Corporate Participants

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Conference Call Participants

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Presentation

Operator
Ladies and gentlemen, welcome to Ma'aden's Yearend 2018 Earnings Results conference call. I will now hand over to Miss Reem Asaad, Head of Investor Relations. Ma'am, please go ahead.

Reem Asaad
Good afternoon ladies and gentlemen, thank you for attending. Today, we have Ma'aden's end of year 2018 earnings conference call. We are going to be discussing the company's results and performance.

[Introductions and disclaimer]

Without further ado, I would like to turn it to Mr Davis.

Darren Davis
Good afternoon everyone, thanks for joining us. It is a pleasure to be here sharing what has been a record year for Ma'aden in 2018, record on a number of fronts not just financial. We're very pleased to see our production continue to grow not only from new projects but from enhancing the performance of our existing core business and I think that is one of the underlying messages here that our core business is extremely efficient and continues to improve its operational performance.

In terms of financials, they speak for themselves, our highest ever net profit, our highest ever revenues, our highest ever EBITDA, almost $2 billion equivalent of EBITDA in 2018. A lot of drivers behind this is prices, but as I mentioned, the production is also an important part of the growth in 2018.

The pricing environment was supportive in 2018, but we did not have a year of very high prices. I think it is important to remember that. It certainly was an improvement on 2016

and, to a certain extent, 2017, but we are still not in a market where commodity prices are particularly high. However, it does highlight Ma'aden's leverage to the commodity prices with the modest gains we saw in 2018 translated to a very substantial increase in financial performance.

The outlook as we go into 2019, though, and I will come back to this maybe in more detail as we go through the slides, is uncertain. We're all aware of the uncertainty in terms of the economic outlook globally, growth seems to be faltering in a number of key markets and, certainly, some of our commodities, particularly aluminium and copper are particularly vulnerable to slowdowns in economic activity.

Having said that, we're still looking towards growth, we have a number of opportunities in the pipeline which we think are attractive, but with the economic outlook as it is, we will be extra cautious as we make those investment decisions in the coming year.

On slide six, this just gives you an overview, and I think the message for 2018, although the averages were higher than 2017, we saw a relatively stable Q1 and then we saw enormous volatility in some of our commodities as we went into Q2 onwards, and then really a slowdown was becoming more pronounced in Q4. We had two stable quarters, if you like, Q1 and Q4, but the middle of the year was very volatile, alumina in particular. I will come back to that in the coming slides.

Turning first to the phosphate market, prices held up well in 2018, they were above our expectation. We felt it was going to be a weaker year, but we saw good supply side numbers where the ramp-up of a lot of facilities including our own and also those in Morocco was slightly lower than people had expected in their forecasts, but more important, demand held up very well. We saw particularly good demand in India, our other markets also showed a strong performance. That combination of good demand and limited supply growth meant we saw a strong market throughout the year. We did see some weakening at the end of the year, but that is fairly normal, it is a seasonal effect and this year, so far, the weakening has not gone beyond where we would expect it to at this time of the year.

The ammonia market, as usual, fairly volatile, but overall the year was above 2017, as a relatively large increase in supply in Q3. We did see some weakening as a result of that, particularly in Q4 where demand also was a little weaker than earlier in the year.

Aluminium was particularly volatile, particularly around alumina. Aluminium itself, the price was higher over the year, but as you will all be aware, although prices were higher, particularly in the first half of the year, the second half saw a steady decline in aluminium prices in terms of LME. What we're seeing there, we think, is really an expectation being built into LME prices because of the uncertainty around the economic outlook. We don't

think the fundamentals have really changed in aluminium. We see more discipline in China and we continue to see that in 2018, and the demand side still remains very healthy for aluminium, so although we saw weakness as you have seen in the last few weeks, even, we have seen aluminium start to push back up again.

