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FLUI.MC - Q2 2022 Fluidra SA Earnings Call

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## PRESENTATION

**Cristina del Castillo García** - *Fluidra, S.A. - Director of Investor & Shareholders Relations*

Good morning, and welcome to Fluidra's First Half 2022 Results Presentation. I am Cristina del Castillo, Investor Relations and Shareholders Director of Fluidra.

Today's presenters will be Mr. Eloy Planes, our Executive Chairman; Mr. Bruce Brooks, our CEO; and Mr. Javier Tintore, our CFTO.

You can follow this presentation in its original English version or in Spanish. You can select your preferred option in the drop-down menu at the bottom right of your screen.

Today's presentation will include live Q&A. (Operator Instructions) Presentation materials are accessible through our website, fluidra.com, and they have also been uploaded premarket open to the Stock Exchange Commission. The replay of today's presentation will be made available on our website shortly after we finish.

Let us start the presentation by opening the floor to our Executive Chairman, Mr. Eloy Planes.

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**Eloy Planes Corts** - *Fluidra, S.A. - Executive Chairman, Executive President, MD & CEO*

Thank you, Cristina. Good morning to everyone on the call, and thank you for joining us for this first half results presentation. As Executive Chairman, first of all, I want to thank our team, clients and suppliers for their continued trust in Fluidra.

No doubt, we are facing a volatile and changing environment. Increased inflation, Ukraine war and inventory correction as supply chains tends to normalize. These challenges are impacting many industries and countries worldwide. I believe you will hear today the strength and resilience of our global platform and the capacity of Fluidra to navigate the environment well.

Later, Bruce and Javier will dive into the Fluidra's numbers, but let me make some comments before to do it. Despite of the noise of this volatile environment, we continue to see solid end-user demand for the industry on top of a couple of years of extraordinary growth, which confirms the step change of the pool industry.

We posted excellent Q2 sales figures driven by price and inorganic activity over a very strong comparable that includes the Texas freeze. On the other hand, margin has suffered in this first half, and there has been a time lag between a higher inflation dynamics than expected and pricing implementation.

We have seen 2 different trends in Europe where read-through has been practically offsetting inflation and North America where we decided to not reprice the backlog to protect our customers impacting us about EUR 30 million of read-through in this first half.

We are seeing an accelerating read-through in the latter part of the quarter, what give us confidence for improving our H2 margins year-over-year. We are then reformulating our estimates for the full year based on the first half figures. We see growth in H2 driven by price, M&A and FX despite the correction of the inventory levels in the channel as the industry move -- as the industry moved towards to more normalized practices.

On the margin front, as I said, we see year-over-year recovery in the second half as a result of all the initiatives that has been implemented. Our company is prepared to continue capturing growth, delivering strong cash numbers. And as Bruce will explain to you later, we have additional margin levers that we have not been able to pull during the last few years of growth, and now we are activating.

And finally, I want to highlight that despite investments in inventory in this first half that will be corrected in the second half of the year, we have a strong and healthy balance sheet that we have recently recognized. We are convinced that the creative M&A is a strong value contributor to our strategy, and Bruce will walk you through a couple of acquisitions that we have done recently. At the same time, we believe in the fundamentals of our business. So I'm pleased to announce that we are launching a stock repurchase program of 3.5 million shares in the next 5 months.

All in all, we continue to be committed to our financial policy of running our company at around to net debt EBITDA by year-end. At this point, I give the floor to Bruce, our CEO, who, along with our Chief Financial and Transformation Officer, Javier, will provide a deeper look at the Q2 '22 numbers.

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**Bruce Walker Brooks** - *Fluidra, S.A. - Co-CEO & Executive Director*

Thanks, Eloy. Let me start with comments on our overall performance and highlights for the first half of 2022 and then turn it over to Javier to provide more details on the financial results. I will then return to provide some color on our outlook.

The numbers you see on Slide 5 are the 2021 and 2022 financial highlights for January through June. In the first half of 2022, sales grew 22% and 8% when adjusted for currency and perimeter compared to the same period of 2021 to EUR 1,445,000,000. This record top line was driven by price and perimeter expansion. EBITDA and EBITA grew 9% and 8% to EUR 361 million and EUR 321 million, respectively. Adjusted for currency and perimeter, they declined 3% and 7%.

Both measures were impacted by significantly higher-than-anticipated inflationary pressure as we were delivering the backlog at 2021 pricing. This decision to support our builders who generally lock in new construction prices will benefit us in the midterm but has had an estimated impact of more than EUR 30 million. Based on the materiality and the continued complexity of the supply environment, we changed our policy in May, as we communicated on the last call.

Cash earnings per share grew 1% to EUR 1.12 per share, impacted by the one-off tax benefit from the merger taken in Q2 2021. The operating net working capital ratio to sales increased 12 points versus last year to 29% due to supply chain recovery, inventory rebalancing in the channel, inflation, M&A and FX. I'd like to remind everyone that our products are nonperishable. It will take a couple of quarters to normalize levels as the industry adjusts to the new situation.

Our net debt stands at EUR 1,245,000,000. Our leverage ratio increased to 2.1x with the deals executed in H2 2021 and the higher investment in inventory.

Moving to Page 6. Let me shed light on the current environment and give an update on our business. No doubt, the world is in a volatile moment. We are encouraged to share that sell-through levels are at mid-single digit on a global basis and even at low double digits in North America, if adjusted for the Texas freeze, demonstrating again the resiliency of our space. On the other hand, volumes are being impacted by some level of correction of inventory in the channel as service level improves on most of our products and the industry returns to demand-based buying patterns.

