and what will drive that significant margin in Q4 that is kind of baked into the guidance? Those are the questions. Thank you.

A – Peter Vanneste

Okay. Thank you, Wim. Taking your first question on the volume. (We have) I talked in my presentation about the mid-single digit growth that we are having in the different quarters already this year. Getting into Q4, we absolutely will continue to see that happening. October's giving some reassurance on that already. So, that momentum is there. (We've not) with the pricing, all the pricing that we have done, (we have not been) actually, we've been winning volumes across. There's a few drivers on that. First of all, there's contract wins that have been helping that. Secondly, there is indeed a clear trend from consumers shifting from A-brands to private labels and to discounters, which, of course, creates a favorable environment (for). (And that's) especially, we're seeing that in baby pants and in fem care. We've seen it also in Europe across baby pants, fem care. In the North America, we've seen that more on baby on the pants and on the diaper side. But that's a clear trend that if I link up to 2023 is also something that we expect to carry over in 2023. Next to volume, we are seeing a very positive pricing and mix. We are growing especially on our strategic categories on banks, on adult, across. So that is not only, of course, on the sales, but also on EBITDA a good thing. I think that's more or less going it across the volume, your first question. There's been relatively limited tenders over the last 18 months, (with) partly driven by COVID. (Background noise) All right. We expect some more tenders next year, which is again, you know, going to create a few more opportunities also for us. So, that's how we look at the volume today.

On your second question, I think was around evolution from Q3 to Q4. You know, (Q2 was already) Q3 was already significantly better in absolute than Q2. (Not yet) clearly not yet at the margin levels that I want to see. But it's important to see that the quarter has been turned, (and we) you know, and all the efforts we've done in the past is now also starting to deliver the margins in the quarter. The step-up in Q4 will actually be bigger we expect than the one between Q2 and Q3, both in absolute as in margins. And that's going to be confirming the momentum. A key driver within that is pricing. It's a continued volume/mix, as I said, in frame of your previous question. And next to that is continued pricing. We still are at marginal levels that we want and we will be seeing growing, and that's why we're still pricing. And some of that will be coming in Q4. And that's driving the increase that you will see in both Emerging Markets and Core.

Q – Wim Hoste, KBC Securities

With regards to inflation, how much inflation are you going to see versus what we saw in Q3 for example?

A – Peter Vanneste

Yeah. (In Q3, we still had an increase versus) I mean, year-on-year we always are still talking big increases there. But sequentially, which is I think what you mean, we had a further increase between Q3 versus Q2. In Q4, you know, that increase will be less, it will be only slightly up versus Q3.

Q – Wim Hoste, KBC Securities

Okay. That's it thank you.

Operator

The next question comes from the line of Charles Eden from UBS. Please go ahead.

Q – Charles Eden, UBS

Hi, good afternoon. Excuse me. Thanks for taking my questions. A couple for me. First one on the change of CEO. And I appreciate you don't want to get into the details here, but I do think it's important to comment. So, clearly, Gustavo has extensive experience in the industry, which would have benefited the firm and sure already has during his time on the board. I guess, what is less clear, to me at least, is the timing of the decision. Because, I guess, one would have to assume Gustavo was heavily involved in the setting of the strategy in the first place. Therefore changing your strategy is unlikely. So, is it simply a view of the need to increase speed of delivery on this strategy, which is given the change. Anything you can kind of comment there would be helpful.

And then secondly, just following up on the earlier question around sequential pricing. Obviously, a step up in Q4. Are you able to kind of give any indication compared to that 6 percentage point increase sequentially Q3 versus Q2 for Core Markets. How you think about the sequential benefit from pricing in Q4? Those are my two. Thank you.

A – Peter Vanneste

All right. Thank you, Charles. Yes, on your question on the timing. You know, Esther has been instrumental in building the new objects in the past two years, in defining, first of all the strategy, of course, together with the board in implementing it and mobilizing the organization around found these themes and certainly also navigating the organization and Ontex through the many headwinds that we have been facing. And we've been consistently delivering on those basic levers (that) and that over different quarters, that we've been (consistently growing our pricing the price savings and sorry) consistently delivering on our cost savings, stepping up our pricing in different ways, volume/mix, I talked about already, on the turnaround and starting and progressing on the divestment program. And we see some of that now in Q3 results. There's more to come. The margins are still low, leverage is too high and inflation is not over. So, more of those levers and discipline will happen in the month and quarters to come. And there will be more opportunities also to realize there. I talked about a favorable private label context. There's opportunities with releasing a bit of the disruption on the supply side. And in all of that, as we enter into the next phase of the transformation, the board believes that Gustavo is the right person and has the right experience to lead us through the next phase.

