ICL Q4 2017 Conference Call

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Operator: Ladies and gentlemen, thank you for standing by, and welcome to the ICL Analyst Conference Call. Our presentation today will be followed by a question and answer session, at which time, if you do wish to ask a question, you need to press star one on your telephone. I must advise you that this call is being recorded today. If you experience any technical difficulties, please press star zero on your telephone.

I'd like to hand the call over to your first speaker today, Ms. Limor Gruber. Please, go ahead.

Limor Gruber: Thank you. Hello, everyone, in the room and on the line. Welcome and thank you for joining us today for our Fourth Quarter and Full Year 2017 Conference Call. The event is being webcast live on our website at www.icl-group.com.

Earlier today, we filed our reports to the securities authorities and the stock exchanges in the U.S. and in Israel. The reports as well as the press release are available on our website. There will be a replay of the webcast available a few hours after the meeting and a transcript will be available within 48 hours.

The presentation that will be reviewed today was also filed to the securities authorities and is available on our website. Please don't forget to review the disclaimer on Slide number 2. Our comments today will contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on management's current expectations and are not guarantees of future performance.

We will begin with a presentation by our acting CEO, Asher Grinbaum, followed by Kobi Altman, our CFO. Following the presentation, we'll open the line for the Q&A session. Asher, please.

Asher Grinbaum: Thank you, Limor. Good afternoon or good morning to all of you joining this call today.

Starting with slide 3, Q4 marked another quarter of improving financial results, with an increase of 20% in adjusted operating income driven by strong potash performance and G&A reduction which totaled $60 million for the year. For 2017, our sales were stable, but our operating margins expanded and we increased free cash flow generation. These are remarkable achievements in light of the challenging commodity business environment, especially commodity phosphates. These improving results, coupled with successful divestments, contributed to a reduction of $230 million in net debt. We will continue to focus on responsible capital management.

Let's turn to slide 4 to discuss the performance of our business lines. Our Industrial Products business line continued to deliver solid sales growth backed by market conditions as well as by our value-based pricing strategy. Our Advanced Additives P2O5 chain also benefited from value based pricing strategy, as well as from an expansion of its customer base. Our Food Specialties business line sales expected to return to the 2016 level in 2018 due to customer base diversification.

Strong potash performance in the fourth quarter was supported by tight global supply, signs of price recovery and strong spot demand, mainly in Brazil, with record potash sales this year of about 1.3 million tonnes. This quarter was also a record fourth quarter for Specialty Fertilizers. The business line grew sales by 5% this year despite commodity headwinds and the ammonia shortage in Israel. In our Phosphate business line, price recovery partially mitigated the negative impact of increased raw material cost and production slowdowns.

Let's turn to Slide 5, for a review of our 2017 achievements and what is waiting for us in 2018.

One of the major achievements this year was successful divestments of low-synergy assets. The proceeds will serve to strengthen our financial position by reducing our debt level, as well as to support our growth initiatives. We achieved a significant improvement of our results in our YPH joint venture in China through shift to specialties and efficiency measures. During the year, we announced a long term natural gas supply agreement, in a lower price than the current agreement, which will further enable us to reduce energy cost. And finally, last month, a long-time overhang over our share price was removed as

Nutrien sold Potash Corp's full 13.8% stake in ICL to a consortium of Israeli and foreign investors.

Among the goals we have set for 2018 are reduction in debt level and CapEx projects execution, mostly in Essential Minerals. We also intend to complete the transition of ICL UK into a pure polysulphate site during this year, after we increased sales volume of the product by 50% in 2017. We will continue to improve the competitiveness of our other mineral assets in Spain, China and Israel through CapEx projects, efficiency measures and cost reduction initiatives.

Before I turn the floor to Kobi to discuss our financial results in more details, I'd like to turn your attention to slide 6, where we summarize ICL's strategic direction.