Northern Europe, who have led the organization and growth percentage for the last 4-plus years, is facing a more challenging environment. In this geography, we not only see inventory correction but also the impact of people again traveling to Southern Europe where we're actually seeing the benefit and energy inflation and the war. As mentioned on the previous slide, in North America, we took the commercial decision not to reprice backlog orders, honoring the conditions that we extended to our customers.

At the end of Q2, after our May price action, we are already seeing acceleration of price read-through. Our mix of growth drivers has changed versus our original guidance with price reading through as a greater contributor, reaching almost 10% year-to-date. On the inflation front, we see an easier comparison as we look forward. Labor and some components continue to add pressure while we're beginning to see some relief in metals and container costs.

Turning now to our business mix. We saw a duality in performance when we talk about our 2 engines. Let me first take a quick step back. We've been able to grow 4% in the quarter on top of a tough Q2 2021 comp of 43% growth with both metrics adjusted for currency and perimeter. New construction activity recorded a solid evolution. So I will share with you later the continued adoption of more energy-efficient and connectivity features, driving an increase in the average ticket. The combination of increased features and higher prices will make 2022 a strong sales value year in new construction.

As we have been forecasting, the aftermarket saw weaker relative performance in the quarter due to specific impacts, including, first, Texas freeze's tough one-off 2021 comparable; secondly, correction of pull forward of heat and above-ground pools; and thirdly, remodel backlog based on pool pro capacity challenges.

Moving to Page 7. Let me share some highlights of the quarter. We're continuing to work to make ESG part of our core culture for the entire organization. On the social front, we are thrilled by the continued high level of employee engagement according to our 2022 survey where engagement reached an outstanding 90%. Our customer-centric culture, our people are a competitive advantage. We are happy to share that we have finalized the first couple of life cycle assessments for some of our pumps and robots, which will help us improve their sustainability and circularity.

Finally, on the environment front, we have a project in South Africa whereby we are converting our facilities to solar. We expect to save more than 500 tons of $CO_2$ per year.

Let's move to IoT and the connected pool. Let me share some numbers in this field where we see continued momentum. First, we committed to reach 1 million connected users by 2025, and we are ahead of the curve at some 700,000 users. We recorded an outstanding greater than 40% growth year-to-date in new users connection rate.

If we focus on North America, it's worth highlighting that the higher-priced connected product sales is growing about 3x more versus nonconnected product in this still capacity-constrained space. We continue to learn and grow in the SaaS or Software-as-a-Service space. Although still small, we are pleased to share that we saw a strong growth of greater than 27% of service revenue in North America on a last 12-month basis.

In addition, our experience shows the penetration of connected new pools in North America has increased to around 80% versus the 65% that we shared back in our April 2021 Capital Markets Day. Finally, as for M&A, we have just acquired Swim & Fun, a market-leading distributor based in Denmark that serves the Nordic market, a market with growth potential and high margins. It supplies a wide range of maintenance and upgrade products, water treatment and above-ground pools and spas, mainly for the mass market.

The company reported approximately EUR 30 million of sales in 2021 and adjusted EBITDA margin close to 20%, with an upfront payment of less than 5x EBITDA multiple and potential future earn-out payable in 2026 based on '23 to 2025 EBITDA. This deal is expected to be EPS accretive in 2023.

Lastly, let me remind you that we reached in June an agreement to merge our Hungarian operations with Kerex, a leading pool equipment distributor that will allow Fluidra to offer a more comprehensive product portfolio to an expanded customer base.

Kerex reported sales of approximately EUR 10 million in 2021 and the EBITDA multiple paid is less than 5x. We expect to start consolidating it as of late Q3. Both deals reinforce our leading distribution position in Europe.

Turning now to Page 8. You see the sales evolution by geography. During Q2, global sales grew 15%, benefiting from our accretive M&A activity in 2021. We grew 4% on a constant FX and perimeter basis. In the 6-month period, sales grew 22% and 8% when adjusted for currency and perimeter.

Southern Europe's good performance continued with currency and perimeter adjusted growth of 10% in Q2, mainly driven by Spain's strong sales evolution in the quarter and very good performance of commercial pool, both helped by the return of tourists. For the 6-month period, this region saw growth of 16%. The rest of Europe was impacted by the difficult environment previously mentioned in Northern Europe and had a tough comparable in Q2 2021.

North America sales were up 34% or 41% for the quarter and the first half, respectively, driven by last year's strong M&A activity. They grew 3% and 6% on an adjusted organic basis against a monster comparable in Q2 2021 where this region saw an outstanding growth of 70% organic, which benefited from the Texas freeze event. We see accelerating sell-through levels post this one-off event.

In mid and late May, we began to see replacement orders slow as customers began to adjust their coverage ratios for product as the supply chain recovers. This trend should peak in Q3 and we believe will be mostly complete by the end of the year, returning the industry to a normal pattern for 2023.

Rest of the World recorded strong sales growth of 26% for the quarter and 23% for the 6-month period on a currency and perimeter adjusted basis. This area saw strong growth in Australia. Perimeter contributed about 5% of Q2 growth and about 6% in the 6-month period.

Next, on Page 9, we see the evolution by business unit. Residential Pool is our largest segment and accounted for 75% of our sales. The business grew 12% driven by M&A and was flat for the quarter and had a 4% growth for the 6-month period on an adjusted FX and perimeter basis.

Q2 performance is mainly explained by the inventory, supply imbalance and the current situation in Northern Europe. Strong evolution in new construction that offset the aftermarket against an outstanding comp in 2021 of more than 50% growth. Top performing product categories were pumps, filters and cleaners.