Of course, trade tensions, particularly are of concern in aluminium and those have yet to be resolved. Those combined with the economic outlook does mean we have an uncertain look forward into 2019. Alumina, of course, enjoyed a very roll coaster ride, particularly in Q2 and Q3 off the back of sanctions first potentially against RUSAL, and then of course the shutdown in Brazil, which is still not fully back on stream. Although the market has held up and started to see some weakness in Q4, alumina prices remain elevated. Of course, with our business model of being fully integrated from rock through alumina to aluminium, this has actually been an enormous benefit to Ma'aden in 2018.

Turning to gold and copper. Gold had a weak Q2 and Q3 where we saw the flipside of the economic turmoil being that gold started to strengthen again in Q4 and continues to into the beginning of 2019, with the gold business growing to be a substantial business now, and we will come to the production numbers shortly. Our exposure to gold is somewhat of a hedge against economic downturns globally.

Copper, unfortunately, did not keep its gains in 2017, so 2018 started off well but weakened during the year, again, off of concerns over the economic outlook. Both aluminium and copper are particularly vulnerable to economic conditions and closely track GDP growth. Again, as with aluminium, the copper fundamentals remain strong. We still think it is a great metal to be in, and we think over the medium to long-term, it will be a good metal to have exposure to.

Turning to slide 10, just looking at the last four quarters, it is the story of the year, really, started off very strongly in Q1 on pricing, and although we maintained our good performance on production through the year, the prices did drive down EBITDA and our margins and, again, this just really underlines our leverage to the commodity prices. When you see even modestly strong prices as we did in Q1, you see a big impact on EBITDA, but as those prices came off during the year, we did see a weakening in margins. Notwithstanding that, 44% EBITDA margin remains very strong for a commodity company, particularly in a quarter that was relatively weak as we saw in Q4.

With that, I will hand over to Ali.

Ali Al-Qahtani
Moving to slide number 13, which shows the composition of our business, which shows the consolidated sales and EBITDA. As Darren mentioned, this year, it is a good year

comparing to the previous year and it is the highest year in terms of EBITDA and net profit. It shows the composition of our business, that phosphate contributes 42% in group EBITDA and also aluminium 44 and gold is 14%. We see the margin of all our EBITDA margin, it is higher than last year. It shows in the gold it is lower, mainly due to the decrease in prices of the gold in 2018.

Moving to slide number 14, which shows more detail about bridging our net profit comparing to the previous year, which shows the price is the major impact [inaudible] SAR 4 billion and also the volume. The increase in the cost effect, most of the inputs, it has increased and has an impact on our cost. It shows about SAR 357 million in 2018. Also, Q4 2018 we declare commercial operation of Ma'aden Wa'ad Al Shamal remaining facilities and Rolling Mill Company, which has an impact on the depreciation and amortisation of one-month and also has an impact in the fixed cost as these plants are still in the ramping up and did not reach the nameplate capacity.

We see also the major impact also here, it is an impairment, it is a positive SAR 569 million, and previous year we have investment joint venture company with Sahara, and in 2016, we impaired all the investments and this year we recovered that impairment due to the improvement of SAMAPCO profitability and this year, this company generates 100 million net profit and that [inaudible] coming this quarter.

At the same time, we had an impairment about $100 million in the auto sheet business. Ma'aden's share of that is SAR 281 million. That has an impact in this year. This ends up this year growth of our profit from SAR 784 million to 2.2 billion.

Moving to slide number 15, it shows the comparative year-to-year 2017/2018 income statement. We have gone through all the examination of this one.

Moving from this to the operational performance and as Darren mention, this year we have a good improvement in our existing facility and also ramping up of other facilities. In the phosphate business, we see Q4, it is comparing to the production it is higher than Q3 of 856,000 tons comparing to 770 and also the sales is increasing. Also, the ammonia production, it is increasing comparing to the previous quarter and sales as well.