Now, your second question was more of sequential Q4 versus Q3. Actually, I answered on that already, I think partly in the previous question, which is mainly driven by pricing (which is). Now the exact amount, I don't have a percentage point. It becomes also more difficult because (we're comparing) when we talk about pricing (we compare) we talk about percentage versus last year. So, what's happening now already in Q3, but even more in Q4 is that you're comparing to a quarter where we already have been pricing. So, last year Q3, we have been pricing, (in) first pricing in Emerging Markets. In Q4, we've been already significantly pricing in Emerging Markets and started in the Core. So, the percentage will be less readable or less (readable or) comparable to previous quarters. But if I look at it absolutely, in absolute numbers, the majority of the increase will come from that and the consistent volume/mix growth. And maybe one thing to do to add to that, (is that within). I always talk about quarter-after-quarter, sequential higher pricing is also within the quarter that we see pricing ramping up. So, September has been higher than August, August has been higher than July. And this is a trend that we've seen also in the previous quarters.

Q – Charles Eden, UBS

Thank you very much.

Operator

The next question comes from the line of Othmane Bricha from Bank of America. Please go ahead.

Q – Othmane Bricha, Bank of America

Hello. Thanks for taking my questions. I have two. First on M&A. Could you please confirm if you are still in discussions with AIP? And do you feel that now you are more advanced in the disposal of Brazil and other Emerging Markets businesses compared to last time (when on results) on Q2 results?

And my second question is more on the long term and trying to understand better your business ambition in the U.S. and specifically, the North Carolina factory, which you opened earlier in the year. So, can you maybe talk a bit about what is the factory utilization rate as of now? What's the product and customer mix? Have you signed with new customers or mainly accession of contracts that you've already had from the Tijuana plant? And also, can you maybe comment more on your market share in which other brands in the U.S.? Thank you.

A – Peter Vanneste

All right. Thank you, Othmane. Taking your first question on AIP and the divestment project. So, if I first talk about AIP. There is an opportunity clearly in the business combination with Attindas, but there's no progress to report on that currently. We'll obviously come back of course when there is a significant change. But at this point honestly, I'm focusing mainly in the big turnaround that we need to make for Ontex. On Brazil and the other divestment projects, so we have as we discussed before, we've engaged with advisors and (we are making) we have projects running on all of them. We're making progress on all these files, including Brazil. And there's again at this point not more to report. We will inform you when there's more. And also here, I mean, we are clearly focusing on (the) improving the profitability of these activities. And we do see that our progress in these markets is gaining traction. Part of the reason that we have guided the full year EBITDA outlook on the higher end of the range, is because we see that we're making structural good progress in the Emerging Markets. Within the Emerging Markets, it was initially more Mexico, but then in Q3, there's actually more traction coming from the other markets who have been suffering a bit more before, from things like hyperinflation or an unstable economic environment.

So, (that's on) that's on that part. And now I'm thinking back what your other question was on the U.S. Yes specifically on operations Stokesdale. Now, U.S. is clearly our strategic growth platform. We are making structural investments in the region to support the group. We have been, and we are, and we will be growing double-digit in that region. And we, indeed in that context, we are initiating many things. We are carving in the Tijuana factory from our Mexican operations. And that's something that is really happening as we speak, and will be done by the end of the year. We have closed our Reidsville factory, which is the fem care factory that we bought some time ago, and integrated that in the operations (in) within the North American footprint. And we officially opened, as you refer to, Stokesdale. Shipping started in quarter two. We are further ramping up. There's obviously customers being served from that factory: existing customers, with new business within existing customers. It obviously needs to further ramp up and to grow and get the optimal profitability. But that's very much within the frame, of course, as we have these double-digit growth plans (in the North) in North America that we are delivering today.

Q – Othmane Bricha, Bank of America

Thank you. And maybe just a comments on your market share in retailer brands in the U.S. now, maybe versus two years ago.

A – Peter Vanneste

We're not disclosing our share on that level. We, obviously, are gaining traction because (we are) at (the growth rate) the double-digit growth rates, it's clear that we're gaining share. And it shows, honestly, we're still fairly low, we're still below the 10% within the U.S. and that (blows) shows that there is a lot of potential for us to grow, especially with the solid footprint that we now have on the ground.

