Saudi Arabian Mining Company (TASI: MAADEN) Q1 2018 Earnings Conference Call May 03, 2018 4:30 PM KSA Time

Corporate Participants

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Ali Asghar	*Saudi Fransi Capital*
Anirudh Patwari	*Goldman Sachs*
Ankit Kumar	*SG Analytics*
Anoop Fernandes	*SICO*
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Sashanka Lanka	*Bank of America Merrill Lynch*
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Presentation

Operator
Ladies and gentlemen, welcome to Ma'aden First Quarter 2018 Results conference call and webcast. I will now hand over to your host, Mrs Reem Asaad, Manager of Investor Relations. Madame, please go ahead.

Reem Asaad
Good afternoon ladies and gentlemen, and welcome to Ma'aden's First Quarter 2018 earnings conference call to discuss the company's results and performance.

[Introductions]

The format of the call will be usual where management will brief you on the results through a presentation, and then we will answer your questions after our prepared remarks. The presentation slides being used today will be available on the Investor Relations section of our corporate website as soon as posting this call.

[Disclaimer]

Without further ado, I would like to turn the call over to Engineer, Khalid Al Mudaifer.

Khalid Al Mudaifer
Thank you, Reem, and thank you all for joining us on the conference call today to discuss the outcome of the first quarter of 2018. I am calling today from Ras Al-Khair where all our operations are doing very well.

On the first slide, I am very pleased to be able to share with you today these very positive results for our business in the first quarter with good news across the whole of our portfolio. Once again, we delivered production increases across each of our business units, both from growth projects and through being a better operator of our more established assets. The

largest increase was in gold as Ad Duwayhi mine continued along its growth trajectory to produce 118,000 ounces of gold this quarter, our best ever quarterly performance. The rest of our businesses also delivered smaller but important increases in production and we continue to work on finding further improvements.

Through the combination of higher production and better prices, we were able to deliver a very significant uplift in financial performance, a good indicator of the underlying strength of our business model. Sales increased 32% to over SAR 3.5 billion and we capture much of this increase in revenues and our operating income which rose 62%, to SAR 1.172 billion. We were therefore able to lift our earnings and our net income reached SAR 754 million, more than doubling from the same quarter last year.

This quarter, all of these efforts helped us deliver an industry leading EBITDA margin of around 35%. As we look forward to the rest of the year, we expect continued price volatility in our commodities, but as ever, we believe the underlying fundamentals would remain strong in all of our key commodities. Therefore, our future growth will continue to focus on those commodities we know well and which we believe have a strong future ahead. The growth will come from the development projects in the Kingdom, which we have in our pipeline, as well as from new international opportunities, which we continue to consider.

On the market, let us turn now to the markets on slide six. During the quarter, we saw mixed movement in the market prices of our commodities, although the longer-term trends in the prices all remain positive. While gold and phosphate saw slight increases, copper and aluminium saw slight decline in the first time in well over a year now, but in both cases, this follows a long period of recovery from the historic lows. The market for phosphate fertiliser held up well in Q1, which is often a weaker season for demand. As I mentioned a few moments ago, the increase in our production across all our businesses combined with our focus on cost control has delivered EBITDA of nearly SAR 2 billion, and a strong underlying EBITDA margin of 55%.

As you can see from the chart on slide seven, DAP prices fluctuated significantly last year, but started off 2018 in a positive direction, increasing by 5% in Q1. Seasonal demand was strong in the key markets of Australia, East Africa, U.S. and China, which offset weaker demand in Latin America. India, the increase in state subsidy for phosphate fertilisers encouraged Indian buyers and pre-season shipments started to increase in March and have continued into April. On the supply side, in addition to the strong Chinese demand reducing exports, the impact of plant closures also supported prices. We expect Q2 to remain strong but over the balance of the year, it is likely to add new volumes from our own Wa'ad Al Shamal and from Morocco may dampen prices.