Next slide, number 18, it is the aluminium performance, we see also the production of Q4 of the primary aluminium, it is 228,000 comparing to 136. Also, the sales is improving comparing to Q4.

Alumina production, it is in the same level of the third quarter and external sales, it is in the same level as well.

For the gold and copper performance, our gold production in Q4, it is 96,000 ounces comparing to 98 in the third quarter in the same level and also the sales at the same level, we see the prices also it is in the same level of Q3. Our copper business, we have a joint venture with Barrick, 50% owned company. The production is 7,000 tons of copper, it is the same level as Q3 2018.

Moving to slide 21, the financial performance. This shows our balance sheet versus assets and liabilities and long-term borrowing, showing that comparing to the type of loan in the lower slide of the presentation.

Slide number 22, cash and long-term borrowings. We show that debt to capital ratio, it is decreasing comparing to 2017 comparing to 61%. Also, the long-term borrowing, it is increasing comparing to 2017. Mainly we have signed and get withdrawal of SIDF loan for Wa'ad Al Shamal in November 2018, about SAR 2.2 billion.

The last slide, 23, we show it maybe every quarter the schedule of the repayments and the curve maybe it reaches the highest in 2025 and it goes down directionally to 2031.

That is it, and if you have any questions.

Darren Davis
Just to summarise, let me just finish the summary. A good production performance for the year across our core portfolio. Most of our plants are operating above their nameplate. We are still ramping up to their full capacity both the rolling company and Ma'aden Wa'ad Al Shamal, but those are moving ahead very well and that is why we are declared commercial production in 2018. Commodity fundamentals remain good across all of our business, we're very pleased to be in the markets we are, but in the short-term, there is vulnerability, particularly in the aluminium and the copper if economic conditions deteriorate any further. To a certain degree, we have a hedge, the phosphate business is much less influenced by economic growth, and of course, gold tends to be countercyclical.

We do have headwinds in 2019, you will have seen in the bridge that the impact of depreciation and financial charges, particularly from Wa'ad Al Shamal as a very large investment will have an impact on earnings in 2019, so we will be working hard to make sure that facility produces the maximum possible capacity during the year. We have the uncertainty of commodity prices, as well, of course.

On the other hand, there has been some relief on some raw material costs, particularly in the aluminium business, a little less so in phosphate where sulphur remains at an elevated level.

As I mentioned, we still have a number of areas we can grow in each of our businesses. We see good opportunities in gold, in aluminium and in phosphate. Phosphate, of course, we already began the construction of the third ammonia plant last year and this year, we will be looking at the next phase of the Phosphate 3 expansion. We continue to look at opportunities in gold and in aluminium as well, but with the outlook being uncertain, we will have to remain very disciplined. We have the cash on hand to withstand any further downturn and still invest, and it is often a good rule of thumb to invest on the downturn if you possibly can, and we would like to retain that ability where we see an opportunity for long-term value for the company.

With that, we will be pleased to take any questions.

Question and Answer Session

Operator
[Operator instructions]

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

Anoop Fernandes
My questions are on the accounting side of the aluminium business. Would it be possible to shed some light on how the accounting of this inter-segment transfer is done from the smelter to Ma'aden Rolling Company? Is the primary metal transfer accounted at cost or is it at LME prices or is there some other mechanism.

If you could also give us a sense of where the recycling business is accounted, is it under MSE or MRC?

The second part is depreciation seems to be unchanged quarter-on-quarter in the aluminium business, is this because MRC depreciation and interest expenses were being booked in the past as well, because I remember, I think a year ago or maybe late 2017 you had mentioned that MRC interest and depreciation expenses were being booked but EBITDA, revenue and operating costs weren't, so has that practice continued.

Secondly, there seems to be SAR 1.4 billion CWIP in the aluminium business, is there anything that remains to be commercialised towards that. Thank you.

