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Half Year 2019 Johnson Matthey PLC Earnings Presentation

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PRESENTATION

Martin Christopher Dunwoodie ***Johnson Matthey Plc - IR Director***

Thank you very much, everyone, for coming to Johnson Matthey's Half Year Results Presentation. This is going to be a live webcast as well, so if I could remind you to switch off mobile phones, devices or put them on silent for the presentation. We will have a presentation from Robert and Anna as usual and then time for Q&A afterwards.

And with that, I will hand over to Robert. Thank you.

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

And good morning, everybody, and welcome to Johnson Matthey's First Half Results Presentation. Today's presentation is in 3 sections. First, I'll take you through the highlights. I'll then hand over to Anna to review our financials, and after that, I'll give you an update on our strategy, following which we'll be happy to take questions.

We've had a good start to the year, and I'm pleased by our continued progress on executing our strategy of sustained growth and value creation. We delivered double-digit sales and underlying profit growth. And we now expect full year operating performance towards the upper end of our guidance of mid- to high single-digit growth.

Our Clean Air business continues to perform strongly, and Efficient Natural Resources grew well. And in Health and Battery Materials, we are making good progress as we position for breakout growth over the medium term.

We increased the interim dividend by 7%, and our return on capital was 16%.

I'll talk through our strategy a bit more later on, but first, let me hand over to Anna to talk you through the financials.

Anna Manz ***Johnson Matthey Plc - CFO & Executive Director***

Thanks, Robert. Good morning, everyone. We've had a good first half as we expected. Both sales and underlying operating profit were up 10% at constant rates, and underlying EPS growth was up 9%. We've increased the interim dividend by 7%, reflecting the confidence that we've got in our current and medium-term growth prospects.

First, looking at sales for the group. Sales grew 10%, with growth across all of our sectors. This was driven in particular by double-digit growth in Clean Air in both light-duty and heavy-duty businesses. Despite volatility in the macro environment, such as Europe and China autos, we continue to deliver exactly as planned. And we expect this momentum to continue across the group as we continue into the second half.

Operating profit also grew 10%. The underlying businesses overall grew strongly, with Clean Air and Efficient Natural Resources both performing particularly well. Health declined, in line with our full year expectations, and New Markets operating profit was also lower.

We continue to drive further efficiencies throughout the group, and we're investing in the systems and processes to realize further future efficiencies. Some of these investments are reflected within the sectors' operating profit, while others are in our corporate costs. So you'll not yet see the full benefits of the current savings being delivered.

Overall, a good operating performance from the group, with underlying businesses delivering strong growth and cost savings on top of that, whilst also continuing to build the platform that will position us to deliver on our strategy.

Moving now to the sectors. Clean Air had a very good first half with sales growth of 11%. We delivered double-digit growth in both light and heavy duty, well ahead of growth in global vehicle production. In light duty, the growth was driven by our European business. Our diesel catalyst sales grew 18% in a market that declined 6% as we've seen the share gains that we previously talked about ramping up. Our share in the light-duty diesel European market increased from around 45% at the start of the year to around 60% by the end of the half. And to remind you, we expect to be at 65% at the end of the full year.

Our gasoline business in Europe grew 4%. This was behind the market growth of 8% and largely due to weaker performance by some of our customers. Our Asian light-duty business grew ahead of market production, with growth in all our key businesses across the region, while our Americas business slightly underperformed the market.

In heavy duty, we outperformed the truck market in Europe and Americas, and we were in line in Asia. Our double-digit growth was driven by continued strong performance in the Americas where we grew 24%. Here, we've outperformed the U.S. Class 8 truck market. Strong demand in this market remains, and we now expect high levels of production to the middle of the calendar year 2019.

Our European heavy-duty business grew 8% in a low-growth market, driven by outperformance by our customers and a strong performance in non-road. In Asia, our sales were flat. As anticipated, the China truck market was weaker in the period, following the strong growth over the last couple of years, and our sales also reflected that. However, sales in India grew strongly.

Clean Air's operating profit grew 15% with a slight increase in margin due to the volume leverage, particularly in Europe, and tight cost control.

I'm pleased with the first half results, and we expect continued strong sales growth in the remainder of the year as the rest of our share gains in European light-duty diesel come through. Benefits from operational gearing in the second half will be offset by price-downs and trade tariffs and some additional costs as our share gains ramp up further. Therefore, the margin for the full year will be in line with the prior full year margin.

Looking now to Efficient Natural Resources. Sales grew 3%, driven by growth in Catalyst Technologies and Pgm Services. Catalyst Technologies grew 3%, delivering double-digit growth in sales of refill catalysts and additives. This strong growth was partly offset by a significant decline in sales of first fill catalysts. First fill catalysts are inherently lumpy and are driven by the timing and number of new plants being commissioned. As expected, after a number of years of decline, our licensing income was broadly stable. Activity around new plant builds, especially for the technologies we license, remains at low levels.

That said, we are seeing signs of improved activity in certain markets, such as methanol. And development and commercialization of new technologies is also progressing very well. We won several new licenses in the period, but we won't see the benefit in the near term as revenue is recognized over a number of years depending on the length of the project.

In Pgm Services, sales grew 2%, benefiting from higher precious metal prices, partially offset by lower sales of industrial product. As we said in our AGM statement in July, we had unscheduled downtime in one of our pgm refineries in the half. And that's resulted in a significant increase in our precious metal working capital. The downtime did not have a direct impact on sales, although we have incurred additional costs as our refineries are working at high utilization levels and as we invest to improve their resilience.

Moving to operating profit. This was up 26%. And margin improved 3.2 percentage points. The business benefited by GBP 10 million from the higher pgm prices. Additionally, we saw savings from restructuring and efficiency benefits from initiatives across a number of areas, including operational excellence and procurement. Some of these benefits are ongoing, although around GBP 5 million will not repeat.

We also had higher operating costs in our pgm refineries as we continue to invest to improve their safety and resilience, and this partially offset some of the benefits.