On aluminium, the price recovery that has been evident in every quarter for the last two years slowed, as there were disappointments over the real impact of Chinese supply side

reforms. However, prices remained healthy over the quarter. As we reach the end of the quarter, we of course saw the developments in the environment for global trade with the position of tariffs on aluminium boards to the United States. Although the U.S. is not a big market for us, the knock-on effect of these moves will need to be monitored carefully as this can indirectly impact key markets like Europe and Asia. At this point, it is difficult to say what this will mean for prices this year, so whilst we believe the fundamentals are robust for aluminium prices, we expect price volatility for the medium future.

With the improved production of performance of our refinery, we resumed alumina export in Q1, prices for alumina have been strong since late Q3 2017, due to the impact of rising raw material prices and some supply side impacts. Again, political events have and could again impact the prices, but at the moment, we continue to expect 2018 to see healthy prices for alumina.

Turning finally to gold and copper, gold prices were steady rising only about 1%, but they remain at a good level and it seems that the geopolitical environment, inflation concerns and volatility in the stock markets will continue to support gold prices in the range of current levels. Copper, however, saw the first fall in prices in over a year, although this was after a very healthy recovery in 2017. Weaker Chinese demand contributed to this, as did higher inventories, but we think the medium-term outlook for copper remains very strong. Demand continued to grow, and the outlook for supply growth looks likely to be constrained, which will tend to push prices up over the coming few years.

I will now hand over to Darren who will take you through a more detailed look at the results. Thank you.

Darren Davis

Thank you, Khalid. Good afternoon everyone, thanks for joining us late on this Thursday afternoon. I will start off briefly on slide 11. As Engineer Khalid mentioned, the EBITDA margin for the consolidated group was very strong, 55%, which compares extremely well to other diversified miners. I think the important thing is that across the group we see great margins, it is not just one of the businesses doing well. Gold continues to grow, so the share of our EBITDA, it is almost 20% of EBITDA, that will obviously change over time, particularly as we ramp up MWSPC during this year and once it turns commercial, but we're very pleased to see the gold business becoming a more significant portion of our portfolio and making us more diversified in terms of our exposure to commodity prices. Aluminium of course will grow in terms of revenues during the year, obviously, the margins are looking good, at the moment. As Engineer Khalid mentioned, there is a lot of volatility in the market. Of course, one important asset in the aluminium chain that is not yet commercial is the rolling mill, that is a lower margin business than the rest of the business; the refinery and the smelter, so

that will depress margins somewhat when that comes into commercial operation probably later this year.

We turn now to the net income bridges, let's spend a little bit of time here, I think they tell a good story. On slide 12, if we look at the first quarter '18 against the first quarter '17, clearly the production growth is an important element of the improvement in performance, almost SAR 300 million contribution from just growth in production. I think it is interesting to look at the price effect and the cost effect. I think that tells you some important things, so the prices are rising, but some of the price rises we're seeing in our markets are being pushed by costs, so we don't get the full benefit of price rises, we do have higher costs as well, particularly in the alumina side where caustic soda has continued to increase in price, in fact a very substantial price increase over the year. Sulphur has also increased a lot in the first quarter, and in MPC, the price of gas is now at the 1.25 per million BTU level, where a year ago, it was at 75c.

You can see roughly half of the benefit from the price effects was actually offset by increasing raw material costs. Depreciation was slightly higher mainly because of the gold production, we do a unit production depreciation method, so as production increases, naturally depreciation goes up.

Finally, the [cap] costs in others was higher, that is obviously an impact coming from our improved profitability. Overall, more than doubled our net income year-on-year.

