Israel Chemicals Ltd.

Third Quarter 2015 Conference Call

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PRESENTATION

Operator:

Greetings and welcome to the ICL Analyst Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

I would now like to turn the conference to your host, Ms. Limor Gruber, Head of Investor Relations. Thank you. You may begin.

Limor Gruber:

Hello everyone in the room and on the line. Welcome. Thank you for joining ICL Q3 2015 Conference Call. Earlier today, we filed our reports to the securities authorities and the stock exchanges in the US and in Israel. The report as well as the press release is available on our website. Please carefully review all relevant data and considerations. For your reference, this meeting is being webcast live at www.icl-group.com. There will be a replay available a few hours after the call and the transcript within 48 hours. The presentation that you will see today is also available on our website and was also filed as an immediate report, and of course don't forget to read the second slide with the disclaimer.

Our comments today contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on Management's current expectation and are no guarantees for future performance. Today, as usual, we'll start with our CEO, Mr. Stefan Borgas; followed by our CFO, Kobi Altman. In addition ICL's Executive members are on the line and we will all be happy to answer your questions after the presentations. Stefan, please.

Stefan Borgas:

Thanks Limor. Good morning, good afternoon, good evening from London today. Happy to give you an update on what happened in the third quarter at ICL. If you want one slogan it's back to business. We've had a lot of ups and downs over the course of the last year and all of this is making it through the system. Third quarter now shows numbers that finally represents in a good way from which basis ICL will develop over the future. Let me lead you through the first half of that pack and then Kobi will go through the second pack—half with the numbers and then hopefully we'll have the rest of the half an hour—another half an hour for Q&A.

We were able to compensate for the negative impact of the lower potash prices and of the lower potash volumes, mainly because of pretty significant cost reduction. Efficiency initiatives across all the major sites are beginning to show. The operating income, the adjusted operating income declined only by 8% compared to last year and mostly this is due to lower cost. A lot of this is around doing—some of this is helped also from freight cost and a little bit also from currency, but the biggest pot is really the cost reduction in the potash plants in Israel and also of course in the phosphate and in the specialty operations.

Just at the end of the quarter we decided to take a decisive step in the UK in our potash plant. This is not so much driven by the market volatility but it is driven by the near term end of the reserves in this mine and the cost competitive reserves in the mine will be finished more or less by the end of 2018, plus/minus six months; it's more difficult to say. So we have decided to take the first step towards the restructuring. We announced a reduction of one third of the labor, unfortunately, in Boulby in the north England. It's nothing that we do with any kind of joy because it's a tough, beaten area of the country anyway, but we have no choice, there's no more potash in the ground, so it's nothing much we can do. We are with all our force trying to build up the polysulphate business so that we can preserve at least as many jobs as possible and then as this polysulphate business builds add them step by step. We will invest into the infrastructure there in order to make this polysulphate work. I'll get to that a little bit later.

Let me give you some visibility on what's going on in our market. The potash market demand is somewhat weaker in 2015 than in 2014. That was pretty clear when we started the year because 2014 was so strong. In the meantime this has translated in pretty much overall also lower prices up to a point where there's now production curtailments popping up pretty much everywhere with almost every producer around the world.

The adjusted operating profit in ICL still grew by $4 million despite a $60 million reduction in sales. That shows you what the cost effect—what the effect of cost reduction had. At the end of the year in the Dead Sea we will reach the targeted level of production after the strike, which is going to be 10% higher from the levels that we've had on a sustainable basis before the strike. This has to do with the efficiency and this will balance a part of what we're going to lose in the UK eventually. So this is the balance we have here, so about 300,000 tonnes, on an ongoing long-term average we will be able to produce more in the Dead Sea. Of course the costs there, despite taxation, are better than in the UK.

In specialty and phosphate fertilizers area, we had a fire in the middle of the year in our SSP facility at ICL Rotem. The impact of this could be compensated also by lower cost. The facility will be back up in operation at the end of the first quarter. So the reconstruction is going very, very well. In the margins we're about 100 basis points higher in the third quarter, then in the first quarter of 2014 in our phosphate business. This shows the continued increase in health here. Prices did not contribute to this margin increase in the third quarter because although they had been favorable they haven't increased very much.