Looking to the full year. Our outlook for Efficient Natural Resources is unchanged. We expect slight sales growth and operating profit growth ahead of this because of the operating leverage and restructuring cost savings on top. If the current momentum continues, we could potentially exceed this.

Health started the year in line with our expectations and remains on track for the full year. Although sales overall were flat, there are a number of moving parts. Our Generics business declined slightly. Sales of APIs were down as expected, with certain high-margin contracts for APIs for ADHD treatments coming to an end. Noncontrolled APIs have continued to grow. Here, we saw increased volume across a number of products. This was partially offset by a decreased contribution from dofetilide, which is now being impacted by competition in the market.

The Innovator business continued to grow well, with increasing sales from APIs where our customers are moving into late-stage validation. As we expected, operating profit was down 31%, and margin declined significantly. This was primarily driven by the change in product mix as our current portfolio moves through its natural life cycle. Additionally, we've been taking action to optimize our manufacturing footprint. In the period, we realized some cost savings from the closure of our Riverside plant in the U.S., but these were more than outweighed by transition costs.

We continue to expect a small net benefit for the full year and over the medium term from this footprint optimization, which will, over the medium term, deliver significant benefits. The full year outlook is unchanged, and we expect broadly stable sales, with operating profit to be down.

In New Markets, we saw strong sales growth driven by the alternative powertrain. This benefited from demand for battery systems for e-bikes, and our fuel cells businesses also grew well. We continue to make good progress in the development and commercialization of eLNO. We incurred higher costs in Battery Materials as we invested in strategic customer relationships to support the commercialization of eLNO. And so New Markets operating profit declined. In the full year, operating profit is now expected to be down, although profit in the second half will be ahead of the second half of last year.

Moving down the income statement. Finance charges increased in the period, primarily due to the higher cost of funding metal across the group. This was a reflection of both higher lease rates continuing from the second half of last year as well as higher volumes of leased metal following the pgm refinery downtime.

The underlying tax rate decreased to 16.3% as expected, following the lowering of the U.S. corporation tax rate. And this will be around 16% for the full year.

Underlying EPS grew 9% at reported rate, slightly ahead of operating profit, benefiting from the lower tax charge, partially offset by the higher finance charges. The interim dividend is 23.25% (sic) [23.25p], a 7% increase.

Free cash flow was an outflow of GBP 206 million due to a net working capital outflow of GBP 391 million, primarily driven by pgm refinery downtime. This working capital outflow is disappointing. However, the business has strong cash generation characteristics. Metal working capital volatility can distort this in any particular period, but the business is and should be cash generative.

CapEx in the half was GBP 104 million, with cash spend of GBP 96 million. And Robert will comment on a number of our big projects.

Precious metal working capital was significantly higher at the end of March -- September. September, I think. This was mainly due to downtime at one of our pgm refineries, which meant we had to go into the market to source metal that we were contracted to refine and return. We're working hard to reduce this working capital. And while we expect to have made significant progress by the end of the year, we will not yet to be at normalized levels. You can see from the chart that our precious metal working capital does fluctuate. This is due to metal prices and volumes, and we have significant experience in managing this volatility.

Looking now at non-precious metal working capital. Our continued focus on improving working capital and running the business as efficiently as possible every day has resulted in progress in the period. Working capital days, excluding precious metal, at the period end was broadly similar to the end of the first half of last year at 65 days. Average working capital days, excluding precious metal, improved by 2 days when compared to the first half of last year. This takes us to an 8-day average reduction over the last 18 months and was despite a planned inventory build during the period ahead of the start of our rollout of our global IT system, SAP.

We will continue to drive an underlying improvement in working capital throughout the year. There are, however, some specific factors this year which could distort our performance, including the nature of the U.K.'s withdrawal from the EU and the continued rollout of SAP across our business.

Moving to the balance sheet. Our net debt has increased by GBP 357 million since the year-end, which reflects the increase in precious metal working capital. Our balance sheet remained strong with net debt to EBITDA of 1.5x. We target a net debt to EBITDA of 1.5 to 2x, allowing us to invest in value-enhancing opportunities to accelerate future growth, in line with our disciplined capital allocation framework.

Now to give you a quick update on the progress related to my 3 focus areas. Firstly, rigorous resource allocation. We're continuing to focus on ensuring our spend is targeted to the highest areas of growth. Our annualized return on invested capital was 16% compared to 16.4% at the full year, primarily reflecting an increase in our net pension asset. Clearly, this is not an operating asset, so we're reviewing whether we have the right basis for calculating this to ensure that we give our shareholders the best measure of our true performance. Excluding the net pension asset, return on invested capital is 16.5%, in line with the full year '17/'18 on the same basis. Our target return on invested capital over the medium term is 20%. And despite the recent reduction, we have a clear path to achieve this.

Secondly, disciplined management of working capital. I've talked about this already. We continue to target year-end non-precious metal working capital to be between 50 and 60 days. My aspiration is for our average working capital days to also be in this range, although as I mentioned, working capital this year could be distorted by factors such as the U.K.'s planned withdrawal from the EU, for which we are building inventory in order to minimize supply chain disruption.

Lastly, increasing business-wide efficiency. We can see tangible results in this area with further benefits to come in the medium term. This is an ongoing process, and we're continually identifying opportunities to run our business more efficiently.

The group restructuring program that we started last year is progressing well. We realized an additional cost-saving benefit of GBP 7 million in the period, and we anticipate the annualized savings to be around GBP 25 million from this program.

On procurement, we've continued to invest and expect to deliver GBP 60 million of savings over the next 3 years. Roughly 3 quarters will directly benefit the P&L. This initiative has started to deliver savings in the half with benefits of GBP 5 million and is expected to deliver a total of GBP 13 million for the full year.

We are moving from over 40 ERP systems to one global system with the implementation of SAP. We completed the first site implementation over the summer, with the rollout across the remainder of the group over the next couple of years. So we continue to incur costs with regard to this, but we will drive future cost savings as we run our business more efficiently.

