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Half Year 2019 Umicore SA Earnings Call

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CORPORATE PARTICIPANTS

Marc Grynberg Umicore SA - CEO

PRESENTATION

Operator

Thank you for standing by and welcome to Umicore Half Year 2019 results. I would like to hand the call over to our first speaker, Mr. Marc Grynberg. Thank you, please go ahead, sir.

Marc Grynberg Umicore SA - CEO

Thank you.

Good morning everyone and welcome to the presentation of Umicore's results for the first half of this year. I will cover business and market developments as well as the outlook for the full year. I will then wrap up before opening up the call to you for any questions that you might have.

Looking at the highlights, my first comment is that we have faced a challenging environment. In the second half of last year, we saw the first signs of a downturn in key industries and faltering consumer confidence with declining car sales as one of the most visible effects thereof. These negative trends have either continued in the first part of this year or, in some cases, have gotten worse. In addition, as I explained at the end of April, certain more specific market factors have affected Umicore's growth trajectory in rechargeable battery materials.

Against this backdrop, our performance in the first half proved robust. In Catalysis we have substantially outperformed the automotive market. In Recycling we have achieved a significant improvement in throughput rates in Hoboken following the last wave of investments. In Energy & Surface Technologies, the performance was below the record level of the first half of last year and we have adjusted our capital spending to adapt to short-term fluctuations in demand.

I would also like to point out that our cash flows have substantially improved and Filip will elaborate on this topic in a moment. Another highlight of the first half was the successful private debt placement of € 390 million at historically low fixed interest rates and with maturities of up to 12 years.

Despite the road bumps which affect our growth trajectory in the short term, I am convinced that the growth drivers which support our business are ever more relevant and we remain committed to our long-term growth strategy in clean mobility materials and recycling. So, while we continue to deal with agility in order to mitigate the impact of temporarily unfavorable market conditions, we are making new strides in the strategy execution. For example, we are securing a significant portion of our future cobalt needs through the ongoing acquisition of Freeport Cobalt's refinery and cathode precursor activities in Finland, and through a long-term partnership with Glencore that guarantees access to sustainable cobalt supply.

As another example, we are expanding production capacity in Europe, China and India to support the growth in Automotive Catalysts. In Rechargeable Battery Materials, we continue the construction of the greenfield production site in Poland and will soon start the commissioning of the new site in China, with an adjusted schedule for the addition of new lines due to the current slowdown. We also continue to intensify our efforts in research and development.

In terms of outlook for Catalysis, I do not see any concrete signs pointing to an immediate recovery in car sales. The factors that have caused the downturn in the automotive market since mid-2018 are still very much present and continue to undermine consumer confidence. However, I expect that Umicore will continue to perform better than the automotive market as a result of our strong market position in gasoline applications and the growing market penetration of gasoline particulate filters in Europe and China. This will be supported by capacity expansions in Poland, China and India. I also expect continued revenue growth in Precious Metals Chemistry driven by increasing demand for Umicore's homogeneous catalysts and fuel cell catalysts.

The outlook for Energy & Surface Technologies confirms the trends that I described back in April with



previous projections of 100,000 tonnes of cathode materials sales in 2019 and 175,000 tonnes capacity at the end of 2021 now more likely to be achieved with a delay of 12 to 18 months. I expect the slowdown in the growth of EVs to continue in the near term as the subsidy cuts which were announced in China at the end of March are now in full force and are likely to impact EV demand in the second half. As announced in April, we have adapted the pace of addition of new production lines in China to align with the recent developments in demand. Results in the second half will also reflect higher depreciation charges and upfront costs related to our greenfield plants in China and Poland as well as the impact of persisting low cobalt prices and the overhang of unethically sourced cobalt.

On a positive note, the demand for cathode materials used in energy storage applications may pick up in Korea in the second half following the completion in June of the safety investigation which has exonerated battery producers and their materials suppliers.

Despite the adverse market conditions, I expect overall sales volumes of cathode materials in the second half to grow both sequentially and compared to the levels of the same period last year.