If we look on the quarter-on-quarter versus the last quarter of '17 on slide 13, I think we see actually some quite similar messages in some ways. On the volume side, we see the same momentum in terms of increasing volume, so that is still a big contributor to our performance. Gold is a big portion of that. We have seen probably most of the gold increase production quarterly, so it will probably be more stable during the rest of the year, but every business is showing a positive impact on production there. Again, if you look at the price and the cost effects, although prices were largely better in Q1 versus Q4, we did, again, see some of the impacts of the costs of raw materials offsetting that, particularly again caustic soda, which again rose in Q1 versus Q4, sulphur, a very substantial increase from Q4 and the cost of pitch in the aluminium business. There was, as well, an offsetting factor, you may recall that we had an adjustment for power of around SAR 80 million in Q4, which obviously wasn't repeated, so that amplified this effect. If you remove that, the cost effect would have been about 100 million versus the positive 154 from prior, so stripping out that one-off event, actually, we still would have been better from a margin point of view in Q1.

The inventory change really came from the phosphate business, particularly where we increased our ammonia inventory ahead of a short shutdown in Q2 in the ammonia production MPC, and also there was a delayed shipment at the end of the quarter due to bad weather in Ras Al-Khair, so these are one-off items. Two other items, of course, the

impairment that we took in Q4 '17 on the rolling business is not repeated and there was the one-off cost of refinancing the aluminium debt, which I will come onto later, it was obviously a positive, but had a negative impact in Q4. Still, overall, a big turnaround from Q4, and a very healthy profit in Q1.

Looking at the businesses briefly one by one, we will go to slide 15. You have already heard the positive production story across the business. Phosphate was no exception. Sales prices also improved, although ammonia was broadly stable quarter-on-quarter, with a big improvement from a year ago. Ammonia sales are dropping, this is to be expected. As we ramp-up the Wa'ad Al Shamal DAP production, of course, we consume more ammonia, so we are now heading closer towards a more stable state of where we sell much less ammonia, and as we will, as we commercialise , obviously, recognise the sales of DAP and MAP from MWSPC later in the year. Although we kept a control on costs, the impact of sulphur was significant. The sulphur price increased around 85% from the fourth quarter to the first quarter of '18, and that is our single biggest component of cost in the production of DAP.

Moving now to slide 16 and aluminium, the smelter continues to gradually edge up production, very stable operation, but we're still working on squeezing a little bit more material out of the smelter. We're very pleased with the operations down there. External sales were lower and this is a side effect of the increased sales of the rolling company. The rolling company continues to ramp up sales very effectively through good marketing into new markets, but that does consume more production from the aluminium smelter at the moment. The refinery is operating very well. It is currently above nameplate capacity, so we're looking forward to a good year for the refinery and we have now resumed the exports of alumina in Q1, and we expect to continue to do that during the rest of the year. As I mentioned, on the cost side, it is concerning the pitch and coke prices on the aluminium, and caustic soda on the alumina have risen substantially over the year and have continued to rise, certainly pitch and caustic soda quarter-on-quarter as well, so we need to keep an eye on that. Generally, though, those raw material costs are pushing up prices, so we seek compensation there.

Finally, on gold and copper, the gold story obviously is very positive year-on-year as Duwayhi is ramped up. Production was particularly high in Q1, as we are currently in a high-grade zone in that mine. We would see levelling off of production for the rest of the year, but still, obviously, we're on track for a record year of production in the gold business. Jabal Sayed is also reaching its steady state production and doing extremely well, very pleased with that business, although the copper price did come off slightly in Q1 versus the last quarter, of course, we're still healthily above the lows that we saw in 2015 and 2016. Both businesses, importantly are dropping their costs, mainly driven by the effect of volume production, so unit costs are coming down, but obviously with healthy prices, if we can keep that pressure on costs, it is very positive for the bottom line.

Looking briefly at slide 19 on the financial position, I think this is a story you're used to. We still have a large portion of our assets in work in progress, that is the Wa'ad Al Shamal plant excluding ammonia, and the rolling mill. We expect those to be commercial during the course of this year, both are ramping up well.