Overall, I'm really pleased with the continued progress in this area.

Turning now to the outlook. We're confident in the outlook for the full year and now expect the group to deliver operating profit performance towards the upper end of our previous guidance of mid- to high single-digit growth at constant rates. This will continue to be led by Clean Air as share gains in light-duty European diesel catalysts ramp up further. We currently expect a GBP 2 million benefit for the full year on underlying operating profit from foreign exchange translation.

Working capital continues to be a focus, targeting a further reduction in underlying average working capital days. And we expect CapEx to be up to GBP 350 million for the full year, with some spend now phased into next year.

So a pleasing first half performance overall. I'll now hand back to Robert, who'll take you through our strategic progress.

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

Thank you, Anna. As I said earlier, now I'm going to talk about our strategic focus and progress. But first, let me remind you of what JM is all about. Johnson Matthey is a world-class technology company. We provide solutions for cleaner air, improved health and the conservation of the world's natural resources. And at the heart of our business is world-class science. We apply this cutting-edge science to solve our customers' most challenging problems. We deliberately focus on complex issues. We don't do easy. We develop partnerships with our customers to solve the problems that others can't. And our competitive advantage is the combination of our fundamental understanding of science and technology with an ability to design and develop scalable solutions for our customers.

There are 4 parts to our strategy. Through our science, customers, operations and people, we will deliver sustained growth in value creation over the medium term.

We invest in our science and technology to deliver competitive advantage. We focus on serving our customers in high-growth, high-margin, technology-driven markets. Our advanced technology supports our customers, and this enables us to develop and subsequently maintain leadership positions. We relentlessly focus on operational efficiency and are driving improvements across all aspects of how we manage our business so that we are more connected, agile and efficient.

And our strategy is, of course, delivered through attracting and retaining the best people, those who align with our vision and who embrace the opportunities that come from working both across JM and with our customers in an increasingly complex and rapidly evolving world.

We deliver our strategy through 4 sectors: Clean Air, Efficient Natural Resources, Health and New Markets. And over the medium term, each sector will contribute to the delivery of shareholder value, which we define as mid- to high single-digit earnings per share growth per annum; expansion of our return on invested capital to 20%; and as a result, a progressive dividend.

In Clean Air, we will deliver sustained growth over the next decade with share gains in Europe and tighter global legislation. In Efficient Natural Resources, our focus on technology and higher-growth segments will enable us to deliver market-leading growth, with efficiency gains driving profit growth ahead of sales growth.

And in Health and Battery Materials, we're positioning ourselves for breakout growth. In Health, our new generic product pipeline is expected to deliver an incremental GBP 100 million of operating profit by 2025. And in Battery Materials, we're progressing our plans to commercialize our next-generation eLNO materials.

So that's our strategy, which we laid out at our Capital Markets Day last year. We are confident that this will enable us to deliver on the promises that we have made. And indeed, whilst the world is constantly changing around us, we have and will continue to deliver successfully. Over the last 6 months, we have seen increased concerns over global economic growth prospects and uncertainty in the outlook of China given weak economic data. However, rising oil prices provide us an opportunity for our efficient natural resources sector.

There are a number of market factors which continue to impact the automotive market, most of which will be well-known to you. In Europe, the world harmonized light vehicle testing procedure, or WLTP for short, came into force this September. And whilst this is proving challenging for some OEMs in the short term, it provides us an opportunity for more complex catalyst systems in the medium to long term. On the other hand, of course, the diesel share of the market in Europe continues to decline, but this decline is in line with the forecast we made last year. Further developments in automotive powertrain over the next decade and beyond provide further opportunity as our technology leadership means we are well positioned for success in this dynamic landscape. And of course, the global political backdrop is quite uncertain, too.

Going forward, there will inevitably be noise around all of these and potentially other factors, but we have successfully navigated any change before. And I'm very confident that we will be able to do so again effectively and deliver against the strategy that we've laid out.

So now let me provide an update on our strategy by sector. First, Clean Air. I'm pleased to say we're on track to achieve our goal of sustained growth in this business. Our strategy is underpinned by our global leadership, supporting our customers in meeting increasingly stringent legislation requirements with the best technology and an efficient manufacturing footprint.

Our European light-duty business is growing strongly in the short term as we benefit from platform wins, which are driving share gains. And as Anna mentioned, we've seen continued share gains in our European light-duty diesel business, and we are on track to achieve a market share of around 65% by March 2019.

In gasoline, whilst the profit impact is immaterial if the market stays as it is currently, we may not achieve our previously anticipated 5% market share gains by 2021.

Taking all these factors together, I'm still confident that following a strong period of growth in European light duty in the short term, that element of our Clean Air business should be broadly flat over the next decade as diesel declines and battery electric vehicle penetration increases.

As I've mentioned, tightening legislation globally is a key driver of our growth in Clean Air. Our Asia business will transform, led by tighter legislation in China across both light and heavy duty. We'll also see growth from India and Southeast Asia as legislation is upgraded. On the light-duty side in China, we are on track with platform wins for China 6, and we expect to maintain a constant share. And on the heavy-duty side in China, we are planning to at least maintain a consistent share. The phasing of China 6 may be earlier than expected given the Chinese government's Blue Sky legislation, which requires early implementation across some provinces from early 2019. Although this doesn't alter our medium-term strategy, the timing of our customers' platform launches may be earlier than expected.

More broadly, across the heavy-duty side of our business, we've maintained leadership with good growth in heavy duty, particularly in North America due to Class 8 strength but also in India, albeit from a lower base.

To support our growth in Clean Air, we have taken steps to expand our manufacturing footprint and capacity in Europe and China. Construction on our plants in Poland and China is underway, and we're likely to need further additional capacity in India to meet increasing demand there. But overall, I'm really pleased with the momentum of our Clean Air business. I'm confident in our ability to deliver mid-single-digit sales growth over the 10 years with a broadly stable margin.

