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UMI.BR - Umicore SA Expansion in Cathode Materials Call

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PRESENTATION

Operator

Good day, everyone, and welcome to the Umicore Expansion and Cathode Materials Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Mr. Marc Grynberg, CEO. Please go ahead, sir.

Marc Grynberg - *Umicore S.A. - CEO and Executive Director*

Thank you, and good afternoon to those of you in Europe, and good morning to investors joining the call from North America.

Today marks a very significant milestone in Umicore's development as we have announced the largest organic growth investment in our history. I would like to explain in some more detail the reasons for the investment and how this will be driving value creation.

In summary, what we are launching today is a significant and fast expansion program to add production capacity for cathode materials. This program is not based on hopes to shift capacity on the back of expected market growth. It is in response to a sharp uplift in customer orders. This uplift represent growth for Umicore that is well above the growth levels in the market, and this confirms that we are benefiting from more unique and early positioning in cathode materials.

Overall, we are set to invest EUR 300 million over the coming 3 years to meet this surge in demand, and this comes on top of the EUR 160 million investment program that we announced a year ago and which is currently under way. If we look at the 2 programs combined, by 2020, our production capacity will be more than 6x higher compared to the levels of 2015. This expansion will drive economic value creation for Umicore and it underscores the leadership position that we are forging for ourselves in clean mobility materials.

I mentioned a minute ago that Umicore was growing faster than the market. Let's look for a moment at the expected market evolution in the next few years. As you all know, the electric vehicle market is now growing fast. Car producers and governments are seeking ways to tackle the dual challenge of clean air and lower CO2 emissions and consumers are becoming more attracted by the benefits of electric transport. Compared to when we made our projections at the Capital Market Day back in 2015, things have evolved faster and more positively than we had imagined. Not only is vehicle electrification gaining traction in several regions, we are also seeing that NMC is really establishing itself as the go-to material for most vehicle types.

In addition, the trend to higher driving ranges, which is mandating larger batteries, and the growth in e-bus demand are providing further support to the volume requirements for cathode materials. This is translating into even higher market growth than we projected in our optimistic gauge back in 2015.

You can see from the index charts that we now expect the market for cathode materials to quadruple between 2015 and 2020. Even if you will disregard the chemistry that Umicore is not currently offering, such as lithium iron phosphate and lithium manganese oxide, the picture would be the same. I'm happy to say that for Umicore, the picture is actually even more positive than this. We have experienced a big surge in orders in recent months from a diverse base of customers, mainly in China and South Korea; and for materials that will be used in many types of electric vehicles. These range from plug-in hybrid passenger cars all the way through the electric buses, which are really becoming a major feature of China's drive for cleaner air.

We owe this successful development to a combination of strength that are making our materials particularly sought after in the market. First of all, we have a long track record in the industry and have been developing better materials technology for more than 20 years, and we now have an extensive IP portfolio. We were one of the first movers to develop specialty grade of products that were suitable for automotive applications and we qualified our products and production lines early in the game. We have an unrivaled ability to scale up from lab to prototype and from prototype to industrial scale, and this is proving crucial to our customers in automotive applications.

And finally, our closed loop offering is another unique element that enables us to stand out in the markets.

So what will the investment entail? Well, first, it is worth pointing out that we have been working round-the-clock to fulfill customer demand in recent months and we are operating at full capacity. The sheer scale of the customer orders for delivery in the near term requires a significant addition of capacity. This means a EUR 300 million investment spread over 3 years at greenfield sites near our existing facilities in Korea and China.

In terms of CapEx profile, we anticipate that the main CapEx spend will come in 2018, with the remainder roughly evenly split between 2017 and 2019. Just to be very clear, this will come on top of the current EUR 160 million investment wave, which will start to come on stream and generate revenues from the second half of this year. Taken together, the investments will increase our cathode materials production capacity by more than 6x by 2020. The commissioning schedule show that the first lines from the current investment wave will start to come on stream as from the second half of this year, while the commissioning of the lines related to the new expansion will commence in the second half of 2018.