Darren Davis

Some of those are simple, so even as a non-accountant I can answer some of those. The transfer pricing is just made at LME plus various additions, so it is basically at an arm's length basis between the smelter and the rolling company. The can recycling is within the Ma'aden Rolling Company, and that is how it is accounted for there.

I think the third item was about the depreciation of the rolling company. The MRC was slightly different to Wa'ad Al Shamal and we've been recognising the finance cost of the Rolling Company for some time, since we first impaired it two years ago, but in terms of depreciating the book value of the asset, that only began in December 2018.

Ali Al-Qahtani
One month impact it's SAR [50] million depreciation of MRC.

Anoop Fernandes
Okay, thank you, yes, 30 million.

Darren Davis
What was your final question, Anoop?

Anoop Fernandes
It was on the SAR 1.4 billion in CWIP under the aluminium business. I'm just wondering if there's anything that's left to be commercialised there.

Darren Davis
Yes, it's just the automotive sheet.

Anoop Fernandes
Just a follow-up on the first part, Darren. I'm looking at the segmental disclosure and there seems to be a 305 million loss under MRC, but I would assume that also includes 280 million under impairment from the auto sheets. So net-net if I consider the fact that MRC is essentially a fully debt funded balance sheet, and I add these things back, the EBITDA seems to be pretty decent and so is the EBITDA per ton, so from a target point of view are we somewhere close to the target in terms of where our EBITDA per ton is, and if there is some improvement expected what are the factors that could drive incremental EBITDA per ton from here?

Darren Davis
Yes, I think you're right that the aluminium has improved, but I think there's a few things moving in aluminium you need to think of. So the write-down of course within aluminium, but also the reversal of the impairment on SAMAPCO was on there as well, because that's where we account for SAMAPCO in the segmental reporting, so actually at the moment…

Anoop Fernandes
Sorry, just to clarify this is not the aluminium segment entirely. In one of the pages of your disclosure you've broken this down by segment, by the business, by [MAC] the Ma'aden bauxite and alumina, so under that when I look at the MRC section when the revenues have been mentioned and then it flows with the net loss of 305 million, so that I would assume includes the impairment as well. So adjusted for that the net loss is some SAR 20 million, so if I add back the things like depreciation of interest…

Darren Davis
Yes, that's where it gets a bit confusing. So the automotive sheet asset is not in MRC at the moment for various reasons. It was developed later, so when you look at those MRC numbers that is just MRC, that section you're looking at, so as you will then conclude is that the MRC is not very profitable at the moment. It's not fully ramped up. As you saw, the run rate in December 2018 was around 20,000 tons of product, which is a run rate of about 240,000 tons. We will want to be significantly above that in 2019 and going forward. It's a real volume business. Until you really hit around 300,000 tons plus you don't really see the full benefit of owning that company.

Anoop Fernandes
Just a follow-up before I join the queue again. Now, I would assume that the biggest cost component for MRC would be the primary metal. What would be the two other big cost components in this business?

Darren Davis
Yes, I mean, it's really, LME is a pass-through as you fully realise, so we don't look at that in the cost structure, if you like. It's really a conversion business. The margins typically in that sector are very thin and typically in single digits EBITDA level, so really the main costs are all fixed. That's the issue with it, so labour would be one, probably energy would be another one.

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

Asim Bakhtiar
Just a couple of questions from my side. Regarding ammonia, I noticed that in terms of volume sales through the first nine months they were down 26%, so I was expecting that in the final quarter a ramp up, a significant jump in volume sales in phosphate, but that didn't really happen, so I'm just wondering are you stockpiling, is there something else happening, because I was assuming that conversion would pick up and there would be higher phosphate sales.

Darren Davis
There's always variability quarter-on-quarter with shutdowns and shipments, but I think the other thing is in Q4 we did run Wa'ad Al Shamal particularly in October/November with a relatively low production rate, as we were doing some work on some of the phosphate part of the value chain, so that's why we consumed less ammonia in that quarter internally.