Commercial Pool grew strongly, supported by the recovery of tourism, which we expect to continue, our strategic investments and accelerated by inorganic activity. The business increased 20% once adjusted for FX and perimeter in Q2 and 23% in the first half, positioning us well for further growth.

Pool Water Treatment grew 26% for the quarter once adjusted for FX and perimeter and 27% in the first 6 months of the year. This business unit saw a strong performance of both Water Care Equipment segment, along with Chemicals, positively impacted by price and negatively affecting the overall mix.

The Fluid Handling business recorded a 3% growth in the quarter and 10% in the first half, adjusted for FX and perimeter, aligned with our residential activity.

No doubt, our global platform is truly demonstrating its resiliency and balance during these volatile times. Lastly, I want to thank our talented team of more than 7,000 employees and business partners for their agility, positivity and sacrifices.

With that, I'll turn it over to Javier to explain the financial results in more detail before I return to share our outlook and guidance.

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**Javier Tintore Segura** - *Fluidra, S.A. - CFO*

Thank you, Bruce. Let's turn to Page 10 and take a look at the P&L in some more detail. Sales growth of 22%, which can be broken down in 5 points from currency, 9 points from inorganic growth and 8 points of growth at constant perimeter. This organic growth is entirely driven by price as volume is slightly negative in the first half.

Gross margin reached 51.1%, 220 basis points lower than prior year. The impact of higher-than-anticipated inflation and product and region mix was not fully offset by pricing and our value initiative. Since we implemented the new pricing policy in North America, price is ahead of inflation, and we expect to remain positive for the remainder of the year.

Operating expenses reached EUR 378 million with an increase of 25%, which is 14% if we adjust for perimeter, impacted by higher logistics and transportation costs as well as investments in marketing and R&D. Acquisitions represent 17% of points of the OpEx growth as acquired companies have a higher expense profile pointing to the synergy opportunity as we integrate them.

EBITDA reached EUR 361 million with an increase of 9% driven by acquisitions and currency that offset the negative contribution of price inflation and mix. EBITDA margin reached 25%, which is 280 points lower -- 280 basis points lower than prior year. EBITA achieved EUR 321 million, up 8% and reaching a margin of 22.2%.

Below the EBITA line, the amortization increased to EUR 36 million driven by the intangible asset amortization of all the acquisitions performed during 2021.

Nonrecurring expense of EUR 11 million, which is 58% down to prior year due to lower stock-based compensation and M&A activity versus a year ago.

Net financial result is EUR 45 million, EUR 27 million higher than last year due to EUR 12 million write-off of noncash fees generated in the refinancing, EUR 7 million of higher interest expense on higher debt and the remainder being unfavorable currency.

Tax rate is at 26% versus a 22% tax rate in 2021, which benefited from a one-off impact coming from the Zodiac merger.

Net income reached EUR 167 million compared to EUR 174 million in '21, down 5%, impacted by margin pressure, additional amortization, the higher financing and a higher tax rate.

As you know, with that cash net profit, a good indicator for Fluidra as we have a very significant amortization entirely purchase account-related that impacts our net profit and EPS calculation.

Cash net profit is EUR 219 million, up 1% to prior year and better than net income results due to the noncash nature of the refinancing write-offs.

The following page shows the free cash flow statement as well as the net debt evolution. Free cash flow for the first half has been a use of EUR 113 million versus a use of EUR 167 million in 2021. However, the components of this cash usage are very different year-to-year.

If we look at the operating cash flow, the company has invested EUR 269 million more in working capital, which are partially offset by the EUR 46 million of incremental EBITDA.

If we zoom into the investment of working capital, this is entirely driven by investments in inventory, which is impacted by perimeter, inflation, longer in-transit times as well as investments to protect service to our customers in the supply challenge environment. These investments are partially covered by an increase in payables and continued efficiency on receivables as collections performed nicely around the world. As we look at the remainder of the year, evolution of net working capital will correct towards a more normalized pattern with net working capital between 17% to 18% of sales by year-end.

On the investment front, we have used EUR 229 million less cash in 2022. The key driver of this improvement is the inorganic activity executed during 2021 as we completed the CMP and Built Right acquisitions. In the financing front, we have used EUR 80 million less cash than last year driven by less investment in treasury stock.

Finally, net debt reached EUR 1,245,000,000, up EUR 462 million driven by the investments in inventories and the execution that we executed in the last part of 2021. Our leverage ratio is 2.1x that compares to 1.6x in June of 2021.

And with that, I will give the floor to Bruce and Eloy for guidance and closing comments.

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**Bruce Walker Brooks** - *Fluidra, S.A. - Co-CEO & Executive Director*

Thank you, Javier. Moving on to Page 12. Let's talk about our outlook and specific guidance. The market is changing towards more normalized patterns. We see sell-through at mid-single-digit growth for the full year, with North America at double digit once corrected for the Texas freeze, which is validating the step change of the industry.

As the supply chain stabilizes, we're going back to a more normalized ordering pattern, generating a temporary inventory correction that is driving lower volume. This is impacting our sell-in in the second half of 2022, peaking in Q3, but let me reinforce that it is a temporary situation.

On the margin front, the higher price read-through in H2 begins to recover margin and positions us well for 2023. We decided to revise our pricing policy in May. The new conditions ensure that price increases will read through faster with added transparency for our customers. In addition, the normalization of the supply chain and the inventory correction is affecting our net working capital composition and free cash flow generation, mostly correcting in H2. We expect to return to recent trends in 2023.