So overall, this is a very exciting development for Umicore and one that will be contributing strongly towards our Horizon 2020 ambitions and beyond. If we look at each contribution in turn, it is evident that the manner in which we are outpacing the market growth is a testimony of how much our leadership in cathode materials is recognized by the customers. If you combine this with our offering in Automotive Catalysts, we have a unique offering in clean mobility materials that no other company can presently match.

In terms of value creation the accelerated growth in Rechargeable Battery Materials makes us even more confident in our quest to more than double earnings by 2020. The returns for this investment are in line with Umicore's overall targets and we expect the new capacity to be earnings accretive during the ramp-up phase and value enhancing shortly after we reach full capacity.

Umicore has strong growth prospects in all three of its business groups. The demand we are seeing in cathode materials will accelerate the growth of Energy & Surface Technologies. I'm sure that by 2020, this business group will have very much stepped out of the shadow of its Catalysis and Recycling cousins from a revenue and earnings perspective.

Finally, I would like to add that one of the reasons for our success in this business is our ability to source raw materials such as cobalt in an ethical and sustainable way. This has been a strong selling point with customers and something that we will look to do more of in the future.

And with that, I would like to turn the call over to you for questions regarding this expansion program.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Peter Olofsen from Kepler Cheuvreux.

Peter Olofsen - *Kepler Cheuvreux, Research Division - Analyst*

Yes, a question on the 2020 targets. It seems you're now a bit more confident on achieving these targets, and I'm specifically referring to the doubling of EBIT. It's a quite meaningful investment. So why not upping the targets rather than keeping the target? And also looking at the rebalancing of earnings that was also one of the objectives of the Horizon 2020 program, how do you see that playing out in the coming years? It seems it might tilt a bit more towards Energy & Surface materials. So a bit more color there would be helpful. And then final question, on the CapEx per tonne, it seems a little higher than with the plan that was announced last year. Can you explain why that is and whether the CapEx per tonne of the current plan is indicative of what we should expect going forward?

Marc Grynberg - *Umicore S.A. - CEO and Executive Director*

Peter, let me start with the third question, which I think requires some clarification. The capital expenditure per unit of volume or unit of tonnage is roughly in line with the previous investments. I think it's important to bear in mind then that if you, first of all, triple your capacity and then double again, when you double, you actually add 50% more volume than when you triple. That's sheer arithmetics because you start the doubling from a much larger base than when you start the tripling. So the expansion program that we are announcing today represents actually, volume wise, 50% more than the expansion we announced a year ago for EUR 160 million. That's 1 aspect. Secondly, in the previous expansion, we still benefited to a certain degree from existing infrastructure and certain also existing precursor capacities. While here, because we are going to develop greenfield facilities, the investment will be marginally, but only marginally, higher. This being said, this will not have an impact on margins because the scale effects will also be bigger than in the previous phase. So all in all, CapEx per tonne slightly higher, not much marginally higher, because we have greenfield investments here; but scale effects outweighing that. Now when it comes to the 2020 targets, clearly, the market in the Rechargeable Battery Materials has developed faster and our position has improved more than the scenarios we had envisaged when we announced the targets back in September 2015. Things are in flux in that business, so I don't think it would be appropriate for us to change the targets every time there is a change in the market there. But clearly, it is true that we are more confident than in the past that with that very positive development and more positive development than anticipated, we will be able to reach or even exceed the targets that we announced back then. And the same goes for the rebalancing. Obviously, the E&ST segment will grow faster than we have anticipated at the time and its contribution will grow bigger in proportion a bit faster than we had anticipated.

Operator

Our next question comes from Jeremy Redenius from Bernstein.