I will touch on debt maybe on the following slide, rather than on this slide, so if we just look at slide 20. The net debt to EBITDA ratio, which is a good indication of the direction we're heading in terms of our leverage position, we have come down from a high of almost 13 in 2016 down to around 6 times. It is still high for the industry, we would like to see that down below 4, but we're heading in the right direction as profitability comes back and we enjoy the upswing in prices. On the other hand, we're still reconfiguring our debt as much as possible. You will recall the successful refinancing of the smelter last year. In Q1, we issued our first Sukuk issuance, which went extremely well. We're very pleased with that issuance, that was for the MPC project, and we have other refinancings coming up during this year, which we think will continue to deliver benefits for us. Interestingly enough, if you look at our financing costs year-on-year, we're actually roughly flat, even though debt was the same and despite LIBOR and CIBOR rising by about 100 basis points. That is mainly because of the refinancing benefits we have seen by reducing our margins through each of the refinancings. We will continue to explore these. In the meantime we are very comfortable in terms of liquidity, so we're well positioned for our new growth to over SAR 6 billion of cash and our revolver, which we renewed in December, 7.5 billion remains undrawn.

Let me just wrap up on slide 21, the message I think we keep saying and hopefully you now believe us that our long-term fundamentals of our core products really are very promising. We really believe in these products and we're starting to see as we move out of the cycle, or the down parts of the cycle, we see the benefits of not only being in the right products, but having the right business model with a fully integrated value chain, particularly in the phosphate and the aluminium business.

We're seeing sustained recovery in prices. I wouldn't call this a boom time, but we're certainly glad to be out of the down cycle. We see volatility for the rest of the year, but overall we see the trends being positive. Production continues to grow. The future increases in production are likely to be more incremental, but they're valuable nonetheless and we continue to look for opportunities to do that in all of our businesses.

Raw material costs are a cause for concern, but that's another reason why production increases are so important. If we can keep our unit costs down, we can absorb and mitigate at least a portion of those raw material costs. As I mentioned, those raw material costs also push up prices, so we do of course benefit on that side.

Finally, the increased cash flow we have allows us to look at options of improving our capital structure, certainly continuing to address our debt position either through reconfiguring the

debt and continuing to reduce the debt, while at the same time having enough capital available to pursue the growth projects we heard about earlier, both in the Kingdom and as we start to look at internationally where we see opportunities to boost our existing product lines.

With that, we will hand over to Q&A.

Question and Answer Session

Operator
Our first question comes from Sashanka Lanka, Bank of America Merrill Lynch. Please go ahead.

Sashanka Lanka
I have two questions. The first question is your costs, especially on the selling, marketing and logistic expenses, decreased significantly quarter-on-quarter and your margins for this quarter were pretty good; I think on a quarterly basis they are the best in about three to four years. So my question is how sustainable are these margins and also why have we seen such a big fall in costs quarter-on-quarter despite volumes up? My second question is in terms of your aluminium power cash cost realisations, have you started realising the new cash costs, which you were supposed to realise in Q3 last year?

Darren Davis
Thanks, Sashanka. I think as we mentioned in the call last quarter, also the year-end, the selling and marketing costs were a little higher than normal in Q4 due to some one-off effect. I think we're closer to a more normalised level. The thing is about the marketing costs is there are adjustments in there as well, because we sell on an estimated price and there are adjustments as the actual prices come through, so I think you need to look at the trend overall, but as you'd expect, marketing fees will increase as prices go up and the expenses of shipping products of course go up as we increase our volumes as well. Margins, yes, I mean, they did increase quite substantially from Q4 to Q1. If you look at the bridge, there are some impacts which are one-off. There's the power costs that you mentioned in MA, so that is a one-off that won't be repeated. But also, the inventory change had an impact as well, which is a one-off, or two one-offs I should say, one there was a delayed shipment from MPC and there was also some increase in inventory of ammonia quite substantially by the end of the quarter, as I said, ahead of a planned shutdown in April at MPC.

Sorry, I didn't quite catch the last question.

Sashanka Lanka
So, my second question was on your aluminium power cash costs. I understand you're being charged $11/MWh and there was supposed to be an increase on accounting to $17/MWh, which was reversed in Q4 last year, so I just want to understand, in Q1 this year what are your aluminium power cash costs.