In our Specialty Fertilizer business we have pretty strong competitive environment especially because the markets in Russia and Eastern Europe are very weak mostly because of currency issues there. A lot of headwind in the Specialty Fertilizer business but we've had very little growth here.

In the Industrial Products segment, our pricing strategy is very nicely implemented. We have announced price increases in November 2014. This is sticking very well. We have lost some market share in the beginning of the third quarter. We also had some ramp up time of course after the strike there. We're fully back to our regular production volumes and also our sales volumes are back to the levels in which we had. Although we will be—continue to be extremely disciplined on prices, in certain spot areas we're not willing to give up volumes significantly and we expect the market to follow us so much. This has worked.

If we go into part of this business, the Merquel business is quite stable; an increase is expected for next year in this business. We are very, very satisfied with the launch of our new Polymeric Flame Retardant for the construction industry in Europe. Despite the fact that the ban has been postponed by two years, customers are buying this product, they're switching to this more ecological product. It's safer to use. So customers are using it even though the ban hasn't been fully implemented.

Looking at 2016, we're looking at stable demand with the exception of the Clear Brine Fluids where really we have no visibility because our customers, the big oil service providers also don't have any visibility. They're ordering month by month which they have never done before and that shows you how uncertain the oil market is. So we have to be a little bit flexible on what's happening here.

But the rest of the business looks actually pretty stable. We had one highlight which makes us very proud in the third quarter. That was the first installation of a bromine-based, large scale bromine-based battery for energy storage to be collaborated here with one of the start-up companies and we set this battery in one of our own production sites in California. Very happy about this because now we can—the industry can see how well bromine performs, especially versus lithium is just as superior material with much better properties.

Last but not least in our Performance Products business, also some light and shadow. On the darker side, lots of imports from China of phosphoric acid and also of phosphate salts putting pressure on the commodity part of this business. This has increased by the upcoming ban of STPP in dishwasher tablets in Europe which will happen so that we will—the market will lose about 50,000 tons of demand. This was counterbalanced in ICL's business with good performance of many of our specialty niche business especially the fire safety business in North America, in the United States but also in Canada so that the performance actually was quite good.

In our Food Specialties business we benefited very nicely from the whey proteins that had been added to the portfolio and that are puling through also the rest of the portfolio. So this is quite nice, double-digit growth in this business. If we eliminate the effect of the divested businesses from last year, then we have very nice operating profit growth in the Performance Products business.

Let me spend a minute or two on our mine in the UK. This business is going to be transformed from a potash business to a polysulphate business, going more towards a niche product which is comparable with the SOP with NOP with those kinds of niche markets. We're building this business right now. We're selling roughly three times the quantities that we sold last year, but the ramp-up of course is still going on. We have very good trials and very good interest from customers in China, in Brazil where this product fits the soil very well. In the US we're a little bit behind because we didn't have volumes last year to test so we're only in the test phase there. In Europe it starts to become established it needs a little bit of CAPEX to get into this business but not very much; mostly CAPEX that needs to be invested on the site into infrastructure and in the port infrastructure. We're debating whether we should build a granulation plant in Bulbi itself in order to be able to offer a higher percentage of granular products. This we will decide over the course of the next year as we get feedback from customers. This will remain eventually quite an attractive asset for ICL because as a standalone polysulphate producer it will have very low cost and it will be able to offer this nutrient cocktail in this mineral at very competitive conditions for the farmers that buy this. So, in the long run this is not a problem. We will not incur any kind of cash constraint here. This mine made a profit this year. It will make a profit next year. So this is not a disaster but we have to react early enough in order to avoid any kind of disaster happening.

What is polysulphate? Just to remind you, this is a product from which we have ample supply in the ground. We have 200 million tonnes of resources. We have even much more in the ground which are not identified specifically. So if you want to produce 1 million or 2 million or 3 million tonnes per year the reserves here are not an issue. It will be very low cost. It’s environmentally friendly. There's no chemical processing involved in this. We take it out of the mine and basically ship it directly to farmers with some screening and sieving and crushing but no chemical processing. There's no waste that comes out of this. It has very low chlorine content so it works very well for those crops that are sensitive to chlorine, that's why it addresses slightly different niche markets than potash. It replaces costly existing products that farmers need to use in order to supplement their crops—their fertilization for these crops. For 2020 we're targeting sales of around 1 million tons. Long term the potential we think is more around 3 million tons. It's very difficult to say at this point how fast this ramp-up. It could easily also go faster. It depends a little bit on the next I would say 18, 24 months. Quarter by quarter we will update you of course how this is going.