In Efficient Natural Resources, we are making targeted investments in higher-growth segments. We have categorized our portfolio based on the growth potential, and we're aligning our CapEx and R&D investments to these opportunities. For example, we've redirected resources to high-growth segments such as methanol, gas processing and areas of oxo alcohols.

Alongside our investments, we're taking steps to increase efficiency. Anna has given you the financial detail on this, but I wanted to add some context from a strategic perspective. Firstly, our product portfolio review will continue to drive improvements across the business over the next couple of years. And secondly, we have instigated a program of increased investment in our pgm refineries to improve their safety and operating resilience. In an ever-changing world, the security of supply that these refineries provide to Clean Air is a key element of our strategy.

We also continue to look at additional opportunities for long-term growth that will benefit from our science and technology. And I've previously talked about our plans to commercialize newly developed technologies. For example, we've won our first license for our recently developed mono ethylene glycol or MEG technology, which enables the production of MEG from a variety of raw materials. And we've also recently commercialized our waste to aviation fuel technology.

So to summarize, I'm really encouraged with our progress to date, and we will continue to grow sales and drive efficiency across our operations.

In Health, we are taking action to improve the performance of our existing business through identifying new sales opportunities and partners as well as improving our operational and manufacturing effectiveness. In the last 6 months, we have optimized our manufacturing footprint with the closure of our Riverside plant in the U.S., and we are ramping up on our U.K. site, Annan, which is expected to be fully operational by the end of 2019/'20.

A key area of focus is expanding our new product pipeline and portfolio across both Generics and Innovators. Firstly, on Generics. Through investments in our generic pipeline, we will deliver an additional GBP 100 million in operating profit by 2025. We are still on track to deliver this pipeline, and I'll cover this in more detail on the next slide. Secondly, on Innovators. Although this business is only around 30% of our sales at the moment, we do see significant potential here. The Innovators side typically involves more complicated drug design, and this complexity demands better capabilities in material characterization and particle technology. And this plays right into our sweet spot. Our Innovator pipeline is also progressing well with 3 products in late-stage development and nearing commercial launch. All of this will deliver breakout growth.

And so moving on now to the generic pipeline in more detail. On this slide, we've given some additional detail on that pipeline. The top chart shows the potential operating profit by product per annum, and we've categorized the product by time to launch. Below this, we've given some additional detail on how the pipeline is progressing. Our generic API products move from development to market through key stages, from the early stage to formulation development to filing and retaining regulatory approval through to launch. And as you'll see from the chart, we currently have 20 products in early stage, 19 in formulation development, 6 in regulatory, and one product is launched this year. Throughout the process, we work closely with our customers. Timings, however, depend on our delivery, our customers' time frames and the time it takes to get regulatory approval and subsequently to launch.

You can see here our progress since April 2017 from the arrows on the bottom of the slide. As you can see, we've had one product launch. Five have moved into the regulatory stage to bring this total to 6. Of course, this does not mean that all of these will launch in the next couple of years because some take much longer and are awaiting patent expiration. There's been a net loss of one from the formulation development stage, reflecting 5 products moving along the process and one dropout, which is to be expected, at a net increase of 6 in the early stage, reflecting 5 products moving into formulation development and additional products being added to the pipeline. This hopefully gives you a sense of the progress we're making and the size of the opportunity across various time frames. We have a diverse portfolio, we're not reliant on any one drug, and we now have 46 products in our pipeline of generic APIs.

Moving on now to Battery Materials. In New Markets, we're positioning for breakout growth in Battery Materials with our ultrahigh energy density next-generation eLNO materials. Over the last few years, we've been working hard to develop our Battery Materials business. Our progress has been driven by our science and technology leadership. That is what JM does best. Given this is such an exciting opportunity for us, I'm going to spend some time on this topic over the next couple of slides. But let me start by saying that we've made tremendous progress accelerating our Battery Materials strategy.

We're adding resources to further develop eLNO. And we now have around 80 R&D scientists and engineers in our Battery Materials team, which we scaled up significantly in the past year. And our total R&D investment in eLNO has increased by 60% in the period. Customer sampling is still progressing well, and feedback remains excellent. And our commercialization plans are on track. All of this will lead to breakout growth.

As we've previously talked about, eLNO is a significant development. It offers a step change in energy density, lower cobalt and lower dollar per kilowatt hour per cycle compared to current and future cathode materials. eLNO's superior performance is attractive to our customers and will enable increased penetration of long-range battery electric vehicles. This gives JM a sustainable competitive advantage. And today, I wanted to give you some insights into the Battery Material production process and where we play in that value chain.

On this slide, we've shown a simplified version of the overall battery production process, starting with raw materials all the way through to the battery pack that is used by the OEM. JM's expertise and investments are in the cathode material production, the blue box at the top of the slide, which can be separated into the wet end, where we make the precursor; and the dry end, where we make the final cathode material. We have chosen to operate across the entire production process, from metal salts to eLNO, because this allows us to differentiate and optimize eLNO through every step of the manufacturing process. This further enhances our ability to maintain our technology leadership and deliver market-leading solutions for our customers.

We are also assessing the opportunity within Battery Materials recycling, which utilizes our core competencies. There will be some time before sufficient batteries need to be recycled, but we are looking at all areas of battery activities across their life cycle.

Our commercialization plans for eLNO are on track. We've come a long way, and I'm excited about what we've achieved so far. On this slide, you'll see our progress to date and key milestones over the next 12 months. We have developed the best-in-class next-generation battery material, eLNO, and we continue to receive positive feedback from our customers. We've also progressed our scale-up activities. The dry end of our pilot plant is operational, and the wet end will be operational next year. Our full-scale commercial plant, which will be built in mainland Europe, is also on track, and we received board approval for the initial CapEx in July. We are now completing the front-end engineering design and progressing land purchase and permitting.

Over the next 12 months, what can you expect from us is that we will continue to expand and invest in our R&D team to ensure that we maintain our competitive advantage. We will also continue eLNO customer qualification with our strategic partners. We've previously shown you the stages of qualification and their time lines, and you can find this in the appendix. We expect to break ground on our first commercial plant in Europe. And of course, we're already thinking about increasing capacities above 10,000 tonnes.