Jeremy Redenius - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

It's Jeremy Redenius from Bernstein. Firstly, I just wanted to try to clarify on the capacity part. So I'm reading today that you're increasing total cathode material capacity by more than sixfold. So if I could just check, because I think previously you talked about specifically NMC capacity, and so if I were to read this today, I think you're saying, if I believe you have 10,000 tonnes of NMC capacity that's going to increase or have increased by 50,000 up to 60,000 tonnes by 2020 once you've done this tripling and then doubling. So first of all, I just wanted to see if you could at least validate the logic that if you were to have 10,000 tonnes that it would be increasing to 60,000 tonnes. Then secondly, I'd like to hear you talk a little bit about the relationship you have with your customers who would be taking this volume. What type, if any, volume guarantees do you have when you set about building this capacity expansion? Or is this simply based on their forecasts and hope that those develop and then, therefore, you'll be available to supply those if their forecasts develop as planned?

Marc Grynberg - *Umicore S.A. - CEO and Executive Director*

Jeremy, let me start with the second question. As I mentioned during my presentation, it is not based on hopes. It is based on orders. And so we need that capacity to deliver the orders and the business that we have won. That's as straightforward as that. Secondly, I'm not going to validate your assumption that we have 10,000 tonnes of capacity today. We have never mentioned any number and I'm not going to start now. Suffice it to say that we're going to multiply our total capacity by a factor of 6 and that the vast majority of that will be NMC. This being said, we are also increasing our capacity for LCO because the demand and the orders that we have for LCO, for high-energy LCO, are also increasing.

Jeremy Redenius - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

Okay. And then, if I could just ask a follow-up on the customer relationship. So if they're based on orders, like what teeth do you have in your contracts in-force, the volumes associated with those orders?

Marc Grynberg - *Umicore S.A. - CEO and Executive Director*

I'm not going to get into any detail of our contractual arrangements and, at this stage, I would only confirm that the expansion is not based on hopes to fill the capacity but on the need to deliver.

Operator

Our next question today comes from Charlie Webb from Morgan Stanley.

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

Marc, just a quick one on return hurdles and time frame for investments. If you could just remind us what your return hurdle is and the time frame in which you hope to or aim to meet that? And then also, when thinking about this investment in particular, kind of the price declines that are factored in based on OEM cost road maps, is that a factor you're baking in today or is that something now you're not worried so much about?

Marc Grynberg - *Umicore S.A. - CEO and Executive Director*

Charlie, on the returns, I can only repeat what I said earlier that the investments and the expansion program is going to be value enhancing once we reach full capacity, which is relatively shortly after we started the new lines. So it is not like we need many years for the investment to generate returns over and above the cost of capital and reach then the Umicore targets. So these are pretty positive prospects that we have and otherwise we would not commit to such investments, I would say.

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

Just on that, so you're suggesting that returns, once fully ramped up, will be at the level of the group?

Marc Grynberg - *Umicore S.A. - CEO and Executive Director*

I didn't say that. I said that, it would be value enhancing, so creating more return than the weighted average cost of capital. But I didn't say how much, I said more. And secondly, I'm not going to go into the details of pricing expectations because that is commercially and competitively sensitive. Suffice it to say that we have taken into account everything that needed to be taken into account in terms of pricing potential, possible pricing developments as well as scale effects.

Operator

(Operator Instructions) And our next question comes from Sebastian Bray from Berenberg.

Sebastian Christian August Bray - *Berenberg, Research Division - Analyst*

I would have 2, please. The first is, the extent to which all of this capacity is booked out as soon as it comes to market, I think you mentioned earlier that this was required to meet customer orders. But is the amount of capacity more than is sufficient to meet customer orders in the sense that there's a bit of spare there? And secondly, could you provide any guidance and the ramp-up costs that you would expect to be associated with this additional capacity?

Marc Grynberg - *Umicore S.A. - CEO and Executive Director*

Sebastian, so the capacity, I think it's fair to say that the capacity is booked out. And today, we are running at full capacity and the addition is badly needed to meet the orders that we have. And we're actually adding capacity as fast as humanly and technically possible. So we're not adding spare capacity. And secondly, the ramp-up costs, I'm not going to go into details there. Suffice it to say that there is nothing out of the ordinary because we're adding lines. We've been adding lines all along and will continue for the next few years. It's not that the entire capacity is coming overnight in one go. It's a gradual commissioning that we have with the gradual ramp-up for the additional lines. So you will not see major fluctuations in ramp-up costs from one period to the other.