Our focus continues to be our 3 core value chains; bromine, potash and phosphate. We will continue to strengthen the competitiveness of our existing mineral assets, improving production capabilities and reducing cost per tonne. ICL Iberia's mine consolidation and efficiency plan will turn this site into a solid profitable potash site even in low-cycle periods. Shifting to Polysulphate at ICL UK is expected to bring this site to break-even in the short term and to solid profitability in the medium term.

The growth of ICL's specialty businesses will be supported by our value based pricing strategy, bolt-on acquisitions and introduction of new, value added products and solutions. In addition, we aim to leverage our position and capabilities in the fertilizer market and the growing use of precision agriculture to enhance our marketing capabilities and to develop advanced and focused agriculture solutions to an expanding customer base.

With that I will hand it over to Kobi to discuss financials

Kobi Altman: Thank you Asher, and good day everyone. Starting from slide 8, our fourth quarter strong results marked an end to a year of improved performance. I will mainly focus on analyzing the adjusted results, as comparing reported results is an "easier" comparison due to the significant write downs we had in 2016. In addition, you can see that our adjusted results this quarter are lower than the reported results. A reconciliation table can be found in the press release, but the main item that contributed to this phenomenon is the capital gain we booked on the divestment of IDE. Our sales this quarter show a modest growth, but our adjusted operating income grew by 20%. Throughout the year our specialty businesses took the front stage, leading the growth in our operating income. However, this quarter's results were driven by strong potash performance, supported by higher prices. The negative impact of sales volumes on revenues was reversed in the operating income into a small contribution mainly due to increased share of potash sales from the Dead Sea and higher fire safety sales compared to the fourth quarter of 2016. The achievements Asher discussed earlier are reflected in a 12% increase in our adjusted operating income for the full year. This growth comes despite headwinds in our commodity business as well as currency impact, mainly the strengthening of the Israeli shekel against the US dollar, which resulted in a negative currencies impact of $47 million to the annual operating profit. I would like to mention two additional topics – the higher tax rate which led to a reduction in adjusted net income this year and our improved free cash flow generation. I will elaborate on these topics shortly.

Slide 9 illustrates what I discussed earlier – the last two years marked a reversal in the segments' contribution to operating income as Specialty Solution segment accounted for about 60% of the group operating income. Nevertheless, in Q4, for the first time in two years, Essential Minerals took the lead generating 52% of the group operating income.

Slide 10 explains the increase in our effective tax rate in 2017 compared to 2016. I will go over the table and will try to explain it line by line.

The first section represents our regular income taxes and natural resources tax across the globe. Here you can see an increase of ~2% in our effective tax rate (from 24% to 26%). The major impact here comes from the expiration of tax benefits plans we had in Israel.

The second part of the table shows an increase to our effective tax rate that comes from the fact that in some operations we are losing and we are not booking tax assets on those losses. As we will progress with our plans to transform those operations to be profitable we expect this section to decrease.

Following the above our effective tax rate in 2016 was 29% vs. 30% in 2017.

The last section of the table contains several items that have reduced our effective tax rate in 2016 to 20% while in 2017 it did not impact much.

The main item here in 2017 was the impact of the strengthening of the Israeli shekel versus the US dollar.

The approximately 30% adjusted tax rate for 2017 reflects our estimation going forward although we believe that this line item will continue to be highly volatile. It should also be noted that this is based on certain assumptions we made regarding Natural Resource Tax expenses. This is a new tax regime that applies only to ICL and as a result, no regulations have been issued, no opinions have been published by Israel Tax Authority regarding the matter and no relevant court decisions have been rendered. We made the tax provision based on certain assumptions and interpretations regarding the value of property, plant and equipment in the financial statements for each mineral, as well as calculation of the operating income for each mineral. It is possible that in future periods the Israel Tax Authorities will have different views and argue that the Company should make additional payments, even for very significant amounts, based on alternative interpretations.

Our Specialty Solution results, analyzed on slide 11, benefited from higher sales quantities of bromine, fire safety and industrial phosphates products as well as from higher bromine prices and the contribution of our value oriented pricing strategy implemented throughout the segment. This contribution was more than offset by an increase in other operating expenses mainly due to provision for bad debt due to the situation of a customer, from some inventory adjustments, higher royalty payments in the bromine value chain and an income related to employee benefits recorded in Q4 2016. Exchange rates positive contribution on sales, mainly due to the strengthening of the euro against the US dollar, was reversed in the operating income due to the impact on costs.