We are revising our full year guidance. At current FX rates, we now anticipate sales between EUR 2.5 billion and EUR 2.6 billion, which implies a 14% to 19% growth rate, EBITDA between EUR 600 million and EUR 630 million, cash EPS between EUR 1.77 and EUR 1.90. Our communicated midterm targets have always reflected our expectations of normalization at some stage. We are a strong company, and we are well positioned to navigate this transition.

We plan to hold our next Capital Markets Day in Q4 2022, shedding more light on market evolution, our simplification program and midterm strategy in this volatile environment.

And now back to the Chairman to wrap up the prepared remarks before moving to Q&A.

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**Eloy Planes Corts** - *Fluidra, S.A. - Executive Chairman, Executive President, MD & CEO*

Thank you, Bruce and Javier. Let me summarize what I see. We continue to see solid end-user demand for the industry after a couple of years of extraordinary growth, which confirms the step change. We delivered record results despite the temporary margin impact. The company has demonstrated its ability to increase pricing, and we expect margin improvement in the second half. .

The industry is transitioning to a post-COVID world with normalizing ordering patterns, which is leading to a temporary inventory correction in the channel that we expect to have mostly corrected by year-end.

Our teams have been focused on serving our customers during these extraordinary growth years in a difficult supply chain environment. We have also been busy completing a number of accretive deals to reinforce our company.

In addition, we now face an uncertain economic environment. The combination of these facts combined with the industry returning to a normal patterns finally allow us to launch our simplification program that will deliver a total of EUR 60 million of EBITDA improvement at the end of the next 36 months.

Our leading platform is ready to grow in the mid- and long term, solid fundamentals with a strong cash generation, thanks to the strong recurring revenues from aftermarket business; a strong balance sheet refinanced early this year with maturities by 2027 and 2029. We're still committed to run the company at around 2x net debt to EBITDA; and clear cash allocation policy: accretive M&A, cash dividend and opportunistic share buybacks, like the one announced today.

In summary, we have a winning strategy which supports our investment thesis. Thank you for joining us today and for your continued interest and trust -- trusting us in our company.

Now I will turn the call back over to Cristina to begin our Q&A session.

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## QUESTIONS AND ANSWERS

**Cristina del Castillo García** - *Fluidra, S.A. - Director of Investor & Shareholders Relations*

Many thanks, Eloy, Bruce and Javier, for your presentation. We will now begin the Q&A session. (Operator Instructions)

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**Operator**

(Operator Instructions) And our first question today comes from Andre Kukhnin of Credit Suisse.

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**Andre Kukhnin** - *Crédit Suisse AG, Research Division - Mechanical Engineering Capital Goods Analyst*

I wanted to start first with the raw materials versus price that you mentioned of EUR 30 million. Can I just double check whether that's the kind of entire impact over the group in the first half that you've seen from that gap between kind of adjustment of price versus what the raw materials have done? Or is that specific to North America? In which case, could you give us an indication for the whole group? I'm just trying to gauge how much of improvement which you see in the second half by closing that gap.

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**Javier Tintore Segura** - *Fluidra, S.A. - CFO*

Yes, Andre. No, no, that EUR 30 million really refers to the fact that we didn't reprice the backlog, and it's an entire impact of North America. If you are looking for the equation, let's say, of price versus inflation for the entire company that you see on the 220 basis point improvement in the gross margin, of that -- of those 220, roughly around 40% corresponds to the price versus inflation equation impact.

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**Andre Kukhnin** - *Crédit Suisse AG, Research Division - Mechanical Engineering Capital Goods Analyst*

Right. Right. I think I'll go back and work through that. Yes. And the second, really, question I have is just trying to assess the kind of degree of pull forward in demand that we've seen in your key end markets across Europe and North America and hence, trying to understand the degree of normalization that needs to take place before we come back to what you described as sort of traditional normalized demand-driven model.

Have you looked into how much of this kind of extra run rate that you're enjoying now being easily 50%, 60%, in some cases, 70% above the prepandemic level, now how much of that is due to just increased kind of ticket size per project, per swimming pool as opposed to a number of projects that happened during last 18 months or have been at least kind of ordered during the last 18 months that would have otherwise been taking place maybe sometime in 2023, '24, so something else pull forward from the future?

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**Bruce Walker Brooks** - *Fluidra, S.A. - Co-CEO & Executive Director*

Okay. There's a lot to unpack in that question. And Andre, let's see if I get it right, okay, in all the topics and we can come back and follow up if not. I mean what you're asking is kind of how the -- what the pull-forward effect is. And I think you really got to look at it on 2 tiers. You got to look at it on both engines of the driver, okay? So first engine, let's talk about new construction. And no doubt, since the pandemic start, we've seen an acceleration of people wanting to stay at home or even now with the continued hybrid work-from-home type of model.

The backyard has an additional room practically to the house. We've seen acceleration in the new construction. And that's been, I think, really helpful for the industry. And frankly, we'll set up the industry really well for the long term to go to the much bigger driver, which is the aftermarket, aftermarket traditionally making up about 75% plus of the industry.

Now what we've been saying is that the aftermarket has been impacted by several factors prior to this call. One being the Texas freeze, which was an unusual event last year that for us was about 2% of sales or about EUR 40 million.

Secondly, we felt like there were some categories that were pulled forward. And what we were looking at them when we were sharing that information is that the run rate of those categories was stronger than the run rate of the overall business for the last couple of years.

A couple of examples of those would be aboveground pools, which because of the temporary nature we have in the aftermarket and also heat, whether it's gas heaters or heat pumps, we have seen both of those categories decelerate much as we expected.

And then the third element, which we still think is pent up, is they're just -- as the new construction piece has been big, there's not enough pull pro capacity to get to remodel. And so we do see remodel still being backed up specifically in North America.