Q – Othmane Bricha, Bank of America

Thank you.

Operator

The next question comes from the line of Patrick Folan from Barclays. Please go ahead.

Q – Patrick Folan, Barclays

Yeah. Thanks for taking my question. Just two quick ones for me and you touched on one of them briefly before. On the volume mix, just heading into Q4 in 2023. Can you provide a rough split of the volume benefit you saw between contract wins and then consumers trading down to retailer brands? I think you mentioned that there's limited tenders this year. So, will that impact the volume mix number heading into the first half of next year, or will the momentum carry through into 2023? And on that volume mix, are you seeing stickiness in terms of pricing on those negotiations?

And then secondly just a quick one. Is there any market or any category to call out that you have seen any price elasticity at all? Thanks.

A – Peter Vanneste

All right. Thanks, Patrick. Okay, on the volume side. So yes, two elements that quoted before. So, that's the contact wins that we have. And actually, it's a little bit broader than that if you look at Q3 because we also had some more traction, especially on fem care for instance, where we had a bit more supply disruption challenges before and now with a bit of a catch-up on that level. But essentially, yes, contract wins both in North America and in Europe. And then a trend from private from A brands to private labels considering the recession that that they upended, the purchasing power challenges that they have. We expect absolutely that to go forward into 2023, there's no reason to believe at this point that that momentum is going to leave, is going to go away, and it's not what we see today in our volumes and the start of Q4 either. You asked about pricing negotiations. So far (we have not) we've been pricing significant. We have not lost volumes, on the contrary, we've been gaining volumes through that. This is not surprising for inflation. This is an industry challenge that everybody's facing and if you look at other companies, public companies, communicating, you'll see similar things. So, within that context, we believe we are well-positioned also on the volume side to continue the momentum that we have.

Q – Patrick Folan, Barclays

Just on the down trading. What percent of that 11% volume mix was due to that trend? Is there a rough split there?

A – Peter Vanneste

Yeah. I'm not going to that in that level of detail. They both are contributing and fairly consistently.

Q – Patrick Folan, Barclays

Okay. Thank you. (Background noise)

A – Peter Vanneste

Sorry, Patrick, (we didn't) I didn't get to your second question. Could you ...

Q – Patrick Folan, Barclays

Yeah. Just on pricing elasticity, is there any particular market or category within the portfolio to call out that you're seeing. (I think, it seems like) it seems pretty robust at the moment considering the trends. But, just any market you've seeing anything.

A – Peter Vanneste

No. (I think it's very) we're pricing across, considering the nature of the reason why we price, we're pricing across categories, across markets. What you can notice and you have probably seen that is that the step up between (Q3 and) Q2 and Q3 has been higher in the Core from 5% to 11%, so 6 points up, which is more than what the further step-up in Emerging Markets, who have been started to price earlier. If you look at the segments, you could make a nuance (between) for the institutional market where in healthcare, where basically it is a bit more complicated because there's longer-term contracts and there is legal constraints sometimes. So, it takes a bit more time to price in these circumstances. But still, we're also making progress there and we are pricing and there's also a rollover of context, of course (that as). Every day or every month there's contracts being renewed. That's obviously then the opportunity to price.

Operator

The next question comes from the line of Karel Zoete from Kepler Chevreux. Please go ahead.

Q – Karel Zoete, Kepler Cheuvreux

Yes, good afternoon. Thanks for taking the question. I have two questions. The first one is on staying with pricing and the upcoming price rounds in a few months. Has the tender structure in your industry have been altered at all, or will it remain like it was where you have typically a 12-month agreement with each other? The reason for asking, of course, is that retailers are clearly seeing that prices have gone up dramatically and maybe more is needed. But also, at some point, cost might come down.

The second question is more on net debt and cash flow drivers. You already spoke on EBITDA improvement or adjusted EBITDA improvement and the working capital drivers and the decisions there. But can you speak about other cash drivers, how you see debt developing in the coming quarters? Thinking about the interest cost, but also certainly CapEx where you must have some inflation in those lines as well and some cash-out for exceptionals. So, any guide on cash flow items would be much appreciated. Thank you.