In Recycling, the latest wave of investments which we carried out in Hoboken during the extended maintenance shutdown earlier this year has improved the throughput rates of the plant and, by the end of the year, we expect to achieve a throughput rate corresponding to annualized volumes significantly above the record volumes of 2018. The supply mix is expected to remain supportive in the second half too and the same goes for certain precious metal prices. Unfortunately, second half results will be dented by about € 10 million, corresponding to the impact of the fire incident which occurred in Hoboken at the beginning of July. The installations have been repaired in the meantime and the Hoboken plant is now back to normal operations.

All in all, I expect full year recurring EBIT to be in the range of 475 to 525 million euros, which is fully in line with the guidance that I provided at the end of April, as the market trends that I described at the time have effectively materialized or been confirmed in the meantime. This guidance assumes no material further deterioration in the macroeconomic context in the second half.

As I also mentioned back in April, I expect full year recurring EBIT in Energy & Surface Technologies to be well below the record level of last year and, both in Catalysis and Recycling, I expect it to grow year on year.

Let's now turn to the business review and comment on the main developments in each of the three business groups in the first half of the year starting, in alphabetical order, with Catalysis.

Global car production in the first half declined by 6.7% year on year as trade tensions and a weakening economic outlook continued to weigh on consumer confidence, directly affecting vehicle purchases. In China, car production was down 12% and the decline was exacerbated in the second quarter by the destocking of China 5 compliant vehicles ahead of the early introduction of China 6 standards in certain cities. In Europe, car production was down by more than 6% year on year with diesel, as expected, showing a larger decline of 13%. Diesel car sales in the region now represent 36% of the market. In North America, car production declined by close to 4%. The recent news flow from the automotive industry does not provide any indications of an imminent upturn in demand.

Against this backdrop of a sharp contraction of the automotive market, we achieved a strong performance in Catalysis in the first half, with revenues increasing by 1% year on year to € 717 million. Recurrent EBIT for the business group was similar to the first half of 2018 at € 87 million, while recurring EBITDA was up 3% year on year.

The Automotive Catalysts business, which currently generates about 90% of the business group revenues, benefitted from market share gains in gasoline applications and an increased market penetration of gasoline particulate filters. You will recall from the Capital Market Days presentations in June of last year that we have been highly successful in winning new gasoline platforms, in particular those requiring particulate filters in Europe and China, and this is the most significant factor which enabled us to outperform the market. We also



explained then that, over time, these market share gains would offset the negative impact on margins of the lower proportion of diesel cars in the mix and I confirm that we are gradually getting there. Also important to mention is that we recorded higher revenues in the heavy-duty diesel segment.

In the light duty segment, Umicore's catalyst sales are well balanced from a geographical point of view, with Asia currently accounting for 37% of our global sales volumes, Europe accounting for 31% and the Americas for 32%. In Asia, I would like to highlight our very strong performance in China. While car production there declined by 12% year on year, we managed to grow sales volumes and revenues in the first half well above the levels of last year. This was due to the market share gains which I referred to a moment ago as well as a supportive customer and platform mix.

In Europe we had strong sales of gasoline catalyst technologies, which mitigated the impact of lower light duty diesel sales. With gasoline applications now representing about 3 quarters of our light duty catalyst volumes in Europe, we are well positioned to benefit from the changes in engine mix in the region. The contribution from gasoline particulate filters is growing and the trend is set to continue as the market penetration of such filters increases.

Production capacity is being expanded for gasoline catalysts and filters in both Europe and China: in Poland the new production lines started to come on stream in the second quarter, while the new production lines in China are due to come on stream in the second half of this year, as is the production capacity expansion in India, to cater for the new Bharat 6 awards.

Revenue growth in Precious Metals Chemistry was driven by stronger demand from the pharmaceutical and chemical industries for Umicore's homogeneous catalysts. This portfolio has been expanded by the purchase in July of intellectual property from Evonik covering metathesis and cross-coupling catalysis. Revenues from fuel cell catalysts were also higher and Umicore is expanding its fuel cell catalyst production capacity in Korea to benefit from the growing uptake of fuel cell drivetrain technology. The new plant will be commissioned at the end of the year.

Mid and longer-term perspectives in Catalysis are promising with tighter emission norms being introduced in several regions both for light and heavy duty applications. The most significant impact of the new norms in terms of catalyst market value uplift will be visible in China, Europe and India over the next two years. Umicore is set to benefit from this tightening of emission norms as well as from the increasing share of gasoline platforms in the mix and the growing importance of gasoline particulate filters.