We are investing in our customer application center in the U.K., which will be operational next year. And to support future expansion, we will enhance our capital projects team to add further rigor in our investment strategy.

In summary, we're on track, and I'm really excited by the opportunity that lies ahead. There's a huge amount of activity in Battery Materials, and I look forward to updating you on progress over the next years.

So to summarize on the progress we made in the last 6 months. Firstly, I'm very pleased with our good performance this half as we continue to successfully execute on our strategy to deliver sustained growth and value creation. Against an evolving market backdrop, we have delivered on our promises whilst at the same time being incredibly busy investing across the business to build our platform for future growth. Our strategy remains strong, and I'm extremely confident that our core technology strengths and ability to solve the increasingly complex challenges that the world and our customers are facing will enable us to drive attractive returns.

So thank you very much for listening. That concludes our presentation for this morning. And with that, I'll pause, and Anna and John will join me up on the lectern, and we're happy to take any questions you may have.

QUESTIONS AND ANSWERS

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

Who would like to go first? Should we start over there? If you could state your name and where you're from.

Charles L. Webb ***Morgan Stanley, Research Division - Equity Analyst***

Charlie Webb, Morgan Stanley. Maybe first one for John, just around HDD. I think last time, you talked about Class 8 perhaps normalizing calendar year next year. Any change there? It seems like the orders look pretty good. So just thoughts around that. And then also an HDD, have you benefited at all from the retrofits with Cummins and what they've set aside there? First question. Second question, pgm benefit. So GBP 10 million in the first half. At current market pricing, what do you expect for the second half? And then finally, you didn't touch on it, but the license you signed for GEMX, G-E-M-X, however you pronounce it. What do you get with that? Are you the only guys licensing it? Who else, if any others, have licensed it? And what does that bring to you?

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

Okay. Thanks very much. So John, do you want to start off with the HDD question?

John F. Walker ***Johnson Matthey Plc - Sector Chief Executive of Clean Air & Executive Director***

So Class 8, I think we said in the announcement that we expect the Class 8 cycle to continue through the middle of next year. I don't think that's different than what we said at the end of the full year. So we expect that. If it continues, great. We're ready for that as well. But we're not changing our guidance there. And on retrofit, yes, we have had some benefit from the retrofits in North America.

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

Okay. Anna, do you want to answer the pgm question?

Anna Manz ***Johnson Matthey Plc - CFO & Executive Director***

Yes. We had a GBP 10 million benefit in the first half. I'm not going to guide explicitly on the benefit in the second half, but it's less significant.

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

And of course, it will depend on what happens to metal prices, which one never knows. And on the license that we announced today, that just gives us protection and protects our portfolio position or our IP position. Doesn't give us anything particularly other than the protection that we need to make sure that we can continue the development of the eLNO. Who else has it, we don't know, and that's -- I guess maybe other announcements may happen in the future, I don't know. But it's -- that's not our issue.

Charles L. Webb ***Morgan Stanley, Research Division - Equity Analyst***

Is there -- were there any costs associated within the first half?

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

No.

Charles L. Webb ***Morgan Stanley, Research Division - Equity Analyst***

No, okay.

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

Should we go to -- actually, I think there was a lady behind who is first. Sorry, Adam we'll come back, but we do it in the order.

Ming Lee Tang ***Exane BNP Paribas, Research Division - Analyst***

It's Nicola Tang from Exane BNP Paribas. I wanted to ask a question on the outlook comments you made in ECT -- in Clean Air, sorry, around tariffs and whether that was more a comment on indirect impact or whether it was direct for JMAT. Staying with the macro, you also mentioned Brexit. Anna your comments on working cap, I was wondering whether you could maybe expand on that a little bit or maybe talk about wider impacts beyond working cap and what you're doing ahead of Brexit. And finally, I was just trying to understand, on Clean Air, the margins in H2 and why what -- what was the reason behind the ramp-up costs in the second half given I would have thought the volume -- given you've been seeing the market share gains in diesel and the volumes going up, I was wondering why you aren't going to see more volume leverage in the second half on that.

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

Oh, should we keep going with the theme? John, would you answer -- do you want to answer some of the Clean Air questions?

John F. Walker ***Johnson Matthey Plc - Sector Chief Executive of Clean Air & Executive Director***

Okay. Well, the tariffs, I guess, split into 2 categories. It's what the vehicle makers are going to do. So whether the tariffs have any impact on where vehicles are made, we have some room to be flexible with that. But the other area where tariffs in North America have an impact is in North America with some raw materials that we import from China. So we do have some impact on that. We've made good progress in the first half at mitigating some of those tariffs. But some of those tariffs increase in January of 2019, so we'll continue to try and mitigate those tariffs. But the challenge of mitigation is getting bigger.

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

But the team are doing a really good job in mitigating them. And you can't mitigate them overnight. It takes a bit of time to put in alternative supply chain options. But we are doing a really good job mitigating. The team is doing well there. So John, on the second question, I think, on Clean Air, if you just keep going, was on margins and the question about the sort of new products. Do you want to...

John F. Walker ***Johnson Matthey Plc - Sector Chief Executive of Clean Air & Executive Director***

So right now -- so I guess there was a Brexit question as well.

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

We'll do the Clean Air one first.

John F. Walker ***Johnson Matthey Plc - Sector Chief Executive of Clean Air & Executive Director***

Okay. So for Clean Air margins in the first half, as we reported, our margins are up 0.5%. We've got positives and negatives in there. As you've pointed out, we've got strong volume growth leverage in the first half. And as we just talked about, we've been able to mitigate some of those tariffs impacts. Anna talked about some of the procurement savings that we have. So we've had a lot of those benefits flow through in the first half. In the second half of the year, our product mix becomes more challenging. We're starting to ramp up some of our new facilities, so we're going to have additional costs to be able to start up some of those facilities. And our product mix is getting more challenging because of the more complex products that the new legislation is delivering. So we're just forecasting more challenges in the second half and forecasting to hold margins same as last year.