Sebastian Christian August Bray - *Berenberg, Research Division - Analyst*

That's helpful. If I could just quickly ask a follow-up to that, which concerns, number one, is the new capacity specific to a type of NMC being produced? Or is it broadly able to, how to put this, produce different grades of NMC? And secondly, is there any scope within this capacity expansion for shifting NMC lines at some stage in the future to NCA if you choose to enter this market?

Marc Grynberg - *Umicore S.A. - CEO and Executive Director*

The capacity we're building is for a number of NMC grades, and so there is a certain degree of versatility in the capacity. Although, as I mentioned in previous conversations, one has to bear in mind that we have a pretty good visibility on the technologies and the chemistries that are going to be required in the future because of the very long life time of the platforms. With this being said, there is a degree of versatility in terms of product grades. NCA is a bit different and requires a somewhat different production technology, so it is not totally fit for NCA production without any adjustments.

Operator

Our next question today comes from Adam Collins from Liberum.

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

I had 3 questions, I think. So first of all, on LCO, I wondered if you could give us a sense of the scale of the capacity expansion there? And on a related note, there's been some concern lately about the commercial potential of LCO given the sharp increase in the cobalt price. I wondered if you could just confirm that there's no potential risk in the LCO area from the emergence of high-energy LNO or indeed a switch to NMC? So that's the first question. The second one is on the significance of bus demand now for NMC. I wondered how significant it was that the Chinese authorities had leveled the playing field for NMC by allowing it now to qualify for subsidies and aligning the subsidy program more with energy density on the bus side than was the case previously. And then the final question was on why you have decided to go for a greenfield expansion rather than extending the existing facilities in (inaudible) in China. If I'm not mistaken, there was some surplus land that you could build on, but it may be not enough, so if you could just explain why the greenfield route has been taken now?

Marc Grynberg - *Umicore S.A. - CEO and Executive Director*

Adam, let me start with the last question. Actually, the expansion in Korea, whether you call it a greenfield or a brownfield, is borderline because we're expanding on adjacent lands or, as you referred to, spare land that we had. While in China, we need to, indeed, develop a greenfield because we need more space than what is available next door. It's somewhat in between, clearly, in terms of picture. Then taking your questions in reverse order, the bus demand is growing fast and very strongly in China. And yes, the fact that the authorities have aligned the subsidy mechanism to driving range or energy density requirements is definitely supporting that trend. Although, I must say that so far the capacity has been constrained and more demand from the bus sector would have been impossible to meet with the right production capacity in the supply chain anyhow. But clearly, this is a factor and we are pretty happy about our positioning in China and in that segment as part of it. And then coming to your question about LCO. For high-end applications which require very high energy density, we don't see a substitution of high-energy LCO by other chemistries. And to the contrary, we see higher demand for high-energy LCO for these high-end applications. But it is a distinctive factor. And one of the reasons, without entering into the technical details, that there isn't such substitution for high-end applications is that you have to bear in mind that NMC or LMO are not operating at the same voltage as LCO. And that is one of the factors that you should definitely take into account and does not allow a 1 for 1 substitutability of these products.

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

Yes, okay. What about the size of the scale-up in LCO, Marc?

Marc Grynberg - *Umicore S.A. - CEO and Executive Director*

Well, it is by far less spectacular than for NMCs, really.

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

You don't want to pin any sort of number on it? Is it twofold? Is it fourfold?

Marc Grynberg - *Umicore S.A. - CEO and Executive Director*

I don't want to put a factor on that. I can only say that NMC is really the key driver to this expansion program and it was already the key driver by some margin for the previous investment that we announced a year ago.

Operator

Our next question comes from Chetan Udeshi from JPMorgan.