Darren Davis
Q1 was back to $11. We're currently in discussions with [SWIG], who manage the power plant, and we expect it's likely sometime in this quarter we will switch to the higher power cost, but it's not finalised yet.

Operator
Our next question comes from Asim Bukhtiar, Saudi Fransi Capital. Please go ahead.

Asim Bukhtiar
My question is just on the Wa'ad Al Shamal phosphate fertilizer, so I see that you're selling ammonia from Wa'ad Al Shamal, when do you expect to start selling phosphate fertiliser from WAS?

Darren Davis
So we are actually producing and selling fertiliser at the moment, but it's in the pre-commercial period, so I guess you're referring to when will we see it in the income statement. As we said, our target is to reach production capacity by the end of the year. We still think that's achievable. Between then and now we will reach a level which we think is sustainable and justifies the declaration of commercial production. We haven't decided when that will be yet, but we wouldn't expect it to be too far in the future. Probably not this quarter.

Asim Bukhtiar
Does that mean volumes sold will double by the end of the year? Is that a fair assumption or is that going to take longer?

Darren Davis
No, so the target would be to reach full production by the end of the year – full production, not a run rate, but there's obviously a curve when we go up during the year, so we're well on the way to doing that, but I think we're not releasing exactly the volumes at the moment. We will do once it goes commercial.

Operator
Our next question comes from Saul Rans, Morgan Stanley. Please go ahead.

Saul Rans
Two questions from me on the gold business, if I may. You've had a very nice increase in your gold sales volume in the last couple of quarters driven by the Ad Duwayhi ramp up and I think if my understanding is correct, Ad Duwayhi is probably producing at the moment at a level which is significantly above the average run rate over the life of the mind, so can you just tell us how long you think Ad Duwayhi will continue to product at that sort of elevated level before the output level normalises? Secondly, regarding your older mines actually in gold, I believe a number of the older mines are possibly coming towards the end of their economic life. When do you think that some of those or more of those older mines may reach the end of its economic life, if we assume current gold prices? Thank you.

Khalid Al Mudaifer
For Ad Duwayhi, you are almost right, we are at a high grade… we are running as per the mining plan of course, so this year and next year will be the highest two years of the mine based on the current mining plan. However, we are improving and working on the mine and we still have reserves to continuously keep the level at this level until [inaudible] comes. The second question is what, sorry?

Saul Rans
So, I think that some of your older gold mines are possibly coming towards the end of their economic life and so my question was do you see it in the next year or two, the possibility that one or more of those older mines closes down as it runs out of commercially exploitable gold?

Khalid Al Mudaifer
Yes, thank you. At a gold price above 1,100 we will continue producing for the coming two or three years from our existing mines. However, if the prices went below that level, we

would of course as usual review our profitability and economic benefits of each mine, but at above 1,100 we have…the reserve is still there.

Operator
Our next question comes from [inaudible]. Please go ahead.

Question
I wanted to ask that if you switch to the higher electricity cost for the aluminium, how much would be the impact for quarter b?

Darren Davis
So if you remember from Q4, I think the impact was around SAR 80 million.

Question
So SAR 80 million [audio] costs.

Darren Davis
That's right.

Question
And you mentioned as compared to fourth quarter 2017 to first quarter 2018 when the inventory changed, can you please explain what that is exactly?

Darren Davis
So there's two elements. One was in the Ma'aden Phosphate Company, we have a planned shutdown in April for the ammonia plant, so to ensure that we have sufficient ammonia to keep running the DAP plant at MPC, we have effectively filled our inventory or our storage capacity of ammonia, so that plant can continue, so the storage is full in MPC. The second element was that we had a shipment, a large shipment, due at the end of quarter one of DAP, but due to bad weather in Ras Al-Khair we could not load the ship, so that slipped into Q2, the shipment, so therefore it was an inventory.

Operator

Our next question comes from Anoop Fernandes, SICO. Please go ahead.