This translates into ICL's potash franchise development. As you can see it in this chart, we're able to add potash production in small increments in the Dead Sea, in Spain and some of this in Ethiopia. The projct in Ethiopia, with the short term negative outlook on potash that all of you are giving us, is much more focused now on SOP than on MOP. We can play here with the cocktail of products so we will mostly likely in the next five or six years not make significant demands of potash in Ethiopia but start with SOP which gives us another niche market, another one of those semi-specialties that ICL is so good at developing and managing. So the ratio here might change and for sure we're going to develop this step by step. But if you look at this on average even if we execute all of these 200,000 tonnes per year is not really a dramatic growth for that significant market.

Let me switch to phosphates. We have now closed the joint venture with Yunnan Yuntianhua. We have taken over this operation and we have hired a Management Team. It's fully in place. It's totally integrated into ICL's Global Phosphates business units. We have had concerns in the beginning, are we going to be able to convince some of our experts and professionals and executives to move there. Who wants to move to Kunming, China. We got completely surprised as we showed people this beautiful city in the mountains of South China, it's about 1,800 meters high, about 6, 7 million people living there. It's one of the cleanest places in China. We had many more people who wanted to go and at the end we could offer jobs. So we have about 10 professionals, production professionals, procurement professionals, finance professionals that's moved there from many of our international units but we hired some fresh blood also in China and of course some talent from our partners. So I'm pretty excited about the Management Team that we have there. They're much more aggressive than the numbers that I show you here. We have to see how they execute. Our partner's very collaborative and I think this is going to be a good step for ICL in order to build our phosphate franchise into the future.

The collaboration we received from the local authorities and from the national authorities was extremely professional, very, very detailed-oriented, a lot of scrutiny, but extremely predictable. So we could—with the team we've set up we could shorten the approval process. The second part of this investment is an investment into our partner's company. 15% equity investment in our partner's company has not been approved but that is due to the blockage on IPOs that the Shanghai Stock Exchange had. This has been now lifted so now we expect this to move forward as well. I'll be in China next week and I'll see how this goes.

Let me switch to bromine. The bromine compounds and the bromine business have been improving, especially on the price side. Our market share is pretty much the same that it has been in the past. Customers are willing to pay us even higher prices than most of our competitors for supply reliability, for quality and also for better environmental management. Bromine is a sensitive product to handle and isotank in which this is shipped have special technologies and here we are recognized to be significantly better. People have lower leakage and fewer problems in handling this material. So we're quite satisfied with what happened here and now we're profiting of course from the cost reduction. This will generate, this cost reduction will generate about $23 million in annual savings in 2016, and which will increase to about $30 million in 2017. It has a stepped reduction because we need to do some things on the site before we can get to the $30 million. That we expect to hit completely in the bottom line and of course this is in addition to the price reductions.

With this, I want to leave you with the numbers. Kobi, it's all yours.

Kobi Altman:

Thank you Stefan. Good afternoon to all of you. This quarter marked our first post-strike, as Stefan had said, back to business quarter. We've successfully completed the quick ramp-up of our potash production in the Dead Sea, as well as also on our bromine compound facilities, although we need to remember that a ramp-up of sensitive and complex chemical facilities takes a little bit more time and as a result of that we can look at this quarter still as a ramp-up quarter in the bromine compound. Business environment this quarter was quite turbulent, impacted by the macroeconomic factors that Stefan already mentioned most of them, and those economic factors coupled with also the effect of the reintroduction of VAT on fertilizer in China and the other factors were negative to the entire fertilizer market, especially on the potash market.

The challenging external market conditions are the main reason why we were and we will continue to be extremely diligent in executing our cost saving program. I think it is now evident why we had to go through a painful exercise of adjusting our cost structure to the market reality.