In addition, Umicore is well positioned to benefit from the growing uptake of fuel cell drivetrains and the new production capacity for fuel cell catalysts will help establish a strong foothold in this emerging technology segment.

I am now moving to Energy & Surface Technologies.

As I explained at the end of April, the growth in demand for cathode materials used in Li-ion rechargeable batteries started to slow down in the first half of 2019 for several reasons. In China in particular, sales of electric vehicles have continued to grow year on year albeit at a slower pace than in the first half of 2018 and, in absolute value, have remained well below the levels of the second half of last year.

At the end of March, the Chinese government announced a change in the subsidy mechanism for new energy vehicles, with deeper than anticipated subsidy cuts on national level and removal of all regional subsidies, making electric vehicles substantially more expensive in the context of an overall weak automotive demand in China. As the subsidy cuts took full effect at the end of June, there may have been some EV pre-buying in June and the full impact of the subsidy cuts on EV demand is likely to be seen in the second half of 2019. The new subsidy scheme is also likely to be less supportive of NMC materials for use in electric buses for short distance public transport.

The other application segments have also seen significant developments in the first half. In Korea, the largest



market for energy storage, the installation of new systems came to a complete stop during the first half following a series of safety incidents. The good news there is that the safety investigation was completed at the end of June and has exonerated the battery producers and their materials suppliers, which opens the door for the business to resume in the second part of the year.

In portable electronics, global demand for high-end devices was subdued in the first half of the year and sales of Umicore's high energy LCO cathode materials were lower. The reduction in demand was exacerbated by high inventory levels in the supply chain and by the price disadvantage that Umicore experiences compared to products containing unethically sourced cheap cobalt. There are no signs of turnaround in the near term and we expect our customers to continue reducing their inventories.

You will also recall from the discussion we had back in April that Umicore's cobalt-containing products are placed at a competitive disadvantage by the unethically sourced cheap cobalt units originating from artisanal mining. While the persisting low cobalt price has led to a reduction of the inflow of such cheap cobalt, the stock overhang is still affecting the market and pricing dynamics.

Revenues for Energy & Surface Technologies in the first half were down by 7% year on year at € 607 million and recurring EBIT decreased by 16% to reach €102 million, while recurring EBITDA was down by 5%. This performance reflected the impact of lower metal prices, lower volumes of NMC cathode materials used in energy storage batteries and lower shipments of high energy LCO cathode materials for portable electronics. Sales of cathode materials for automotive applications were flat.

The lower metal prices had a material impact on revenues and recurring EBIT as Umicore's margins were reduced in the refining, recycling and distribution activities, compared to the record high levels achieved in the first half of 2018. While it is difficult to accurately quantify the effect of the inflow of unethical cobalt on volumes and margins, we estimate that the combination of low metal prices and unethical cobalt has had a negative impact on the recurring EBIT of the business group of about € 10 to € 15 million compared to the first half of 2018.

The downstream product and distribution activities in Cobalt & Specialty Materials were also affected by low cobalt prices and by customers destocking inventories that were acquired during the period of price increases. Similar to LCO, the sales of the cobalt containing products of the business unit were also affected by the competition from cheap cobalt units which are unethically sourced from artisanal operations. Revenues for Electroplating were slightly down while those of Electro-Optic Materials, were stable.

Despite short-term fluctuations in demand, the underlying fundamentals supporting the electrification trend remain strong. The regulatory push in China is continuing despite the deeper than anticipated subsidy cuts, with other levers being applied, including sales tax exemptions and removal of registration plate limits. Similarly, in Europe, CO₂ legislation and low emission credits are expected to increase the penetration of electrified vehicles, with average CO₂ emission levels again having increased in 2018. At the same time, drivetrain electrification is confirmed as the main avenue to drastically reduce vehicle emissions and all automotive OEMs have started to roll out their electrification strategy or are stepping up their efforts in this respect.