The main contribution to the Essential Minerals segment results, presented on slide 12, came from the recovery in potash prices with an increase of 10% in our average FOB price year over year. The significant negative impact of quantities on sales was almost zero on operating income due to the breakdown between our different potash sites. The higher share of the Dead Sea in sales is also reflected in a decrease in the calculated average cost per tonne compared to Q3 2017. The negative impact of raw materials and exchange rates is mainly due to the increase in Sulphur prices and the strengthening of the Israeli shekel vs. the US dollar.

Turning to slide 13, In 2017, we continued to put a lot of focus on capital allocation. Our strict capital allocation strategy led to improved free cash flow generation compared to 2016 and significantly higher than 2014 and 2015. Looking into 2018, we expect investment in CapEx to increase mainly as a result of the pumping station and the salt harvesting projects at ICL Dead Sea as well as the site consolidation in Spain. The higher investments are expected to result in lower free cash flow. In Q1 2018 we might even see a negative free cash flow due to some significant CapEx payments to contractors. The successful divestment of IDE helped us to reduce the net debt balance at year’s end. The upcoming closing of the Fire Safety and Oil Additives businesses will result in over $800 million reduction in net debt upon closing. We will continue to focus on balancing between securing our financial position, investing in our top and bottom lines growth and providing solid dividend yield.

Before we will move to the Q&A session, I would like to summarize the key highlights for this quarter and year, as presented on slide 14. Our robust performance this year was mainly driven by our actions to reduce costs, including G&A expenses, as we promised in the beginning of 2017. This comes together with the contribution of our specialty business, mainly bromine and Advanced Additives, and with the support of some signs of recovery in the potash markets in the second half of the year. The improvement in our financials together with the focus on cash flow generation and the IDE divestment resulted in a reduction in debt and improved debt ratios. We expect further reduction in the coming months upon completion of the Fire Safety and Oil Additives divestment. We have a clear strategic direction and we will continue to focus on the execution of our growth and efficiency plans.

Thank you for your time and we will be happy to take your questions now.

Operator: Thank you very much. We will now begin the question and answer session. If you'd like to ask a question, please press star and one on your telephone and wait for your name to be announced. If you do wish to cancel your request, please press the hash key. Once again, that is star and one if you do wish to ask a question.

Your first question comes from the line of Joel Jackson. Please ask your question.

Joel Jackson: Hi, good morning or good afternoon. A couple of questions. So thank you for the strategic outlook. You made a lot of moves and you have a lot of moving parts. Can you give us an idea here, when we look at your invested, excuse me, looking at your returns on capital versus your cost of capital, the performance hasn't been good for a lot of reasons. Can you talk about how you look at the Chinese phosphate JV, the Spanish assets, Boulby, other assets as it relates to the returns you can get versus your cost of capital, and how that might affect your decisions going forward?

Kobi Altman: Joel, this is Kobi. Our general guidance for return on investment is that we would like to get a return of at least 15 percent on any investment that we are doing. Specifically for the joint venture in China and the operations that we are doing now in Spain, I will start one by one:

On China, yes, it is true that we had a very challenging 2016 with the significant drop of the phosphate commodity prices. We have done a significant change in this operation in 2017. Yet still, this site was losing money in 2017, but a significant improvement was done there. The move from a pure commodity player, in the past before we created this joint venture, to a future of a much more balanced with most of the focus on specialties should bring the site to profitability, and will start to generate return on the invested capital that we put forming this joint venture.

So far, by the way, the ongoing CapEx we are investing there is not significant. But yes, to your point, so far, we had - 2016 is a very tough year, 2017 with significant improvement and more improvement to come in 2018 and beyond.