Sales in the quarter were roughly 10% lower than the prior quarter in 2014, impacted mainly by the non-cash divestitures that we had, the decrease in the potash, bromine and phosphate volume and the devaluation of the euro against the dollar. Despite the lower volumes and the non-cash divestitures, the adjusted operating profit for the quarter was down by only 8% compared to last year, and this is attributed mainly to the reduced cost fueled, as Stefan said, from external, but mostly from internal drivers. You can find in the press release reconciliation between the reported and the adjusted operating income. The adjustment in the quarter still includes some strike related impacts, provision for prior periods for electricity tariff imposed by the Israeli authorities retroactive from June 13 and some other small provisions.

Cash flow for the quarter was impacted by large payment related to the royalty arbitration with the government. The provision for that was made last year but this quarter we paid it. It was also impacted by severance payments to employees who left the Company as a result of our cost reduction plan executed following the strike conclusion.

Moving now to our potash business. Though this quarter's production exceeded last year, the sales volume were over 100,000 tonne lower than in Q3 '14, as market conditions dictated lower shipments. The devaluation of the euro and the pound versus the dollar also negatively affected the sales. Contract prices were higher in China and India; however lower prices in other markets, especially Brazil, US and Europe, resulted in the $7 million negative effect on the sales.

Moving to the adjusted operating profit, we are very pleased however that we were able to achieve higher adjusted operating profit versus last year. The low volume sold and lower prices had a negative impact of $16 million on our operating profit but this was more than offset mainly by $12 million decrease in shipping expenses, decrease in energy cost and lower labor cost as we started to benefit from the labor reduction at ICL Dead Sea. Favorable exchange rate due to the devaluation of the Israeli shekel versus the dollar positively affected cost in the Dead Sea operation. ICL UK, Stefan already mentioned that it's transforming to a pure polysulphate mine, and this requires no immediate write-down. We have though implemented an accelerated depreciation of the potash assets and it will add about $3 million of additional depreciation per quarter for the next three years.

Reduction in our cost per tonne is an important measure in the existing business environment. The calculation here is very straightforward. You can extract it from the reports. We basically took the total operating expenses and divided that by the total volume that we are selling and the decrease is evident and this is helping us to demonstrate improvement in margin of almost 600 basis points. Some external factors as we said worked in our favor; currencies, shipping, oil prices, etc., but there is also an important contribution of the operational excellence and cost cutting initiatives, which is finally reflected now as we are over the strike and back to full operation.

Moving now to specialty and phosphate businesses, despite the fire in one of our production facilities at Rotem that crippled our fertilizer production this quarter and will still impact Q4 '15 as well, we continue to show very nice improved performance at Rotem resulting in a record high acid production and near record high of phosphate rock production. Apart from the lost volume caused by the fire, the lower euro and the shekel has negatively impacted the sales both on the commodity fertilizer business and the specialty fertilizer, especially in the eastern part of Europe.

If we look at the operating profit, the higher prices contributed $16 million compared to the same quarter of '14, and offset following items: the lower volume sold, about $5 million negative impact and the increase in prices of raw materials mainly the specialty fertilizer, and increase in some other operating expenses also negatively impacted. If we exclude the impact of the fire at Rotem from the sales as well, we recorded a 70 basis points improvement in operating margin despite the lower sales volume. This was driven by the higher price and lower production cost which is reflected in the chart in the following slide.

This slide shows the continuing trend of reduction in cost to produce our product. The slide demonstrates the result of our cost reduction initiative taken in our phosphate facility at Rotem. Since 2014 we increased phosphoric acid production by 15% despite a 10% reduction in labor force. Utilization improved to over 90% and this helped us to reduce the cost throughout the value chain. Other cost reduction initiatives were implemented at our rock mining and production and we could also improve utilization there and reach record production levels.

Moving to the Industrial Products segments, the performance here reflected the continued trend of declining demand and as I said it was still a ramp-up quarter following the strike. We witnessed a strong demand for clear brine fluids still this quarter, although the future is yet to be seen, and the sales of the bromine compound of mercury emission control.

Moving to the adjusted operating profit, you'll see it's less quarter over quarter and the more positive price environment in China and our price increases coupled with the lower energy and raw materials fully offset by the decline in quantities produced and sold in the product mix.