So we felt like those things were going to be a drag on the overall aftermarket. We felt like the higher ticket that we're seeing from connectivity, the price increases, the new products that we've launched, all those things would kind of offset some of the pressure in the aftermarket, and therefore, get us to some of the growth rates that you're seeing.

What we probably didn't anticipate to the scale was the size of the inventory correction as the industry kind of comes back to more normalized patterns. So hopefully, I got all that was in that question.

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**Andre Kukhnin** - *Crédit Suisse AG, Research Division - Mechanical Engineering Capital Goods Analyst*

Yes, that's really helpful. And if I -- maybe just the last one and kind of probably going further into territory of unfair questions. But if we do think about sort of hypothetical scenario where there is a sharper downturn maybe in one of your key geographies or maybe somewhere sort of -- somewhere around 5% to 10% volume, given the shape of the group now and everything you've done in the last years, what kind of margin impact should we anticipate if we go into that sort of scenario of, say, 5% volume downturn or slightly worse?

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**Javier Tintore Segura** - *Fluidra, S.A. - CFO*

Yes. Andre, here, the -- I mean we've shared with the market the variable fixed mix in our OpEx is around, I would say, 40% variable, 60% fixed. And then all of our cost of goods sold is entirely variable. So that's the read-through that you should be expecting.

Now as Bruce has pointed out, when we have long-awaited program of company simplification that we have not been able to launch in recent years due to the fact that our resources were focused on being able to deliver product on this supply chain challenge environment and doing the acquisitions, we are now focusing our attention to that program, and we have identified this target that has been shared by Bruce of reducing our fixed base by roughly around EUR 60 million in the next 36 months.

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**Andre Kukhnin** - *Crédit Suisse AG, Research Division - Mechanical Engineering Capital Goods Analyst*

And if I may, that program is kicking off kind of right now? Or is that more sort of from beginning of 2023?

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**Javier Tintore Segura** - *Fluidra, S.A. - CFO*

We are in the planning phases right now, so we don't expect any impact in 2022. It's not baked into the assumptions. We'll start to see it through in '23.

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**Operator**

Our next question comes from George Featherstone of Bank of America.

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**George Featherstone** - *BofA Securities, Research Division - Research Analyst & Associate*

A couple for you on the aftermarket, if I can. So firstly, I just wanted to get some help, if you think about the resilience level of the aftermarket going forward. And maybe within this question, if you could help split out the level of share of consumable revenues or repair and maintenance as well and what you think in terms of the aftermarket that's actually discretionary.

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**Bruce Walker Brooks** - *Fluidra, S.A. - Co-CEO & Executive Director*

Okay. I'll take that and correct me if I go astray here, XT. We've always seen the aftermarket as incredibly resilient. In fact, the aftermarket grew during the GFC. Now for us, we look at it at about 80% of it being consumables and repair and maintenance. So the discretionary part of it is, let's call it, 20% of the aftermarket, which is the remodel sector.

And for that, I mean I would argue that about half of that is truly discretionary -- well, I shouldn't say discretionary. It could be impacted. And the other half is high-end pools that tend not to be impacted during this type of climate.

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**George Featherstone** - *BofA Securities, Research Division - Research Analyst & Associate*

Okay. Obviously, they're helpful. And then if we just think about how the installed base of pools that you can serve in the aftermarket has grown over the last couple of years, do you have a figure of that?

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**Bruce Walker Brooks** - *Fluidra, S.A. - Co-CEO & Executive Director*

Question was the installed base of pools, how much has this grown. In what time frame, George?

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**George Featherstone** - *BofA Securities, Research Division - Research Analyst & Associate*

I guess really, what's relevant over 2020, 2021, and ultimately kind of where people might think that you've had accelerated new construction versus historical trends. I mean you could give industry statistics here, but maybe what's more relevant is the ones that you could address in your aftermarket.

**Bruce Walker Brooks** - *Fluidra, S.A. - Co-CEO & Executive Director*

Yes. I think it would just kind of follow industry norms. I mean our footprint is truly global. So we can address the aftermarket opportunity in all areas. I would say in North America, George, our footprint is stronger in the sunbelt. And so the fact that there's been a migration from north to south, from cities to country, that type of thing, has certainly benefited us and should continue to benefit us as you look forward. I think we'd have to get back to you with specific if you're looking for new construction numbers by geography.

**George Featherstone** - *BofA Securities, Research Division - Research Analyst & Associate*

Okay. Maybe a last one for me. In Q2, I think it was -- or you've mentioned now that basically your price is running at about 10% impact on the revenues. And therefore, should I read that the volumes for Residential in Q2 were down 10%?

**Javier Tintore Segura** - *Fluidra, S.A. - CFO*

Yes. And actually, there was an impact in volume reductions in the second half. And part of this, as we have shared that the sell-through is in that mid-single-digit type of time frame, has to do with partial the start of this inventory correction that we have mentioned in the call, George.

**George Featherstone** - *BofA Securities, Research Division - Research Analyst & Associate*

Okay. Sorry, I might need to just maybe rephrase my question a little bit then. I think, Bruce, you said the price is running at 10% this year so far. And your Residential revenue growth organic was basically flat or slightly down. So therefore, should I assume that the volumes in Q2 for Residential were down 10%?

**Bruce Walker Brooks** - *Fluidra, S.A. - Co-CEO & Executive Director*

The only thing that I would add to what Javier was talking about there, because I don't believe the volumes in total are down 10%, George, is just the comparable of the Texas freeze. So remember, as we're talking about kind of mid-single-digit sell-through, if you take that one off out, you add that EUR 40 million back in, I think you'd find that the sell-through is higher than what we're saying, okay?