A – Peter Vanneste

All right. On your pricing question, on tender structures, I mean, tenders have not structurally changed. I did comment before that (they've been) we're seeing less than before in the last 18 months. And that's again linked to probably the context that everybody has been facing and some extent COVID. But the structure itself has not changed. It's, of course, (in the) when we're renewing contracts in certain areas like healthcare, we, of course, try to learn from sometimes the complexity in some specific cases that we have and implement that. But apart from that, I think, there's no fundamental changes to how that is being done. You did hint and ask about when inflation would start coming down? Again, I would be looking forward to that moment. At this point, we do see further inflation and we do see the market still (being) needing to do what we have been doing over the last months. And is now finally resulting also in an increase of the margin.

On the cash side, and the different drivers, you talked about CapEx. Let me start by CapEx. (We) in sort of the areas, CapEx together with, I'd say, combined in this logic with non-recurring investment. So, the one-offs is that something that we're really really carefully managing in a very disciplined way. So, we've been spending less than what we have been talking about in terms of long-term or mid-term guidance. So, I think we've been in the first half, we have been at 2.3% (Q3) of sales on CapEx, and we've been higher in Q3. We will be going gradually and again in a balanced way up to the guidance that we have on the 4%. And we see the end of the year Q4 will be little bit higher as well. But again, we play it in the right way because we need to balance it with the recovery of our EBITDA and the improvement on the working capital side of our cash flow. But just also to be sure on that, (we are) the large majority of that CapEx is being focused on the strategic growth drivers. So, we're making all the investments that need to be made, especially on the priorities on pants on U.S. expansion. On interests, there is a limited increase. Most of the interest costs are quite protective against the interest levels. And what I especially want to highlight is that (we're on the) versus our current that we will be reducing our current net debt level with the proceeds from the Mexico sales. So, with the EUR250 million that we expect early next year, we'll be paying back our term loan, which is the area where we have the covenants and there's a bit more impact on the level of our leverage (and the level of our leverage). Now, after that, we will be essentially with debt that consists of the bonds, which is EUR580 million. And that's the 3.5% fixed rate and the maturity in 2026 and carrying no governance. So, I think we have a strong financial position with that.

Q – Karel Zoete, Kepler Cheuvreux

Many thanks.

A – Peter Vanneste

You're welcome.

Operator

The next question comes from the line of Daan Schelfaut from Nerisa. Please go ahead.

Q – Daan Schelfaut, Nerisa

Yes. Hi. Thank you for taking my question. I have just one. Can you help me understand the dynamics between your working capital expectations and factoring? Because you said that working capital is above what it should be. But I'm just a little bit puzzled by why that should change in Q4 when you continue to grow debt substantially and with input costs not coming down that much. So, should I be looking at it in terms of factoring that has changed? And could you also perhaps help me on the factoring in Q3 and what your expectations are for Q4? Thank you.

A – Peter Vanneste

Yes. All right, Daan, thanks for your question. It's a clear and good one. Maybe also short on that (I think the positive) well, first of all, I need to put a bit of prudence because we are navigating working capital within the context of insecure supply and that's why sometimes we do make calls to keep safety stocks higher than what we intended it to be two months earlier because there is a supply area that we want to cover up. Now, having said that, the improvement to (which) Q4 is actually twofold. The first is really (is) inventories. There is improvement in the supply disruption area. It started a year ago and then we gradually started again – not just Ontex, it's an industry challenge – and then it started improving month after month. There was a bit of a setback at the moment of the Ukraine-Russia crisis. And then again, we're improving very nicely right now, which also means that all the working capital, we don't need to – on inventory specifically – we don't need to be taking all the precaution measures that we have been taken before. So, we are gradually releasing that. I hope to be able to do that mostly in Q4. If not, it's going to be the first half of next year. And secondly, the second driver is on the DSO side. That we have a further ambition to progressively improve our DSO, which has already happened so far year to date, but we will take it another step in quarter four.

Q – Daan Schelfaut, Nerisa

And could you also comment on the factoring?

A – Peter Vanneste

Well, (factoring is) we do that since several years and we don't disclose it at the quarter level, but I can tell you that (we've been using the) since we use it, we've been very consistent in the usage. So, (there's not) this is not a major driver.

Q – Daan Schelfaut, Nerisa

Okay. So 4Q, end of Q4, we can assume it will be equal to half year?

A – Peter Vanneste

Yes.

Q – Daan Schelfaut, Nerisa

Okay. Thank you.

Operator

The next question comes from the line of Peter Testa from One Investments. Please go ahead.