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

I was just going to finish off with, remember, if you recall the full year results, we talked about the fact that we've been able to maintain our margins for the year, and our guidance is absolutely to do that. We've done better in the first half, but as John said, there are some competing sort of headwinds that will reduce the margins in the second half. But overall, it'll still be consistent margin compared to where it was last year. And finally, since the Brexit question is sort of a working capital question, Anna, do you want to...

Anna Manz ***Johnson Matthey Plc - CFO & Executive Director***

Yes. I'm not going to guide on the working capital impacts of Brexit, I mean, beyond saying we are working with each customer individually on Brexit plans across all possible withdrawal mechanics from the EU. Those plans differ customer by customer and, in some cases, involve us building working capital ahead of time. We also have other plans in place. We have already started recruiting some additional people to help us process things. So we feel we are well positioned to navigate whatever comes to pass.

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

Okay, all right. So should we go to the next question here, and then afterwards will go over to Neil?

Adam Robert Collins ***Liberum Capital Limited, Research Division - Analyst***

I had 3 questions. It's Adam Collins from Liberum. First one is to help us understand the China catalysis exposure. You tell us what the Asia exposure is, and it's 14% of HDD revenues and 21% of LDV. But are you able to just give us a sense of the China bit to the extent that some of us are concerned about the slowing market conditions there? And that's the first one. The second one is on the process technology and catalysts where you're talking about increased licenses. I wondered if you could talk a little bit about specific areas where that has been booked. And then improved activity, besides methanol, what are the other areas where you're noting signs of progress? And then the third one, perhaps for Anna, is on just clarifying where we're at now in terms of the global procurement savings plan. A couple of years ago, you mentioned there was going to be GBP 100 million CapEx. It's a 3-year program, roughly similar savings. And I think it was slightly delayed on your arrival as you reviewed it. Could you just give us an update on what the associated investment will be? What any extra depreciation associated with that would be? I understand it's accelerated. And yes, that would be helpful, just to put any context to what you said historically.

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

Okay. Thank you for those questions, and give Anna some time on the last one. On the first 2, sorry, we're not going to give the detail by country. We already give you a fairly detailed analysis by region, and that's as far as we're going to go, I'm afraid. We do talk about the opportunity for China 6 both in light duty and heavy duty, which is tremendous, and the tripling of content in the heavy-duty side and the doubling in the light-duty side. And the fact that we've got Blue Sky, which is potentially pulling forward some of that benefit, could help us in -- not this fiscal year but maybe next fiscal year. Doesn't change the medium-term outlook, but it might help us in the short run. But we're not, I'm afraid, going to go down by country level. On the Catalyst Technologies side, you know that we've had a couple of -- we've done a few license wins in the first half. Very little revenue associated with those in the first half because they get spread over the plant build. And so the revenue associated with those will come through into the -- in the forthcoming few years as they -- as those plants get built. Couple of methanol licenses within that but relatively small ones, not massive license wins. And the improved activity, besides methanol, well, I talked about the 2 actually, which are kind of non-methanol ones, the mono ethylene glycol is a good win and the one with waste to aviation fuel, which obviously has huge sustainability benefits but also is a nice license. And it's also the kind of small pilot -- not quite a pilot project. It's a proper project. But the opportunity across the U.S. to roll that out is potentially quite exciting. And on -- well, it was procurement, but I think you actually -- it's the ERP systems as well.

Anna Manz ***Johnson Matthey Plc - CFO & Executive Director***

My favorite subject, SAP. So as we said previously, we've invested over GBP 100 million in an SAP system that we will roll out across the globe. And this is moving our many sites -- we have over 100 sites -- on to standard systems and processes, which will give us significant benefit going forward. Just on your financial question, depreciation in the year will be about GBP 7 million, and yes, we are depreciating it. What savings does this give us? It underpins everything actually. So in the first instance, we are now live in Royston. Royston is a -- Royston Clean Air, a big complex site. So we didn't start with a little site. We've gone with a big complex site. And we now have standard transparent processes there. I'm pleased to say that Royston production is now -- is consistently hitting very high levels of output, higher than we had previously. That's in part system driven, and it's in part driven by transparency as to how those processes work. So as we roll out site by site, what we'll see is specific low-level savings, small number of million associated with tidying up systems and processes, greater transparency and understanding of our process. The second layer of savings, which you don't get with the first rollout, is that you can start to retire these 40 ERP systems that we are running, and I can't tell you how many instances we've got of those 40 systems. And as you start to retire those legacy systems, that's a material reduction in support costs, which would be the second tier of saving. The third tier of saving, about which I'm most excited, is clear visibility and data with which to run our business. So yes, we're making really good progress with procurement savings, but right now, we have to extract data from 40 ledgers around the globe, to try to figure out what we're spending. And in every ledger, it's coded differently. So it makes getting at all of that quite hard to do. And we've got a standard set of data and processes. We will be able to manage our pricing real time, understanding customer profitability, understanding product profitability real time in a way that we can't today. And that will materially underpin our ability to drive efficiency across the rest of the group.

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

And I mean, when we talk about operational efficiencies. As Anna said, these systems is -- are foundational places to have to enable you to drive some of those operational efficiencies. So it's really important to get this in.

Adam Robert Collins ***Liberum Capital Limited, Research Division - Analyst***

Just to follow up slightly on the second area, the progress in PT.

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

Yes.

Adam Robert Collins ***Liberum Capital Limited, Research Division - Analyst***

Did I hear you right that you said you're adding resource in methanol, oxo alcohols and oil processing? And if that's the case, are you also signaling therefore that the other 2 areas, which you didn't touch on, oil processing and oxo, have got better?

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

Well, I think I talked about oxo alcohols, methanol and gas processing were areas of sort of additional -- I wouldn't say we're adding massive resource there. It's actually a resource allocation, putting more resources there and less resources in other perhaps lower-growth areas. So it's really targeting the areas where we think we have greater potential. You are not going to see, massive cost savings, it's more of a resource allocation issue.