Now that we're kind of past that comp in, let's say, June, once we got it through kind of mid-May, into June and even into July, we're seeing double-digit -- low double-digit run rate in the states, okay? So there's a couple of other factors that are tied in there, but volume was a factor. We would say for the overall group, George, we think the volume inventory correction piece was -- is probably 1% to 2% in the Q2.

**Operator**

Our next question comes from Francisco Ruiz of BNP Paribas Exane.

**Francisco Ruiz** - *BNP Paribas Exane, Research Division - Research Analyst*

I have a couple of questions. The first one is on the stocks, on the level of inventory. So how sure that -- are you on the decline in the second half of the year? Because at the end, you are not controlling the stock that the pool professional would like you to have, and we have seen some pressure in terms of volumes. And also I mean the economy is in a deceleration mode. So how -- what's your visibility on this decline in inventories?

My second question is, if you could give us a breakdown on the guidance of how much is M&A and FX and how much is volume.

And the last question, you have mentioned several times, I mean you Bruce and Eloy, about normalization from these levels, okay? So I would like to know if your starting point of the normalization is this H1? Or we are talking about a normalization excluding, well, the party that we have after the COVID? So I mean you talk about midterm guidance of 5% to 8% in top line. Should we believe that this is something that you expect for next year or some correction would happen?

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**Bruce Walker Brooks** - *Fluidra, S.A. - Co-CEO & Executive Director*

Okay. So you gave us the easy ones, right, Paco? Thanks. All right. Well, let me talk on the stocks in the channel and the inventory because I think that's the biggest one. And this is really pretty complex. And frankly, we don't have perfect visibility, but we do have a lot of information. We work with our channel partners to try to get visibility and see where this leads.

So I'm going to try to walk you through the logic of our guidance and happy to follow up if you guys need to. So we see the biggest correction in North America. We have the most data in North America. And we've done this analysis really based on historic turn ratios. And we use those historic turn ratios to get a closing inventory target. And then we put the sell-through run rates in against that.

And so right now, our sell-through run rate is low double digit in North America. So in that particular case, we'll use that. And that derives the number for sell-in for the rest of the year, okay? And then we've taken that formula, which covers a good bit of our business, but not all, and then extrapolated it across kind of North America.

In Europe, we have less info, but probably arguably more complex. But because we're the leading distributor, we have a good bit of information on, obviously, the sell-in, but also what we see sell-through rates being at individual countries. So we use that to kind of determine what we believe the sell-in opportunity will be remaining for the rest of the year.

It tells you that the overall inventory correction impact, in our belief, is 4% to 6%. We think that will peak in Q3, but that's how we see it. Now I want to put a few caveats to it. I mean this is a complex analysis. It gets further impacted by price when that reads through. It gets impacted by our backlog. It gets impacted by inventory in unusual places. We've seen inventory in some of our builders trying to protect the price points that they've locked in with customers that would have never carried inventory in the past. And the last assumption is that we see the return of a normal early buy in North America. So we see the industry preparing for that.

My last comment would be, this is a macro analysis. And it's -- the reality is that it will be done in micro, meaning that a customer may have too many heaters but they still don't have enough pumps or anything -- or variable speed pumps or anything that has chips in it today. So there could be some plus/minus.

So all in all, I think it's impossible to be perfect, but you now understand the logic of how we have defined this. We think it will be about 6%, and it will be mostly corrected this year.

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**Javier Tintore Segura** - *Fluidra, S.A. - CFO*

Paco, as to your second question about what are the components of the guidance in terms of M&A, it's mid- to high single digit. And obviously, the bigger part has gone through in the first half of the year. So the contribution in the second half is going to be low single digits.

And in terms of volume, as Bruce was pointing out, we believe that there's going to be obviously a significant impact of price in the back half, which then means that the volume decline portion in the year to go is going to be higher.

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**Bruce Walker Brooks** - *Fluidra, S.A. - Co-CEO & Executive Director*

Okay. And as far as normalization in 2023, I think the really exciting news that we're seeing is the sell-through because the sell-through says that the step change has been validated. So I think your question is, are we building our models off of what year?

And I think there's some noise in 2021, there's some noise in 2022, but roughly, this is the basis, right? Take out the inventory correction, take out a little bit of a pull forward here. But the increases in prices that we don't see going backwards, the addition of a number of new pools that feed the aftermarket, I think the fundamentals are good to build from here.

Now 2023, I think it's definitely too early to call. Clearly, leads are down. The consumer is a bit more cautious in certain markets than others. These are down for new construction. But again, the aftermarket should start to really show some resiliency. We won't have the Texas freeze. We've got higher average tickets. We've got price that's going through. We've got the pent-up demand for remodeling. So we're still positive as we look forward.

From a margin perspective, I think we have a great opportunity really because we should see the recovery of price coming through. And we begin to get the benefits of our simplification program. And last but not least, I mean our manufacturing footprint, I don't want to slam the guys because they've been incredible during this challenging environment of trying to feed our customers. But let's face it, it's been an unnatural environment and they have not been at their efficiency peak. We've got air freight, factories going up, down with COVID, all kinds of factors going on. So I think the opportunity in our control is quite attractive for Fluidra.

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**Operator**

Our next question comes from Christoph Greulich of Berenberg.

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**Christoph Greulich** - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Two from my side, if I may. Just firstly, maybe if you could say a few words on the [contracts] you have been seeing in July. I mean you have had pretty hot weather across some of your key regions. Or I mean if you could say a few words and if you've seen an impact on the demand trends there.

