BMO 2015 Global Metal and Mining

February 24, 2015
9:00 AM ET

Joel Jackson: All right, let's continue on in the fertilizer world. Our next presentation is from Israel Chemicals, or ICL. It's a leading producer of potash, bromide, and phosphate. ICL is now listed in New York, not just Tel Aviv, so it's a much broader investable name. With the involving Israeli dynamic, ICL has made a recent investment in a Chinese phosphate producer, has started expansion of its potash operations in Spain, and is rationalizing its Israeli and noncore operations, and really trying to drive down costs. And presenting today is Stefan Borgas, the CEO.

Stefan Borgas: Thanks, Joel. Good morning, ladies and gentlemen. I think you got the secret tip on who to listen to this morning because, from a value creation over the next years, I think ICL has an interesting story.

And actually, ICL is not just a mining company. ICL is also not just a specialty chemicals company. We operate specialty chemicals plants, and we operate mines, but ICL really is all about building integrated value chains from specialty minerals deep, deep into end markets, and that differentiates us from the pure mining players, and of course from the specialty chemicals space. And why is this so attractive? Because it creates over-average return on invested capital because we manage these value chains.

So, we have four big minerals, specialty minerals that we mine. Of course, we have to be competitive here. And we have three end markets - agriculture, food ingredients, and engineered materials - that we focus on. And once you understand this about ICL, you understand its strategy, because, very simply put, we need to strengthen these integrated value chains. We need to make sure that our mining operations are the most cost-competitive in the world, so we'll have above-average profitability. And we need to make sure that our end market reach is the best in the world, as well, and we need to make sure that everything else we have in the Company gets out of it. I'll show you this in the next few minutes.

If you would chart mining companies' production plants on a chart, it wouldn't look anything like this. This is the view of the integrated value chains just in the schematic base of what ICL operates around the world. You don't need to understand this in detail, but I want to give you a flavor about the complexity and about the know-how that we have in the Company here. Join us in the one-on-ones, and we'll explain this to you in detail.

Let me take you through the different steps of the value chain now, and I'll start with potash in the front end, because this still of course makes up half of our profitability. We have three potash mines in the world that we operate. First, of course, there's our mother ship in the Dead Sea, where we make 60% of the volumes that we sell, 3.6 million tonnes. This is a low-cost asset, but it's not just a low-cost asset. It also has unique operating capabilities because down there in the Dead Sea, 440 meters below sea level, it is absolutely dry. It never rains. When it rains, it always rains on the Jordanian side, because the clouds come over the mountains and they grow over the Dead Sea, and it rains down there.

And as a result of this, we can store potash outside in indefinite quantities. We can store a year, a year and a half, two years of potash right there at the Dead Sea without having any harm to the salts. It's never crusts because it's so dry there. And why is this important? Because we can ramp the plant at all times. We never need to stop the plant. And of course, for asset utilization, this is fantastic. We can breathe with inventory when market demand is low.

And this is important not just for our operation at the Dead Sea, but it's also important for the other operations in Spain and in the UK, because those mines are small enough that, even in low times of demand, we can operate those mines, as well, at 100% capacity and sell it in the world market, and breathe with the inventory stocks in the Dead Sea. And that is asset utilization and, therewith, return on assets that are unmatched in the industry.

In Spain, this is the growth engine for potash for ICL for the next five to eight years. We are at the end of the process of combining two small mines into one and having a platform on which, step-by-step, slice-by-slice, we can increase capacity output to initially 1.4 million, 1.5 million tons from one million tons now over the course of the next three years, and then adding another million ton on top of this, but in incremental pieces as demand goes up over the course of the next eight to 10 years. So, this is the growth area, and with every capacity increase, costs will go down at the same time. With the restructuring that we're doing at the moment from two mines into one, this Spanish mine will move into the lower tertile of the cost curve.

In the UK, the situation is quite different. This is a relatively small mine with 700,000, 800,000 tons of output at the end of its lifecycle. We don't have reserves to increase production significantly, and the reserves might only last another five to 10 years. We actually don't know exactly because the reserves are under the ocean, so we only find them as we go along. So, we cannot increase profitability here based on potash. We can, at best, stabilize the potash output.

But, what we can do, we found another mineral about 150 meters below the potash seam called polysulfate. This is a mixed mineral made out of potash, sulfur, and calcium and magnesium. It can be directly applied on the field without any processing, and therefore is maybe the lowest cost mixed fertilizer available in the world. We have over 200 million tons of reserves there. We've market-tested this product over the course of the last two years, and now demand significantly outstrips our production capability, which we have just decided to de-bottleneck to a volume of 600,000 tons, which in terms of production capacity we can reach sometimes in the middle of 2016.

Last year we sold 40,000 tons of polysulfate. This year we will sell about 150,000 tons of polysulfate. January-February orders are already at that level. Next year, we will double that again until we reach the 600,000 tons in maybe three years from now.

The attractive thing about polysulfate here is the margin. The margins at a market sales price around $180 per ton, where it easily competes with products like SOP, the margins are much higher than the margins of potash in the Dead Sea. So, gross margins above 50% here are feasible, and that makes this mine a very interesting growth engine for ICL into the next five or 10 years.