Chetan Udeshi - *JP Morgan Chase & Co, Research Division - Research Analyst*

This is Chetan Udeshi from JPMorgan. A couple of questions from my side. Can you give us any indication on how long is your order visibility? So if somebody wants NMC materials now, do they have to place an order for it 6 months ahead or is it 9 months? And second question related to that is, if you're actually seeing such a strong demand, why are you not spreading the risk of this incremental capacity with your customers? Why not ask them to prepay for the incremental capacity that you're adding or some sort of guarantee that they don't sort of go back on their commitment? Because historically, auto companies, once they sort of start seeing the weaker demand, they pass it on quickly in terms of their order intake or order to supply chain as well.

Marc Grynberg - *Umicore S.A. - CEO and Executive Director*

Chetan, so first of all, the order visibility is pretty long term, I would say. Considering the time it takes to add capacity, if you want to order something, you better order sooner rather than later. And then, let's face it, we are qualified for platforms that will be launched in a number of years from now and for which the orders are already placed. It's not like you can suddenly place an order for delivery in the next several weeks. The order book visibility is pretty good for the long term. And then coming to your other question, I don't want to go into the detail of the commercial discussions we have with our customers, whether it's about prepayments or payment terms. I understand the point that you're making, I can say that we're sufficiently confident about the volume that will be required to produce to deliver against the orders that we have secured. And I think that with the configuration we are developing, we're also building sufficient capacity to cater for the normal rates of fluctuation that you have depending on how each model is selling in the marketplace. And this is something that is important for us to continue to maintain.

Chetan Udeshi - *JP Morgan Chase & Co, Research Division - Research Analyst*

Can I ask a follow-up question on that? Along with volume, do you have pricing commitments as well for your orders? And second question is, how much of this incremental capacity is just driven by higher orders from existing customers? Or are you also penetrating sort of the other accounts or other customers which you didn't have relationship with, so it's more of an increase in terms of customer base rather than just increased volume per customer?

Marc Grynberg - *Umicore S.A. - CEO and Executive Director*

Okay, Chetan, regarding your last question, actually, it is a mix. We have higher orders from existing customers for existing platforms. We have orders from existing customers for new platforms, and we have orders from new customers. So it's really a mix of these 3 that is driving the surge that we are addressing today. And your other question regarding pricing, yes, there is also a good degree of visibility on the price developments as the orders get placed along with the volumes.

Operator

Our next question comes from Andrew Benson from Citi.

Andrew Benson - *Citigroup Inc, Research Division - MD*

Three questions. The settlement with BASF and the Argonne institute, has that made any difference or is that by the by? Secondly, can you give some sense of where the orders are coming regionally and where the orders are intended for? So is this sort of Asian production for European, American demand? Or is it American demand for American production? And thirdly, on the issue of prepayments, why did you choose not to do that given the tight market condition also with Wacker back in, I can't remember, 2007, 2008. They did a tremendous job of securing substantial prepayments. Is that an opportunity you're missing out on?

Marc Grynberg - *Umicore S.A. - CEO and Executive Director*

Andrew, I didn't say we didn't secure or didn't negotiate prepayments, I just said that we were not going to disclose any commercial agreements that we had. And so that's part of any kind of working capital or payment term discussion that we have with our customers, and we keep that private. Where is the demand coming from? It's, to a very large extent, Asian demand because a big chunk of the extra demand is in China, including, as I alluded to earlier, for e-bus applications. It's also, to a good degree, driven by European OEMs increasing their sales of electrified vehicles. And I would say, overall, it's global, but clearly with the Asian demand dominating in that respect and European demand following suit. And then your first question about settlements, no, that had no impact in a way. And as I mentioned earlier, the investment program that we're announcing today is in response to a surge in orders and is not correlated to the settlement you referred to.

Operator

Our next question comes from Mutlu Gundogan from ABN AMRO.

Mutlu Gundogan - *ABN AMRO Bank N.V., Research Division - Analyst*

Marc, one question. Can you tell me how you see your market share by 2020? In other words, what are your competitors doing, and are you afraid that we will see more of these announcements by your peers?