Asim Bakhtiar
Going forward, what's the sales mix that you expect? Are you expecting to convert all of ammonia to phosphate or are you going to continue to look at the market and sell ammonia depending on pricing and demand?

Darren Davis
So we won't convert all of the ammonia into DAP, but if you look at the MPC production of or sales of ammonia, it's about 500,000 tons from MPC for ammonia. So if you assume 500,000 from each of the ammonia, when you're running DAP at full production you're assuming roughly 500,000 each from the ammonia would be sold.

Asim Bakhtiar
And that should continue once Wa'ad Al Shamal reaches steady state.

Darren Davis
That would be a steady state, so that won't be immediately, but a steady state.

Asim Bakhtiar
The other question I had is just regarding the national industrial development programme. I noticed Ma'aden is featured quite prominently in that. I'm just wondering if you can provide some details maybe on the timeframe, what's your expectation, are there any financial commitments from Ma'aden for this programme? How do you see the company benefiting? I mean, I'm just trying to understand the opportunity here and when we can start factoring some of this impact into our numbers.

Darren Davis
Yes, so the national development programme, as you know, is really a major programme from the Government and we're pretty excited to be part of that. If you look at our particular areas, it's really around the phosphate and the aluminium where we think there are good opportunities. It's still early to say exactly what our role will be. I mean, one part of our role would definitely be facilitating downstream businesses. We have a good position in the Kingdom to be able to supply other industries, both in Ras Al- Khair and Wa'ad Al Shamal, and the industrial cities were always set up to be based… or to allow for more downstream investment, so as a supplier of feedstock we think we're in a good position to do that. Whether or not we invest in the projects themselves, we'll see depending on the financial feasibility of those.

I think the good thing about the programme though is as much as we can build industrial parks next to our facilities, there needs to be a lot more enablers for companies to come in and make investments, because it's not just local companies; it's international companies. It's a big part of the programme is to bring international investment, so it's to make the environment a good place to invest, so it's us being a reliable supplier. It's also having finance available, having clarity on the investment policies of the Kingdom, which you'll have seen just last week. There were some more announcements on making sure the Kingdom is a good place to invest, so we're a part of the story, but the overall plan is a much, much wider strategy by the Government, which includes a lot of different agencies and Government ministries to make the Kingdom a better place to invest. If you look at the scale of it, it is huge but the plan is to implement this over a period up to 2030, so it will obviously pick up pace over the coming few years.

Asim Bakhtiar
Finally on the raw material cost, I'm just wondering if you can give me a breakdown of how much of this is sulphur and if we're trying to model this, what are the factors to look at, and phosphate production versus aluminium mix, maybe just to break down on cost of sales or the raw materials.

Darren Davis
I think probably we'd better take that one offline, Asim, because that's quite a detailed question and what we can maybe you help with is understanding the typical cost structure within each of the businesses to the extent you don't have that. Obviously, sulphur is the biggest single component on phosphate. Alumina is the biggest on aluminium, but we can help you with understanding the cost structure of the industry maybe offline with the IR team, if that's okay.

Asim Bakhtiar
All right, sounds good. Thank you so much.

Operator
Our next question comes from Zia Alnarvoq, NBK Capital. Please go ahead.

Zia Alnarvoq
Could you please give us some guidance on the full year depreciation and financial [strategy] for Wa'ad Al Shamal, and also some [inaudible] for the rolling mill, as well as if you could give us some guidance on approximately what the utilisation rates are at the rolling mill, please?

Ali Al-Qahtani
For the Wa'ad Al Shamal depreciation for the full year expected to be around SAR 1 billion. Financial charges is within the same level, it's about SAR 720 million. I mean, both financial charges and the depreciation around SAR 1.8 billion expected in 2019.