Neil Christopher Tyler ***Redburn (Europe) Limited, Research Division - Research Analyst***

Neil Tyler, Redburn. Two questions, please, first on Clean Air and then on ENR. John, on Clean Air, the sort of renewed -- or the additional optimism with regard to the China VI timing. Can you perhaps shed some light on what has prompted that? Is that platform wins? Is that conversations with customers or just your own hunch? And the second question on ENR. The first fill catalyst, I was wrongly, it seems, under the impression that, that was at a very minimal level, and it seems every time we think that, there's another drop. Can you give us an indication of where that stands, perhaps percentage terms now relative to its peak in revenue terms?

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

Okay. Shall we start with the first question? Is it your optimism, John, or...

John F. Walker ***Johnson Matthey Plc - Sector Chief Executive of Clean Air & Executive Director***

This is the Chinese government pulling forward with the legislation. So they pulled it forward effectively 1.5 years, which brings with it challenges. The first part of that, as we said, which will start in July of 2019, we're getting ready for that now. As Robert said, we have a new factory coming on. We'll be doing the validations of that new factory in the second half of the year. So as the volumes ramp up, we'll transition from some of the products being made in our existing factory to the bulk of those new products being made in our new factory.

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

And this is all about the China government improving air quality. Hence, the reason why it's called the Blue Sky initiative. So they're bringing it forward, I think, inside -- in 13 provinces, the larger provinces in China. And they're pulling forward the legislation, which is -- obviously, for all sorts of reasons, is a good thing.

John F. Walker ***Johnson Matthey Plc - Sector Chief Executive of Clean Air & Executive Director***

So there's no change in the legislation. It's just a timing impact

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

And this is not about market share gains or -- this is purely the Chinese government changing that.

Neil Christopher Tyler ***Redburn (Europe) Limited, Research Division - Research Analyst***

Yes. I guess my question is sort of at what point do you -- would you anticipate the wins in the platforms that are required or that will ensue from the additional technology requirement?

John F. Walker ***Johnson Matthey Plc - Sector Chief Executive of Clean Air & Executive Director***

For the wins that we've had in our plan, we've won more than 80% of those in -- that was in our plan already. So...

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

And on the first fill catalysts, they're quite lumpy, of course, as new plants come onstream. And of course, as you go to a lower number of license wins, then you're going to have a lower number of first fills, and it becomes lumpier. And when you had multiple license wins a year, then you -- it would be slightly less lumpy. So it's probably down about 60% from where we were at the sort of peak or at the higher level. And so I think -- we've talked already about the sort of licensing income -- sorry not licensing income, number of licenses sort of flattened out. It's kind of at low level still. But -- so hopefully, that's -- we're at the end of that sort of downturn. But it is inherently lumpy unfortunately with first fills. The refill catalyst is much more predictable and more -- not quite an annuity, but it's a more predictable income stream. We've got another question.

Sanjay Jha ***Panmure Gordon (UK) Limited, Research Division - Capital Goods Analyst***

This is Sanjay Jha from Panmure Gordon. I have 2 questions on eLNO if I may. You've talked about step change in energy density. Could you give us some idea what is the specific energy density you can get from your technology? And secondly, the -- when you talk about lower dollar per kilowatt against current and future materials, is that a factor of the price of current, the raw materials you are using? Or is there something specific about the way you build the battery cell that makes it sort of lower dollar per?

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

Okay. So I'm going to ask Alan to answer, give a little bit more color in a second, so if you can get a mic to him. We're not going to go into specifics about some of the details about energy density and give you an absolute number. I think we can give you more a qualitative comment relative to competition. And on the dollar per kilowatt hour per cycle, it's a range of things. But Alan, do you want to give a bit more color on that?

Alan E. Nelson ***Johnson Matthey Plc - CTO & Sector Chief Executive of New Markets***

Yes, of course. What we had talked through at Capital Markets Day, to put in relative terms, is that eLNO has between 5% and 10% higher energy density relative to NMC811. And it's somewhere in the region of 20% to 25% higher energy density compared to NMC622. But importantly, what -- where we're really making the difference around eLNO is also increasing cycle life or overall lifetime of the materials as well as increasing the stability of those materials as well. And those are key aspects because in order to be successful in the long-range EV market space, it's not only about high energy density, it's about having all of those other characteristics that'll enable widespread adoption as well.

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

So it is part a lower dollar per kilowatt hour per cycle life. It's -- adding the per cycle life's important because you maintain the ability to -- for the material to charge and discharge and charge and discharge for longer and longer and retain its energy density. Because the stability of the material is really, really important. People talk about stability from, how does it work? Does it catch fire? That's one element of stability. But there's another element of stability in how long it can maintain that energy density without -- as you put the electrons in or out, there's quite a lot of stress on the material. But lower dollar per kilowatt hour, clearly, one of the things that we have here as well is lower cobalt. And that's a factor as well. So there's a range of factors that go into the overarching method.

Sanjay Jha ***Panmure Gordon (UK) Limited, Research Division - Capital Goods Analyst***

But obviously, you have to make quite a big investment if you think this is the way forward.

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

Well, of course, of course.

Sanjay Jha ***Panmure Gordon (UK) Limited, Research Division - Capital Goods Analyst***

It's -- but given that there are a lot of Chinese and other countries spending heavily in this kind of technology, I just wanted to know how sure one can be that they have the lowest dollar per kilowatt hour given the various variables.

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

Well, I think there's lots of variables here, it's not just one variable. And of course, when you look at the overall cost of the material, the largest portion of the cost of material, of the absolute cathode material is the bill of materials themselves, the lithium, the nickel, the cobalt, et cetera, the raw materials that go in. The actual element to do with the sort of manufacturing costs and the labor costs, relatively speaking, out of the overall cost is a low -- much, much lower element. So in reality, you can get -- if you can get a better material with better energy density, you can -- that can outweigh the benefits of maybe a lower capital cost or a lower running cost. So question over here.