And then maybe the second one, coming back to what you just said on the margin. So just to kind of get a feeling for what you think is the reasonable assumptions on what we can expect for 2023. Will it be like a year margin-wise similar to 2021? Or is there still some kind of drag from the inflation side?

And then on the simplification program, so the EUR 60 million that you target for the next 3 years, will that -- those efficiency gains be unlocked in a kind of linear way? Or is it more kind of skewed towards the end of the time period?

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**Albert Collado Armengol** - *Fluidra, S.A. - Secretary*

Okay. So first off, for July, and let's face it weather has been good in June and July, especially in Europe and very warm in the states, sell-through rate has really been the same that I was mentioning earlier with the exception of the states, which is now running double digit now that we've, I think, successfully comped the Texas freeze event. So we're encouraged by what we're seeing from a sell-through perspective. But that same inventory rebalancing that we talked about is also happening from a sell-in perspective.

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**Javier Tintore Segura** - *Fluidra, S.A. - CFO*

Yes. Christoph, as to your second question, obviously, it's a little bit too early to talk about 2023 in terms of margin guidance. But with some of the elements that we have shared with the revised pricing, we've shared with you that there's a EUR 30 million impact in pricing that we haven't seen run through our P&L that shouldn't be there next year.

Plus this concept of efficiency, inefficiency or extra costs associated to all the issues that we have had in this challenging environment, plus the inefficiency generated for this inventory correction, this all should read through positively through the P&L.

In addition, and again, the simplification effort, the simplification program which we are planning at this point, so difficult for me to share what's going to be the reading in '23, '24 and so on. But I'm guessing that there's probably -- and you can go with an even type of assumption at this point. The idea in this aspect is to share with you all the details at the Capital Markets Day that Bruce has shared.

And lastly, as you know, we usually take price in October in North America and in Europe. And we are also considering some additional pricing. We are fine-tuning the details at this point, but probably will be in the mid- to low single digits. But again, probably provide you more color in November.

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**Christoph Greulich** - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

That's very helpful. Maybe if I could just ask one more question on the inventory correction that basically is happening across the industry. Would you say that your vertical integration and the fact that you're doing some of your own distribution, it somewhat mitigates that effect compared to other competitors that are purely an OEM?

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**Bruce Walker Brooks** - *Fluidra, S.A. - Co-CEO & Executive Director*

I think that's certainly true in Europe, right, where we've got our distribution footprint. You need to think about us in a way like maybe a pure-play guy and a distributor, and you've got plenty of information from the guys in the states that way.

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**Operator**

Our next question comes from Erik Salz of JPMorgan.

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**Erik Salz** - *JPMorgan Chase & Co, Research Division - Analyst*

(inaudible) have been answered already, but maybe a few more. Is it -- just an understanding of the normalization of the inventory, is it realistic to think that this will be 2022? And is reducing production on your own behalf, is this one of the levers to reduce that inventory?

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**Javier Tintore Segura** - *Fluidra, S.A. - CFO*

Yes. If I understand, you're referring to our inventory correction, no?

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**Bruce Walker Brooks** - *Fluidra, S.A. - Co-CEO & Executive Director*

Yes, referring to ours or the industry?

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**Javier Tintore Segura** - *Fluidra, S.A. - CFO*

Erik, we're just making sure that if you were referring to our inventory correction, so Fluidra's inventory correction or the industry's...

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**Erik Salz** - *JPMorgan Chase & Co, Research Division - Analyst*

Your inventory correction.

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**Javier Tintore Segura** - *Fluidra, S.A. - CFO*

Okay. Good. Yes, look, if you look at our historical net working capital to sales ratios, you look at 2019, you look at 2020, we were up in the 25% to 30% type of time frame in the June closing. Really, the number we reported last year was abnormally low due to the fact that we were running shorter inventory on one side, and we have seen an acceleration in collection. So again, we are going to a more normalized pattern, but we'll probably be somewhere in between where we were in the past and where we were in 2021.

As to the balance of the year, we are now putting in place plans as we see that the supply chain is normalizing. And we also get components at the most normal speed, probably with the exception of chips. And therefore, we are targeting this 17% to 18% type of rate in terms of net working capital at year-end, which is more or less in line with what we have seen historically.

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**Erik Salz** - *JPMorgan Chase & Co, Research Division - Analyst*

Okay. And then on M&A, is the Swim & Fun cash out, is it already reflected on the cash flow? And a more broader question on M&A is why are you still considering doing M&A in this environment?

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**Javier Tintore Segura** - *Fluidra, S.A. - CFO*

Yes. Sure. Yes. I'll take the first one, and then Bruce will take the second piece. Look, yes, the Swim & Fun numbers are baked into the assumptions for the remainder of the year. Now it's a highly seasonal business, and the impact in the second half is very limited. And it's again included in the guidance.

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**Bruce Walker Brooks** - *Fluidra, S.A. - Co-CEO & Executive Director*

Yes. I think as far as the...

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**Erik Salz** - *JPMorgan Chase & Co, Research Division - Analyst*

(inaudible)

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**Javier Tintore Segura** - *Fluidra, S.A. - CFO*

No, it has not been. It was signed and completed yesterday. So it's not included in the cash flow statement that you have on -- as of the end of June.

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**Bruce Walker Brooks** - *Fluidra, S.A. - Co-CEO & Executive Director*

Okay. As far as the second piece of your question, Erik, listen, there's still plenty of opportunity out there for M&A. Our focus is really to make sure that these are strategically on point. We like both these opportunities because they really reinforced our distribution footprint in Europe. But no doubt, we're going to make sure that the valuation is sharp, and we feel like less than 5x, which is a little lower than what we were paying last year.