Anoop Fernandes
I have two questions. The first is on the aluminium EBITDA margin. There has been a very strong sequential growth and we saw a similar trend last year as well, where margins were some 61%, so what is it that drives the sequential growth? Is it a decline in marketing expenses or is it that this is a shorter month and we possibly sell excess power to the grid, which sort of adds some revenue?

Darren Davis
We don't sell any excess power into the grid, Anoop. I mean, essentially what you're seeing is just the impact of prices. Aluminium has recovered substantially over the last 18 months…

Anoop Fernandes
No, but Darren it's quarter-on-quarter. If I look at it, there was a small decline… yes, a small decline in your volumes as well if I look at external sales volumes, even though there is a small uptick in price, there is also a decline in volumes, so net-net I am not looking at a unique growth in revenue, but the margin is up quite a bit, so I was wondering if it was any decline in any expense, marketing expense, which is usually booked in the fourth quarter and maybe not in the first.

Darren Davis
No, there is no particular drop in expenses quarter-on-quarter. They're fairly stable.

Anoop Fernandes
My second question is regarding the Wa'ad Al Shamal CapEx. How much of the CapEx is still pending and how does this change the debt profile? The debt at the end of FY17 stood at SAR 18 billion. Is this the peak debt that we should assume for this unit?

Darren Davis
So we don't expect to draw any further debt. Practically all the CapEx has been spent now, so there is no further CapEx on Wa'ad Al Shamal, so no we wouldn't. We don't expect to increase the debt in Wa'ad Al Shamal.

Operator
Our next question comes from Adnan Farooq, Jadwa. Please go ahead.

Adnan Farooq
I just have one follow-up question. This is Adnan from Jadwa. You mentioned that the debt restructuring had a positive impact. You were able to secure a lower margin for your debt. Do you have a sense of how much cost savings you do achieve through these debt restructurings in the past 6-12 months?

Darren Davis
I can't say I have the exact number to hand, Adnan. I think just directionally if you look at the finance costs of Q1 ’17 versus Q1 ’18, they're essentially flat even though the debt was roughly the same, but LIBOR increased by about 100 basis points, so that gives you a sense of what's been seen, hopefully.

Operator
Our next question comes from Ali Asghar, Saudi Fransi Capital. Please go ahead.

Ali Asghar
I have one question regarding the aluminium sales. I think in that quarter ending March ’18 you guys have reported the sales as external sales, right? Previously if I am correct these sales were total sales including the ones that were supplied to the rolling mill, so again for this purpose, do you have some kind of volume guidance for the rolling mill that is being supplied right now?

Darren Davis
So we don’t have it in the pack. It’s a bit of a difficult question to answer. There are two factors. I mean, one, MRC is ramping up, so it is consuming more [audio] and that is being largely supplied by the smelter. The other factor is the intention is to use as much recycled material as possible in running the rolling mill rather than primary aluminium from the smelter, and we’re in the process of ramping up what's called a Can Reclamation Unit, so this takes used beverage cans, re-melts them, and also scrap as well and then we can turn those into beverage sheets to customers, so it’s a little bit influx at the moment, which is one of the reasons why it’s not commercial, is we’re sort of stabilising that operation, so the intention would be to obviously minimise the amount of primary metal that goes from the smelter to the rolling company over time.

Ali Asghar
Just a follow-up question, so would it be fair to say that whatever the difference between aluminium production and the selling, the primary aluminium selling, that would be kind of the run rate for the consumption by the rolling mill over the last four quarters?

Darren Davis
Tell me which slide you're looking at. So that's slide 16.

Ali Asghar
Yes, I presume. Yes, slide 16.

Darren Davis
Yes, that’s not a bad approximation actually. The difference is close.

[No further questions]

Khalid Al Mudaifer
Yes, again, thank you very much for your interest in Ma’aden and keeping up with analysis, you have been producing great reports and great questions also, and we learn from them every day, so keep it up and thank you very much.