Q – Peter Testa, One Invest

Yeah. It was a couple of questions, please. One is just for looking at the margin implied in Q4 and as a base for rolling forward at the start of 2023. Just want to make sure that when you think about the sequential nature of your development whether we can consider that as a base margin to start the year next year? Not looking for a forecast per se, but more as a understanding of how the metrics driving that Q4 being continuing?

And the second question is just on the medical side whether there's any opportunities to, in your contract negotiations there, to start the catch-up on the medical-related business on repricing?

A – Peter Vanneste

Okay. Thank you, Peter. The first question on the margin Q4 and being a good base to start 2023 without making a forecast for 2023. Yeah, it is too early to provide guidance on 2023. There is still volatility in the system and uncertainty both on the demand level as on the cost level at the end of the day. But I could talk a bit about what I do know and what we do. First of all, this consumer trading momentum from A-brands to private labels (protecting) giving some protection and grow more volumes. I talked about before, I see no reason to have different things anytime soon. We will have next year a pricing and cost carryover if you consider the ramping up that we've seen on both pricing and cost inflation in the course of 2022. Clearly, that will have a carryover effect in 2023. I mentioned before already that cost inflation is not over. We see some indices going down and (like) things like ocean freight improving. On the other hand, we have areas like fluff; so the RISI is record high. Energy costs (are) – well, I don't have to explain you energy costs – and wages, wage inflation are three areas where we have increasing costs. Some of it we have been protected somewhat in 2022, by either hedging or longer-term or yearly contracts. And that, of course, will be an area, but that also kicks into the equation. Now, we are planning and have already organized additional pricing. And we will continue to do pricing and cost reduction measures where needed. Cost program, we will roll over. We've been delivering consistently. We've talked about EUR80 million cost savings this year and we will be going for that in 2023. So, initially, while I cannot give you a specific forecast, I can easily predict we will be hammering on the same nail and the same drivers as we've been doing this year. And I'm confident to see a year-on-year recovery of profitability also in 2023.

Your second question is on the medical side of the business or healthcare. We are looking at every opportunity to take pricing in healthcare. It is more challenging as I talked about before in our current contracts because (they are more longer) they are longer and they have more legal constraints at moments. So, that's why it takes a bit of time. As I said, we're progressing. We have contracts rolling over. When they're rolling over or when we are adjusting or when we have new contracts, of course, we take into account any learnings to implement in the next ones, because what we're facing in '22 is extremely unprecedented of course. So some of that (was easy) it was not easy to anticipate. As you know next to pricing, which we are carrying through in that segment, we're also working, of course, hard on product mix, to make sure that we protect and grow profitability within that. Pants is one good example of how that works in the second.

Q – Peter Testa, One Invest

So just a follow on my question on the healthcare part was whether (if you looked at) – quite often these are annual contracts and have some annual element to them – whether there's a significant body of that or whether these are still medium-term contracts largely?

A – Peter Vanneste

There's a mix of – if you look at adult or in general, I mean – there's a mix of many contracts. There's not necessarily – a little bit like with the tender question I had before – it is not necessarily structural dynamics that for certain segments, contracts we are getting shorter or longer. It's been a mix overall, it's been longer in healthcare institutional, and we expect that that's going to be the case.

Q – Peter Testa, One Invest

Okay. Thanks very much.

Operator

Next question comes from the line of Fernand De Boer from Degroof Petercam. Please go ahead.

Q – Fernand De Boer, Degroof Petercam

Yes, good afternoon. Fernand De Boer, Degroof Petercam. Just to come back on let's say the credit facility and the term loan. This is contractual that you have to pay down that first because if you look at the current bond price, it seems to be also rather attractive to buy them back at around 80%. So could you comment on that one?

And then on the covenant calculation, I think next year in June, you are back for the covenant calculations. Of course, you will have then the sale of Mexico. But do they then also exclude in the EBITDA calculation, the EBITDA contribution from Mexico? Could you confirm that?

A – Peter Vanneste

Okay. Thanks Fernand. Okay, so on the proceeds from Mexico. Yes, so we are anticipating the EUR250 million proceeds from that divestment and we have agreed with our banking partners that paying back the term loan is the first priority (what we will do), which again will help a lot also in making make sure that the financial debt position is going to be strong. What we will do beyond that, honestly, (we will) we will evaluate and do whatever is best in the interest of the company and the shareholders.