We feel good about the valuation of these particular opportunities. And last but not least, I mean we believe in this market. We're -- we feel like the step change is being validated. There might be some noise, but both of these will be great for us long term.

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**Unidentified Analyst**

(technical difficulty)

of course, you can probably not comment on the evolution of your competitors, but looking at the profit warning yesterday from Hayward, which seems significantly more dramatic than yours, I wanted to know whether this difference is due to maybe company-specific differences or just differences in geographical and product mix or whether you have very different views on where the industry is going for the balance of the year.

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**Eloy Planes Corts** - *Fluidra, S.A. - Executive Chairman, Executive President, MD & CEO*

I'm sorry. We had a little problem with our line. Could you repeat that question from the beginning?

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**Unidentified Analyst**

Sure. The first question would be, over the last couple of years, we've seen a sharp increase in volumes for you. I wanted to know whether this decline that we are seeing now is, in your opinion, just decline in inventory levels, but the underlying demand remains as strong or whether what we are seeing is just a normalization of inventory levels and that part of the demand increase that we've seen over the last couple of years has actually been at least in part just inventory buildup, not actual increase in demand.

And the second question would be on the significant differences in the guidance for 2022 between the -- Hayward yesterday and yourself, whether you have differing views on the industry or whether it's just due to differences in product and geographical mix. Of course, I understand that is a tricky question since you can probably not comment on what competitors are thinking. So...

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**Bruce Walker Brooks** - *Fluidra, S.A. - Co-CEO & Executive Director*

Yes. It is complex. I guess, first off, and the devil is always in the details because you got to look category by category. I mean we're talking about heaters and things like that earlier, what's aftermarket, what's new construction. But fundamentally, no, we're very encouraged by the sharp increase. And I would tell you what we focus on is what the sell-through is. And I know you guys need to look at what our sell-in is to year-over-year.

But at the end, I mean the sell-through that we see in the market is most important. And I think if you look at pool's numbers and some of the others that are reporting straight to the pool pros and straight to the consumers, what you've seen is the overall increase in the industry over the last couple of years has totally been validated. And so we're quite encouraged by that.

As far as the guidance differential between us and our competitors, I guess I would encourage you to put Pentair back into the equation versus Hayward as well. And listen, we've got a couple of really strong competitors out there, but I'm sure we all have a little bit different scenarios and how much was sold in over the last couple of years, what the sell-through ratios were.

I also mentioned things like your backlog. Your level of backlog going into the back half would certainly impact your guidance on this. The important thing to me, keep coming back to the sell-through, get the sell-through matched up to your selling as close as possible so that we can really move forward into 2023 with the industry back to normal and continuing to push forward.

From a European perspective, again, I think our situation is a little bit different than our peers because we're both a manufacturer and a distributor. So we see a little bit maybe more information along the way. I would also say our footprint is stronger in Southern Europe than it is in Northern Europe. And therefore, we're benefiting from the return of tourism and some things like that.

But I think, overall, our position is a little bit different. We've got a truly global footprint. Maybe we don't have the same type of currency impacts as some of these guys do. And we really try to focus on our own information, really dig down, follow that sell-through and work it backwards.

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**Operator**

The last question comes from Manuel Lorente of Mirabaud. Manuel.

**Manuel Lorente** - *Mirabaud Securities Limited, Research Division - Analyst*

So my first question is on the different moving parts of the upgraded revenue guidance in the sense that on the central scenario, you're basically increasing 200 basis points, your revenue expectations for the full year. So my question here is whether this is a combination of, let's say, higher than [inspector FX], a little bit of pricing offsetting lower volumes. That should be the correct way of the different moving parts here?

**Javier Tintore Segura** - *Fluidra, S.A. - CFO*

Yes, Manuel, you got it right. It's a little bit of help from currency based on where we are, additional read-through of pricing that compensates lower volume. That's it.

**Manuel Lorente** - *Mirabaud Securities Limited, Research Division - Analyst*

Okay. And my final question then is on the expectation -- the theoretical expectations for next year. It looks like booming housing prices, it's picking, and also the value of houses are starting to decline. So in this context of, let's say, normalization, should we also expect a decline in the average ticket of both the new builds and the average is paying per unit on the aftermarket? So it will be not only be a normalization volume-wise, but also pricing-wise?

**Bruce Walker Brooks** - *Fluidra, S.A. - Co-CEO & Executive Director*

Yes, I'll take that one. Listen, where I would start is this is an industry that's historically taken price and it's historically not given it back. So that would be the expectation to start with. I'd further that by going the inflation has really gotten into labor. And once it's in labor, it's even harder to come out. So we're pretty confident that you're not going to see pricing go back in the inventory in the industry.

Our product makes up a small portion of the overall portion of a new construction of a pool. And so therefore, we haven't seen people trying to downgrade on the equipment that they're putting on the pool. In fact, I think with legislation in the U.S. on variable speed pumps, energy efficiency and energy prices in general, people are going to be looking at more efficient systems because the payback is good. And the expectation now is for connectivity.

So I mean what we're seeing is that the ticket is rising, not going backwards at this point in time. So that's the starting point that we see. Pricing won't come backwards. And we think that the product is getting so good, it drives the demand.

**Cristina del Castillo García** - *Fluidra, S.A. - Director of Investor & Shareholders Relations*

Thank you, all. This marks the end of today's presentation. We thank our speakers and participants. As always, please feel free to reach out to our Investor Relations department for further queries. Have a great day. Thank you.

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