Darren Davis
On the utilisation rate of the rolling mill, so if you look in December they sold about 20,000 tons of flat rolled product. That was actually below what the production was. That's just a matter of shipping timing, so they're running at 240,000-plus run rate. It's difficult to say what exactly the design capacity of a plant like this is, if an element of it can produce more or less, but the announced capacity we said was around 380,000 tons, so it has some way to go before it reaches full capacity.

Operator

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

Adnan Farooq
I have a couple of questions. One is the full electricity tariff now reflected in the financials for the aluminium plant? The second question is what's your outlook on DAP prices given the supply and demand dynamics with the 12 months given you as well as further suppliers coming in from Morocco I think?

Darren Davis
On the electricity, no, the full costs are not yet taken. We're still debating with SWCC the commercialisation date of the farm there. So the capital element of the charges are not yet in the aluminium power price. I assume that's what you mean by power. On DAP the outlook looks like we're heading sort of stability-wise. We don't think there is awful lot of pressure downwards or upwards at the moment on prices. Q1 is always a little bit weaker, but that's just a seasonal effect, so at the moment the outlook I think for most analysts is for a fairly flat outlook on DAP prices for 2019.

Adnan Farooq
Just one follow-up, the calculated costs related to the power plant, they are around SAR 80 million a quarter. Would that be correct?

Darren Davis
It's roughly in that order, yes. It's not final yet. The discussion we're having with SWCC will finalise exactly when it comes in and exactly how much it should be.

Operator
Our next question comes from Mohamed Mubarak, Muther International Company. Please go ahead.

Mohamed Mubarak
I would like to ask about recent [depreciation], first [inaudible] factory that you have started operations last December. How much do you expect the percentage of sales to the total capacity of 3 million tons career?

Darren Davis
At the moment the plant is not running at a full capacity. We have a few technical issues we're working on to increase production there. That will take some time during the year, so we don't expect to reach or to produce the full 3 million tons this year. It's probably a bit early to start giving numbers at this point, Mohamed, to be honest, but we're hopeful. Obviously we've declared commercial operations, so it's producing at a significant portion of its design capacity, but it's not at 100% yet.

Mohamed Mubarak
Second question, how long does it take to reach uptake?

Darren Davis
It's really technically driven at the moment. We could market the product as zinc if we had the production. There's just some issues on some of the plants where we're addressing them as we speak that will help us move towards 100% production. As I said, we just need probably another month or two to see whether those remedies actually are fully effective and allow us to produce at full production, so I think sort of early in the second quarter, hopefully on the next earnings call, we'll have a better picture for you on how Wa'ad Al Shamal will perform for the rest of the year.

Mohamed Mubarak
What is the reason behind increase in profit margin of joint venture with SAMAPCO?

Darren Davis
It's actually the flipside of what you saw in the aluminium business, Mohamed. If you look at what are the challenges for the aluminium business through the cost of alumina was the increase in the caustic soda price – very rapid over the last couple of years – so of course we have a natural hedge, if you like, in that most of our caustic soda comes from SAMAPCO, so a big part of the recovery is that we think the fundamentals of the caustic soda market have changed in the last couple of years, and the outlook, therefore, for SAMAPCO is stronger, but also there are other products, the ethylene dichloride also has strengthened as well. So the fundamentals of the market that SAMAPCO sells into appear to have improved from two to three years ago, hence the decision to reverse the impairment on the investment.

[No further questions]

Darren Davis

Thank you everyone for joining us. Just to leave you again, I think it's a fantastic year for Ma'aden. We've seen the core business and what it can do when we have a reasonably benign commodity price environment. We do have some challenges in 2019. There's certainly uncertainty and, as you've just heard, from additional depreciation and finance charges from our last phosphate project, we will need to perform even better than we have last year to offset the impact of those, and that will be a drag on earnings in 2019. Having said that, we think we still have a fundamentally strong business. It's generating a lot of cash. We have a lot of good investment opportunities and the environment for investments continues to improve, we believe, in the Kingdom, so we look forward to an exciting 2019. Thanks again for joining us.