Charles Bentley ***Bernstein - Analyst***

Charles Bentley, Bernstein. So a couple of things just on European LDV gasoline. So the first thing you highlighted was the fact that you've seen a lot more growth in larger vehicles rather than smaller and that you're overindexed to smaller LDV engines. Is there something structural there? Does that represent somewhat of an opportunity? So that would be the first part. And then secondly, you're talking about some of the delay to the 5% share gains. Is that something that is a threat? So there's -- and I understand that some of that might be reopening of platforms. So is there an opportunity that, that might not be achieved? And then just going back to the CAMX license, can you just explain to me what specifically you need for that? Why do you need that for eLNO? What does that give you that you were lacking in terms of IP protection? And then just finally, in the -- in one of the slides, you said that in the next 12 months, you need to build a projects team for possible further capacities for eLNO? Is that something we could therefore expect in -- to kind of hear an announcement from in the next kind of 18 to 24 months?

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

Okay. Shall we start with the 2 questions on light-duty gasoline? John, if you want to answer that.

John F. Walker ***Johnson Matthey Plc - Sector Chief Executive of Clean Air & Executive Director***

So on gasoline, the platforms that we're on today and the mix of our platforms was determined 3 or 4 years ago. So we are where we are in terms of being indexed to small vehicles or large vehicles. I think that anecdotally, with some of the information that we have from governments making some statements, I think some of the people who are moving from big diesel vehicles, they wouldn't move to small gasoline vehicles. They'd probably move to big gasoline vehicles if they didn't want to buy a diesel. So I think that's the issue there. And I think in terms of timing, I don't see this as any threat. There are some things. We talked a little bit about WLTP, which has delayed some customers in getting some of their systems approved. So I think some people are still working on the architecture to be able to get through the WLTP testing. And that's just thrown up some uncertainty in the market, but I don't see any long-term threat there. We've talked before about reallocating -- reorganizing our R&D activities and concentrating on gasoline. That's all progressing very well, and we expect that we'll have a good share of the gasoline market in the future.

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

Well, to be specific, I don't think there's anything structural here at all. It's just a nature of where the market is today. Where we were overindexed historically on the smaller cars rather than larger cars. And as we -- as those new platforms come through over the next few years -- there's no structural issue here that puts us in a weaker position for larger gasoline cars versus smaller gasoline cars. On the sort of -- I'll ask Alan to provide because he's probably -- being our CTO as well as running the New Markets business, can give you a little bit more color on the CAMX license if you want. But the further capacity for eLNO, I was really talking about building up the sort of -- there is building up of sort of capital capability of the organization in the Battery Materials business, the drive to deliver the first plant itself. Let's not get ahead of ourselves about when the next new build will come. I know you -- maybe you want to hear the next big thing. We are thinking about what that next big thing will be, how we can enhance our capacity even longer, and I talked about that. And we've said before, it's -- we can't do everything in series. We can't wait until the first plant is built and running and then wait a year or 2 to see how it's done and then start building another one. There will be an element of overlap, but we're not ready to talk about the specifics of that at this stage. Alan, do you want to talk a little bit about the CAMX license, which we announced?

Alan E. Nelson ***Johnson Matthey Plc - CTO & Sector Chief Executive of New Markets***

Maybe to talk about some chemistry, so look, I'll be very clear, eLNO is a proprietary JM product. All of our products, including eLNO and all the products across all of our sectors, are enabled and supported by a detailed intellectual property strategy that sits beneath them. And we've put those intellectual property strategies in place really for 2 key reasons. The first is to ensure that we have freedom to operate, all the way from raw materials to the composition to the process, all the way through into the end markets, in which those products are used. The second, of course, is to create a long-term sustainable competitive advantage for us. In other words, it's a blocker, it's a barrier to entry for others coming into the space. There are times when we pull these strategies together, and we periodically review them, that we identify an opportunity to acquire, license background intellectual property. And that's specifically the case in eLNO. We don't get into the details as to why we license or acquire particular intellectual property only because that thought process and that analysis in and of itself gives us competitive advantage. It's how we think about the unique aspects around our material. But suffice it to say what the CAMX license is, what the GEMX license is, what the 3M NMC license is and all the licenses that we have today, what they provide is an opportunity to improve and extend our intellectual property portfolio to give us a long-term competitive advantage.

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

That answer your question? Good, okay. Any more, if there are any more? oh, Adam you're allowed to come back for another question. Of course, you are. There's one on your...

Adam Robert Collins ***Liberum Capital Limited, Research Division - Analyst***

I wanted to ask John a question about WLTP/RDE testing and its implications. It's pretty obvious from what we've seen so far that the delays that have occurred have occurred mainly on gasoline. And this may be due to the fact there are more variants on the gasoline side, but one sort of theory is the OEMs are having difficulties in getting cars certified without particulate filters. And I wondered whether you thought that this might herald an early implementation of particulate filters as well in Europe before the next stage, the Euro 6d Final, that you might be more optimistic about the fitment rate there because of this.

John F. Walker ***Johnson Matthey Plc - Sector Chief Executive of Clean Air & Executive Director***

So I kind of agree with everything that you said. I don't think that the ramp rate that we had anticipated before is going to be affected by that. We still believe that gasoline particulate filters are coming in now, they're ramping up. We had small volumes last year. We have bigger volumes this year. Over the next 2 years is when we're really going to see those volumes increase.

Robert J. MacLeod ***Johnson Matthey Plc - CEO & Executive Director***

But it could provide, as you say, an opportunity, as John said as he agreed with you. But I think one of the issues is WLTP is clearly making it harder for OEMs to meet the regulatory requirements. And that is -- can only be a good thing for Johnson Matthey because it requires more complex catalyst systems. So the -- it's good news that this legislation comes in place for all sorts of reasons, because it enhances air quality as well, of course, and it's an opportunity for us.

Any more questions at all? No? Well then, thanks very much indeed for coming. And very nice to see you all, and we look forward to seeing you again next time. Thank you.