Let me speak a little bit about bromine, the second important mineral that we have. The Dead Sea, of course, is the largest source of bromine in the world because of the richness of its concentration. ICL is the largest producer of bromine in the world. We have a fantastic cost position here. All the effort of the organization goes in growing the market.

The bromine industry in the last decade has slept in terms of innovation, and therefore market demand has stayed flat, flattish, and we will not see a dramatic change on this in the next two or three years, but the innovation machine has been started. We have increased our R&D expenditures just in bromine to about $35 million per year, coming from about $15 million three years ago, with a lot of attractive projects. But, they will not be material for another three years because it takes that time to bring these products into the market and to register them. So, the value creation in bromine happened on the cost side, adapting to a lower, leaner, environment, reducing cost, and therewith increasing profitability of that business by 10% to 20% in the next 18 months.

The third big mineral in terms of importance for us are the phosphates. ICL's phosphate business is fundamentally different than any other phosphate player's business. In the market, 70% of phosphates go into the large commodities, DAP, MAP, and its commodity NPK derivatives. In ICL's case, only 25% of the phosphates go into those commodities, and 75% go into specialty markets in fertilizers, specialty high-end fertilizers, in food products, and in technical industrial application, 75%. This is a very successful platform that we've built based on our phosphate source in the Negev desert in Israel. So, we have a strong franchise in Europe, and we have a reasonably good position in North America with the different backward integration on a contractual basis.

We have no business at all in Asia. Why? Because the phosphate source from Israel didn't make us competitive enough in Asia in the specialty markets. We have fixed this now with a very large alliance that we have just drafted with Yunnan Yuntianhua, which is the largest phosphate producer in China, very big company, larger volumes than the big worldwide players. One quarter of their business, we acquired 50% of this and now are able to operate this integrated platform from rock all the way into specialty markets in China and in the Southeast Asian and South Asian markets all the way to India with a competitive platform. This will add a business of the similar scale that ICL already operates today, starting at the beginning of 2016 when we expect the approval by the Chinese governments. So, we're very excited about this.

(Video playing)

Stefan Borgas: Why is this video important? Of course, nothing fundamentally new to you, but we're frustrated that farmers around the world actually don't know this. We have 600 million small farmers who essentially don't use potash today, and we complain about lack of growth in the potash market. We make regression analysis, how potash should grow. We talk about logistics chains and billions of dollars we put into mines and production facilities. But, we at ICL are frustrated that not enough of the industry's money is focused on educating farmers.

So, in ICL we decided, even though we're a little player, we're going to change this and take our fate in our own hands. We have two very large farm education programs active now, with stunning results. You see some of this data here. You'll find it in the presentation that you have in front of you. But, this focus on growing demand is absolutely necessary.

From an ICL perspective, you might ask why do you do this? Because this is education that the entire industry will benefit from, and you'll lose a big effect of this. Well, from an ICL perspective, we only need 200,000 tons of potash growth per year in order to present you, our shareholders, with a growth proposition of 5% per year over the next decade.

And we believe with this farmers education programs in those regions in which we are competitively very strong, like India, like Africa, because they're close to our mines, we will do others now in China because obviously we have an access to the Chinese market through our new alliance, we are going to be able to deliver 200,000 to 250,000 tons of potash growth. Half of this is what the market brings anyway, but the other half comes from these programs. And this gives you a potash business you can invest in that has a growth rate of 5% per year over the next decade. And we believe this has great value.

Our food business, the next market that we talk about, is a business that is focused on the improvement of texture and stability in processed food. If you cook a ham today, the water that is in the cells of the meat will flow out into your pan, and the meat will become dry unless you treat it. And these cooked meats you cannot sell and keep it in the refrigerated -- refrigerator chains of the supermarkets without treating it with sophisticated ingredients, such as phosphate salts, but many others, as well.

With this know-how platform, ICL has built a phosphate business of a little over $500 million. But, with every formulation that we prepare for our customers, we only sell 15% of our own products, and we sell 85% of other people's products. So, very simply, we said can we back-integrate into other ingredients that we already sell anyway, and this is what we have done with the transaction in Europe recently into whey proteins. They target the exact same applications, improvement of texture and stability of processed foods. The value of this transaction for us will be doubled through the synergies that we can create through our network.

(Video playing)

Stefan Borgas: One of the things I mentioned at the beginning is that, in this integrated value chain, we need to take cost out. We have committed to take $350 million cost out of these value chains by the end of 2016. The 2014 numbers show that, with a $100 million delivered cost reduction, we're nicely on track to this. There's a good probability that we might even exceed this number. The run rate at the end of 2014 was $120 million. And you can see, in the numbers of 2014, that a third of the price reduction we had to suffer from the potash decline was compensated by cost reduction. The speed of this delivery of course now is going up in 2015.