Also, the technology roadmap requires innovative materials and continues to offer ample room for differentiation. This is driven to a large extent by consumers' expectations of longer driving ranges, shorter charging times, longer battery life and affordable car prices. While these demands make sense from a consumer experience point of view, their combination is complicated to be achieved. In addition, given the volumes of materials requirements for each individual EV platform, the ability to scale up fast and meet the highest quality standards with consistency remains another source of competitive distinction.

Umicore is well placed to meet such product and process requirements and our closed loop offering adds to our ability to create competitive distinction. Umicore is committed to enabling the transition to electrified mobility and is expanding production in China and Poland.

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Alongside the organic investments, we also announced in May two important steps to expand our integrated and sustainable battery materials value chain. One of these steps is the agreement to acquire Freeport Cobalt's refinery and precursor production in Kokkola, in Finland. The acquisition which is expected to be completed by the end of the year, subject to customary closing conditions and regulatory approvals, will add state-of-the-art refining and precursor capacity and will expand our talent pool.

A further building block in Umicore's competitive battery materials supply chain in Europe is the partnership with Glencore which guarantees cobalt supplies that are compliant with our sustainable procurement framework. Umicore has a strict policy of not buying any cobalt sourced from artisanal operations, which often involve child labor and poor standards of health and safety.

Both these initiatives fit perfectly into Umicore's European cathode materials supply chain.

In Recycling, the availability of complex materials increased over the period leading to a supportive supply mix. In particular, we saw an increased availability of end-of-life materials, both spent catalysts and electronic scrap. The higher availability of the latter is probably due in part to the stricter enforcement by the Chinese government of the import ban on electronic scrap. The metal price environment was, on balance, also more favorable with higher prices for palladium and rhodium more than offsetting lower prices for several other metals.

Recycling recorded revenues of € 313 million and recurring EBIT of € 76 million, both 2% down year-on-year owing to an extended scheduled shutdown of the Hoboken plant at the beginning of the year. The comparison to last year excludes the impact of the European activities of the Technical Materials business unit which contributed to the results in January 2018 before their divestment.

The recycling facility in Hoboken was shut down for 7 weeks at the beginning of the year, twice as long as a regular maintenance shutdown, during which time we carried out a certain number of modifications to key equipment alongside usual maintenance operations. While the extended shutdown reduced the plant availability compared to last year, the latest wave of investments has resulted in an improvement of throughput rates which mitigates the impact of the reduced availability on overall processed volumes. We also benefited from a favorable supply mix in the first half as well as higher prices for certain metals.

In Jewelry & Industrial Metals, revenues were slightly higher year on year, excluding the impact of the divested European activities of the Technical Materials business unit at the end of January 2018. The demand for performance catalysts and glass applications was strong and the facility in China for equipment used in the production of high purity glass was commissioned early this year and is now fully operational. The contribution from Precious Metals Management to recurring EBIT increased year on year reflecting favorable trading conditions for certain precious metals.

In the longer run, I see strong drivers behind the growth in Recycling as, by definition, the scarcity of mineral resources can only grow. Also, the public awareness about the need for a much higher level of resource efficiency keeps increasing which will support collection, reuse and recycling initiatives. Umicore is very well positioned to capture growth as its recycling processes are highly efficient both in terms of recovery yields and environmental and quality standards.

I would like to emphasize that the first half performance and the full year outlook are both fully consistent with the messages I gave at the end of April. The market environment has developed very much in line with the views we had back then, which allows me to confirm the outlook for the Group overall and for each business group. The outlook is positive for Catalysis and Recycling while in Energy & Surface Technologies, the slowdown in the pace of EV growth justifies the adjustments to our investment plans.

Our performance in the first half proved robust and our cash flows have improved substantially.

I would also like to emphasize that the drivers behind our growth strategy in clean mobility materials and recycling are structurally sound and confirmed. We therefore maintain the strategic course of action while continuing to demonstrate that we have the agility to handle temporary adverse conditions.



I have consistently told you that our growth trajectory would not be linear and that we should not get carried away when there is an acceleration nor panic when there is a slowdown. I am leading Umicore in a manner that enables the company to pursue its long-term growth investments, research programs and dividend payments to shareholders at every point of the business or economic cycle. Today is no exception and it is rewarding that our robust performance and strong balance sheet enable me to pursue this business philosophy.

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