In Spain, as well, we are investing now in, we'll continue to invest in the next three years an amount of around $250 million, as we already discussed previously. And this should bring Spain to be a profitable site at almost any commodity potash prices for many, many years and the investment that we're going to do there are for dozens of years. We are consolidating their two sites into one. By that, we can reduce significantly the expenses that are coming with trying to operate two sites in parallel. It will be a much more efficient site with the introduction of the ramp and the ability to shift the potash directly from the mine into the plant in a very cost-competitive way using this belt. And the new port facilities that we will be able to operate for many, many years and will improve our competitiveness.

So all in all, yes, we are still yet to see the return on the investment there, but we believe that with this final stage of investment, we will have Spain as a long-term profitable potash site.

Joel Jackson: So on current commodity prices, the extra $250 million in Spain, that will return a 15 percent ROIC? And the extra investments in China, to go to more specialty products, that will return a 50 percent ROIC on current commodity prices?

Kobi Altman: Yes.

Joel Jackson: OK. The other question I wanted to ask is on the Brazilian market, which for potash has been quite strong and price has been up. Now some data is out there suggesting that in Brazil, fertilizers shipments are up a fair bit in '17, but overall consumption was only up a little. Different reports from some of your competitors about whether inventories are high or low on potash. How is the Brazilian potash market faring? What's your outlook for the next 6 and 12 months if it continues? And obviously, there's always ambiguity around some of the new mines coming on.

Limor Gruber: Hi Joel, it's Limor. Alon Gil, our EVP of Sales, Marketing & Logistics will answer that. Alon, please.

Alon Gil: Hi, Joel. Brazilian market is increasing, consumption is increasing year after year. There is no doubt that Brazil will continue to increase in 2018 and in the rest of the year to come. Consumption in, potash consumption, in Brazil indeed were lower than the total import of potash. So you can say there is some kind of stocking up, but we don't see any kind of weakness or reduction in potash in general or in total fertilizer consumption in Brazil.

Joel Jackson: Thank you very much.

Operator: Thank you very much. And your next question comes from the line of Roni Biron from Excellence. Please ask your question.

Roni Biron: Hi, Asher and Kobi. Impressive numbers on the potash side. Two questions on my end. First, potash margins of over 30 percent were a pleasant surprise. How sustainable this level is going into 2018, assuming no major changes in the pricing environment? And how would it be affected by the U.K. phase-out in the second half?

Kobi Altman: So, yes, Roni, the fourth quarter was a very strong potash quarter. I don't think that this is a representative quarter for all the quarters of 2018. But we believe that 2018 average will be better than the average of 2017. The reason is the phasing out of our U.K. facility, which 2018 will be the last year that we will produce potash in the U.K. and the amount we will produce in 2018 is going to be really insignificant, slightly higher production of potash that we plan to do in Spain as well as the regular production in the Dead Sea. We said improved operations of both Spain and in Israel should result in a better average of 2018 versus the average of 2017.

Roni Biron: Thanks. And just a follow-up on Spain, there have been some execution setbacks. What kind of progress are you seeing there? And how confident are you regarding your cost objectives?

Kobi Altman: Yes, so we are doing there a few projects, capital projects as well as a lot of work that we are doing on improving the operation in the site - the ramp, which is the enabler for us to ramp-up the production in the mine that we will continue to operate in the future from around 500,000 tons to 1 million tons in this one mine. The ramp should be ready sometimes in the beginning of next year and this will be a significant enabler for our costs to go down. And the operation there that we will be able to operate instead of two aboveground facilities to move to only one with some investment to modernize these aboveground facilities will also enable us to reduce the operational cost.

So we are on track on this, in this operation and the improvement program. We are tracking that every day, every week, every month and we believe that we will get there.

Roni Biron: Thank you very much and good luck.

Operator: Thank you. And your next question comes from the line of Jeffrey Schnell from Jefferies. Please ask your question.

Jeffrey Schnell: Hi, good afternoon. Can you provide a little more color around your CapEx plans for 2018 through 2020? How do you see the progression by segment? And then also, you mentioned you could be free cash flow negative in Q1? Do you expect 2018 total free cash flow to be positive?