In terms of the growth, inside these value chains also we made very nice progress. Not everything of course is as spectacular as the deal we make with China. There are a lot of little things happening in the background. These are small transactions, but they strengthen this value chain. In the value chain, because of the specialty access into the

markets, we're able to create about 300 to 400 basis points higher value in terms of return on assets valuation than the commodity peers are able to do. And this is the benefit.

The financial results in 2014 I trust that all of you have seen, so I don't want to read the numbers to you. But, I just want to spend one minute talking about the outlook into 2015. In the fertilizer side, we've had a very, very strong demand year in 2014. We don't expect the demand to grow at the same speed in 2015. We look at this more as a flattish year, so cost improvement in terms of value creation is going to be very important on the potash side. On the phosphate, I share my predecessor's optimism here that the phosphate market continues to be relatively dynamic also into 2015. We see this quite well going into the first quarter.

On the industrial product side, the decline that we have seen in the complicated flame retardants in the last year has stopped. This is a flattish demand. But, 2015 is going to be characterized by price increase in the bromine business. ICL is leading this effort. We're tying this together with a strike, a big strike that we have, quite planned strike that we have in our big operations in Israel. And so, the market is short of material, and the price increase at the moment is sticking very nicely. You will see it in the P&L latest in the second half, hopefully already in the second quarter, as well.

And in the performance business, our food business of course is going to take good advantage of this acquisition that we've made. It should close at the beginning of the second quarter. Once we've got all the regulatory approvals, this goes rather quick because it's a complementary acquisition from a product perspective. So, we're looking into a good growth year in terms of profitability in 2015 for ICL.

Couple of fundamentals. Exchange rates go in our favor at the moment. We have $1 billion worth of shekel costs which has depreciated significantly compared to the US dollars. This is the biggest factor, and then we have a lower oil price that helps us on the transportation cost. And both of this good tailwind and the red -- the headwind currency FX here are relatively minor problems for us.

To summarize it up, we have a very strong cash flow conversion rate which we intend to maintain. This is significantly above industry average. We have a very committed dividend policy of 70% of net profits that we're paying out, and this gives you a dividend yield of over 6% on the stock. This is almost like insurance when you invest into ICL.

With this, I'm at the end, and there's just a little bit of time for questions, Joel.

Joel Jackson: Yes, we have about five minutes for questions, if you want to raise your hand, or send on the app. I'll kick it off. You have a lot of great long-term targets and achievements, obviously some things going on in the short-term right now. You have a strike at the Dead Sea. Maybe you can give a bit of an update on how you see that resolving, and the bromine and the Dead Sea potash labor situations, and also maybe some further abilities to reduce costs beyond maybe just some workforce optimizations.

Stefan Borgas: Yes, thank you. The pilot on this was in our phosphate business in March, April 2014, where we went through exact same process. In this extremely heavily unionized environment that we have in Israel, a strike is always the last step of about a one-year process in order to reduce cost and adapt structures. There's a lot of management structures actually that are going to be more flexible at these sites.

The strike is always the last step because, in this very emotional Middle Eastern environment, union leaders apparently need the pressure of this in order to, at the end of the day, agree to what management has proposed. Everybody suffers under this, but this is the psyche of the region.

Why are we confident that this will happen? Because during the strike, nobody gets paid. So, after four weeks, when the next paycheck is due to come and it's not coming, the pressure goes up so dramatically that then settlements are coming very, very quickly. We've practiced this in several cases in the past, so this will happen here, as well. April timeframe should be the time for these settlements. On the bromine side, the strike's already gone three weeks, so here it comes a little bit earlier, maybe.

This is one step of the cost reduction. The other step of the cost reduction is the flexibilization (ph) of the plant and the improvement of the operations themselves in which we can then send people from one place to another and actually really increase the output. Again, here our pilot is the phosphate operation, where with about 15% less people, we are beating one production record after another. Second half of 2014 we had about 18% higher production output than ever before. And in potash and in bromine, we expect similar rates.

Joel Jackson: That's helpful. So, as a bit of a follow-up question on that, sort of, so the question from the app is, is anything going on with Shesnisky taxes and royalties, some permitting issues in phosphate, some of the environmental -- sorry, salt dredging issue at the Dead Sea? They all seem to be large issues in Israel, and maybe you have relations that are strained with the government. How are you addressing these?

Stefan Borgas: Well, the environment in Israel has been deteriorating for reinvestments to a point where reinvestments at the moment are just not possible there. This is not a short-term development. This has started in 2010 and gone on till now, year after year with another burden. The Company basically took this into the consideration. That's why Israel is under optimizing and cash maximization mode. It will help the government, as well, in the short-term, at least, because they get higher taxes from this, but we share it with them. And all of the reinvestments happened outside of Israel.

Like always in these cases, pendulums swing one way or another, and the feedback we're getting at the moment from government bureaucrats -- because we don't have a government in place, we're in the middle of elections -- is that maybe Israel as a country should be interested in future investments in this sector, as well. So, I think we've seen the worst. It's difficult to quantify, but the $120 million additional tax that everybody has in their models now for 2017 and beyond probably is a worst-case scenario.

Joel Jackson: That's great. Thanks, Stefan.

Stefan Borgas: Thank you.