Q – Fernand De Boer, Degroof Petercam

But it's contractual that you are obliged to pay down the term loan first. Because you can buy back at 80%, which is more effective in much.

A – Peter Vanneste

As I said, it's what we agreed with our banking partners that we would prioritize paying back the term loan.

Okay. On the covenant calculation for 2023, yes, obviously, when we have divested Mexico and we update the leverage, we will be benefiting from the lower debt, significantly lower net debt because we are getting those proceeds. And of course, also the EBITDA for Mexico will be excluded as of that moment.

Q – Fernand De Boer, Degroof Petercam

Of course you don't have any covenants anymore if you pay down the term loan.

A – Peter Vanneste

That is correct.
[Clarification: That is correct for the term loan. Covenants remain in place for the revolving credit facility.]

Q – Fernand De Boer, Degroof Petercam

Okay. Thank you very much.

A – Peter Vanneste

Thank you.

Operator

The next question comes from the line of Eric Wilmer from ABN-AmRo - Oddo BHF. Please go ahead.

Q – Eric Wilmer, ABN-AmRo – Oddo-BHF

Hi. Good afternoon. A few questions left. I will ask them one by one. I appreciate it's difficult to share anticipated sequential price increases, but would it be possible to share the exit rate in September? Thank you.

A – Peter Vanneste

Okay. We will go in the sequence of your questions. So, yeah. I mean, we are not going to give specific numbers by month. I already mentioned that within the quarter the pricing has been ramping up, has been higher in August and July and higher in September than in August. And it's clear that the profitability step up in Q3 has been driven by pricing. So, that gives you the answer on the fact that September has been the best month in terms of margins within our quarter. And we also see, of course, that's entering and running over into Q4. And there you also see that momentum continuing.

Q – Eric Wilmer, ABN-AmRo – Oddo-BHF

Okay. That's helpful. Thanks. And then the next question, given your production skew in the Belgian, or to the Belgium market and such your field and your ability to Belgian wage indexation. Does this raise a discussion about moving some production to other countries?

A – Peter Vanneste

Well, we have a - first of all, we have a – we're pretty diversified. You talked about production in Belgium. I mean, we have multiple factories, only two in Belgium. So, that's one part to your element. So it's not that extreme. Next to that, we have a very high ambition and cost program both on operational costs and on SG&A. And we have brought SG&A down below 10% already this year. And we come from more than two points higher. We've done it in different ways. We've done the restructuring – significant restructuring in the last year. This year was more about containing and managing the cost against the growing inflation. We will continue to deliver on the objectives that we have set for SG&A, via the recipes that we will need, but it's not that there's anything on the table like we've been hinting at.

Q – Eric Wilmer, ABN-AmRo – Oddo-BHF

Okay. Understood. Thanks. And then my last question on the competitive environment from A-brands. I think in the past we've seen A-brands introducing aggressive promotions as soon as their volume started to suffer. Is this something you were seeing in any of your geographies as consumers are moving into private label? Thanks.

A – Peter Vanneste

Obviously, I mean, first factually, we are growing volumes and quite nicely and quite strongly actually and especially in the Core. So factually, it's certainly not impacting us right now. Obviously, we see A-branded players reacting and doing what they need to do beyond the pricing. They protect their volumes, which is what I would do if I was in their shoes. But still, we have gained. We see some differences between markets. But overall, we are in a winning position on the volume side and looking forward to Q4, I don't see any sign why that would be different at that moment.

Q – Eric Wilmer, ABN-AmRo – Oddo-BHF

Thank you.

Conclusion

Geoffroy Raskin

Okay. We've reached the hour, so we will not do a second round. For those who want to do that, feel free to get in touch with me this afternoon. So, I'll give the floor to Peter to make his final comments.

Peter Vanneste

All right. Thank you everybody for your questions. As you've seen, we have turned the corner. Q3 has been an important moment. I mean, you can find these efforts on costs, on pricing, on volume sales turnaround, effecting into an EBITDA and a margin that goes into the right direction. Certainly, not happy with the absolute 5.5% margin or leverage of 8%. That speaks for itself. But it's important to see that in Q4, we will be significantly better on EBITDA and on the leverage. And (that will) is the start of turning around and going to the right direction thanks to the different efforts that we've put in place. So, thank you for your time and I'll talk to you soon or next time.

Operator

Thank you for joining today's call. You may now disconnect your lines.