Kobi Altman: Hi, Jeffrey. This is Kobi again. Yes, in the CapEx for the next three years, the projects that we already announced and we discussed, just as a reminder, around $250 million of investment that we're doing in the pumping station in the Dead Sea operation, around $250 million investment in Spain that we will do over the next three years as well as the infrastructure that we need to do for the salt harvesting project in the Dead Sea.

Most of the operation there, we will pay as it goes to the supplier of the harvesting machine, but the infrastructure of bringing the electricity lines into this pond is something that we're going to do and will cost us a few (dozens) of millions. So those are the three main items we already discussed and you have that we will spend this over the next three years.

As a result of that and we tried to demonstrate that in the slide that I presented earlier, we will see some increase in the CapEx spending in 2018 versus the 2017 level. The amount, you can take the amount that I mentioned over the next three years and will give you, I think, some way to estimate what will be the 2018. It's very hard to know exact numbers because of timing of investments, but a good range, I think, you can generate from the information I already gave you.

With regard to the free cash flow, the free cash flow for the full year is going to be positive.

Jeffrey Schnell: Thank you.

Operator: Thanks very much. Once again, if you do wish to ask a question, please press star one on your telephone now and wait for your name to be announced. If you do wish to cancel your request, please press the hash key.

And your next question comes from the line of Andrew Benson from Citi. Please ask your question.

Andrew Benson: Thank you very much. I probably didn't understand correctly on the natural resources tax, which you do highlight as being specific and some uncertainties. Can you just explain, have you made -- changed assumptions in the fourth quarter, which have led to a lower aggregate tax rate? And how do those, if that's so, how do those calculations affect your future expected tax guidance? I know you did qualify that by saying it could change. Can you just give us the idea of the tax liabilities on the divestment that you are expecting in the mid-year and how much actually EBIT it contributed in 2017? Do you plan any other divestments? And when do you think the -- lastly, when do you think the Chinese joint venture will be materially profitable?

Asher Grinbaum: Andrew, OK. I hope I got all your questions, but if I miss something, let me know. On the taxes, a 30 percent effective tax rate that we had for 2017, we believe that more or less this can represent the effective tax rate also going forward, although we wrote that it can be very volatile between the quarters due to some items that can influence that up or down.

The natural resources tax, yes, it's the first year that it applies to our, or the entire set of our minerals. We wrote that we, because it is a new law, we had to do the interpretation of our understanding of the law, and we wanted to put some caveats that because there are no regulations and no opinions by the tax authorities yet on how this law should be interpreted then it might be in the future that tax authorities discuss with different views. But other than that, the 30 percent, we believe, is more or less should be our tax rate, going forward.

In terms of the divestments, we have done the divestment of IDE, already in our numbers for Q4, the capital gain and the tax that relates to that are in our numbers for Q4. The divestment of the fire safety and the oil additives, we plan to close it in the first few months of 2018. Some of the taxes on this deal we already started to pay in 2017 with some moves that we had to do some spin-offs that we had to do already in 2017 as a preparation for the sale, and we adjusted this amount like we will adjust the capital gain once we will close the deal.

Further divestments are currently not in concrete plan. We have done what we said in 2017 that we will do. It might be in the future if there will be some opportunities, we can do, but it's not something that we are actively working on something right now.

The joint venture in China, we want to see this in 2018 more or less balanced and then in the future to be also profitable.

Andrew Benson: If I just go back to the fire safety, the phosphorus chemicals derivative. Can you give us an indication of the total tax that you are likely to generate from that asset sale?

Kobi Altman: Yes, it's still hard a little bit to estimate, but the total taxes should be something at the level of around $100 million more or less.

Andrew Benson: OK, brilliant. Well, thank you very much.

Operator: Thank you. We have no further questions at this time. Please continue.

Limor Gruber: Thank you, everyone, for joining us today. And we look forward to see you in the future. Good day.

Operator: Thank you very much. That does conclude the call for today. Thank you all for participating. You may now disconnect.

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