Marc Grynberg - *Umicore S.A. - CEO and Executive Director*

Mutlu, our market share is increasing. By definition, if we grow faster or even substantially faster than the market, it means we are gaining market share. And are competitors adding capacity? Yes, they are. Are they going to add more? I think this is a distinct possibility. I'm not too much concerned about that given the way the market itself is developing. And whether we will see more of these, I would say, sizeable announcements depends on how successful each company is in qualifying for certain platforms and winning business. It's not a matter of just hoping for the market to be favorable. So we're not alone, and competition is also adding capacity. And some of them are doing relatively well. What I've observed, based on the limited information we have from competitors, is that we seem to be adding more capacity than others, which is also in line with the development, the growth of our business relative to the overall market as we showed in the presentation. I'm not going to give you a specific market share. As you will know from me by now is that I'm not obsessed by market shares. And I think in this business, clearly, scale does matter because of the amount of fixed costs required to develop the production capabilities and to qualify your products and production lines. So scale does matter, but I'm not obsessed by market shares. I'm just happy to see the development we're having now.

Mutlu Gundogan - *ABN AMRO Bank N.V., Research Division - Analyst*

Maybe a quick follow-up question. Do these greenfields offer a brownfield investment as a next step or would you have to greenfield again?

Marc Grynberg - *Umicore S.A. - CEO and Executive Director*

We are actually securing as much land as possible on the greenfield side that we are creating, such that we have some land available for further expansion. I mean, a couple of weeks ago, I was asked during the Q1 call whether the tripling of capacity that we announced a year ago was going to be sufficient. And I said no. And clearly, you have the -- a more specific response to that question now. Now if you ask me if what we're doing now is going to be sufficient for the longer-term beyond 2020, I will have to say no, because the market continues to grow and the -- and we see further penetration on the horizon of electrified drivetrains and this will drive further capacity expansion. So we are trying to secure as much land as we can to enable brownfield expansions after the greenfield investment now.

Operator

Our next question comes from Henry Sanderson from Financial Times.

Henry Sanderson

I just wanted to follow up on the ethical sourcing. I just wondered how long do you think this advantage will continue given that it seems a lot of the market is trying to clean up and demonstrate where their cobalt particularly comes from? And secondly, are you seeing any impact of the higher cobalt price in terms of customers reducing the amount of cobalt in the cathode? I'd just be interested on that.

Marc Grynberg - *Umicore S.A. - CEO and Executive Director*

Well, let me start with your second question. It is not so easy to actually reduce the amount of cobalt because once a platform is qualified with a certain technology and chemistry, that design is frozen for a while and you cannot change it overnight to another chemistry that would consume less of one metal and more of another. So you don't see immediate substitution, but clearly, this may stimulate the carmakers to think about other chemistries when they develop future platforms, indeed. Now this being said, substitution of metals has never solved the issue of the rapid scarcity, it's just moving the problem from one metal to the other. So I'm not so concerned about that but clearly, I think it's important for us to be able to offer a wide variety of chemistries to our customer base. And we do, indeed, have a broad portfolio of technologies. Then when it comes to the ethical sourcing of cobalt, I think we have a definite competitive advantage from having started this widespread effort of sourcing cobalt in an ethical and sustainable manner actually more than 12 years ago. And so we have accumulated and now are in a position and developed a position in that respect, which is there as a significant advantage. Even though other people are now indeed, as you indicated, to clean up their own supply chain, it would take time for them to get there. The other significant advantage that we have in that respect is that we're one of the very few players to have recycling capabilities for cobalt and to be able to offer a closed loop business to our customers, and this has also proven to be a significant selling point.

Operator

(Operator Instructions) We have no further questions at this time. Mr. Grynberg, we'll pass back to you for any closing remarks. Thank you.

Marc Grynberg - *Umicore S.A. - CEO and Executive Director*

Thank you. And I think we have covered the subject pretty well. Thanks to your question, which I've addressed, I believe in a very meaningful manner, all the aspects and implications of the investment program we're announcing today. And this being said, please feel free to reach out to our Investor Relations team should you have follow-on questions after this call. And with this, I would like to now close the call and thank you, again, for your participation. Bye now.

Operator

Thank you. Ladies and gentlemen, that will conclude today's conference call. Thank you for your participation. You may now disconnect.