Last but not least, the Performance Products segment. Total sales in the segment, this quarter were 7% lower than last year. The decrease is mainly coming from the divestments of our non-cash businesses in the amount of approximately $84 million. Partially offsetting this is the $79 million increase in volume sold mostly from the addition of the Prolactal portfolio to our Food Specialties offering, Fosbrasil to our Advanced Additive business and the strong sales of wildfire prevention products due to the historically high wildfire activity in the northern United States and Canada. Eleven million dollar of operating income that was attributed to the divested non-cash business is the key reason for the $7 million decline in operating income recorded this quarter.

By that, we conclude our opening remarks and we will now open the call for a Q&A.

Operator:

Limor Gruber:

Thank you Kobi. We will start with some questions from the room, if we have, and I would just ask you all to limit yourself to two questions because we have a little bit of a line. Thank you. Sophie, please.

Sophie Jourdier:

Sophie Jourdier from Liberum. First question, I just wondered whether you could just clarify exactly the situation now on the tax discussions or with the government is that concluded now, and if it is, what will be the implications on your taxes over the next few years? The second question just on polysulphate, can you just remind me the price you're selling that and how do you set the price with customers? Is it a straight price or is it linked to the underlying nutrient value? Thanks.

Stefan Borgas:

Okay. Let me ask Kobi to answer the tax question. On polysulphate, the base principle is we price all the nutrients as in the replacement value for the particular farmer. To remind you the nutrients are sulphur, about half of the content, potash (K2O) 12% and then magnesium and calcium. Not all the farmers are able or willing to pay for all the nutrients, so sometimes you only price three, sometimes you only price two, sometimes you price all four of them. In some specialty crops you get additional synergistic effect from yields, so we get a premium for those. There's a difference of course between granular and powder. We are producing about 55% granular and about 45% powder, that's what comes out of the mine naturally. So we need to balance both of those. The powder goes mostly to NPK producers and of course they are looking for lower cost because they need to put this into granules themselves. The total cost in the long run will be somewhere between £30 and £35 per ton. They're higher now of course because we're in the ramp-up phase. Prices we're getting for the mix between granular and powder at the moment is around between £70 and £80 per ton. I think as volumes will go up and we will move more into commodities you would be able to see prices go down so that this spread is not a long-term spread but still it will be a very good, very robust business going forward.

Kobi Altman:

On the taxes, the Finance Committee of the Israeli Congress has voted. This is one step before the law is approved. There were quite a few changes that were made to the final draft from the original committee recommendation. To give you a flavor of the reduction, if the impact of the initial committee recommendations, with 2013 potash prices, was around $160 million per year, we are now talking, again at 2013 potash prices, an impact of $90 million to $100 million. Obviously at the current potash prices the impact on the Company is going to be significantly lower.

I would say in addition that we are proud to be already today under the existing tax environment the biggest taxpayer in Israel, but in future investment in Israel will be made based on marits, like we are doing in any other investment and we will factor all the factors into this and where it's worth to make an investment we will do it and if the new environment will not make the investments economically viable we will not do it.

Maybe two other additions. This is now essentially a potash tax. The taxation on phosphate and bromine and other minerals has been more or less eliminated with the details that they put in place. The second thing there is to say, many other regulatory items in Israel are still open. So the environment to make investment decision is still pretty shaky.

Limor Gruber:

Thank you. Any additional questions from the room? Nina, please.

Nina Dergunova:

Thank you. I have two questions. It's Nina Dergunova, Goldman Sachs. On the cost cutting, you made some impressive progress in cost optimization in recent years. Very good progress recently especially in fertilizers. So what's next, what are your expectations in terms of cost optimization going forward in 2016? The second question relates to bromine business. How do you see pricing evolving in the next 12 months? What do you think about competition? Do you see competition intensifying in some regions? What do you plan to do in terms of volumes and sales mix? Thank you.

Stefan Borgas:

Okay, on the cost side we are about two thirds through the delivery of our commitment this year. This year's run rate will be at least $240 million, probably it'll be a little bit higher, but just estimate $240 million for now. To remind you, our commitment was $350 million run rate until the end of this year, so there's one more third to come next year. It will come from procurement with another step up. That organization is doing very well. We are in good hopes that they can over-deliver not only next year but in further years as well. We haven't—we're not finished with the cost improvement in the Israeli side and so there's more to come there. We haven't—we're just about only starting in Spain and in our smaller sites. So the $350 million is very much reachable and also it will not stop in 2016, it will continue after this. We have also decided that now with the first roll-out of our SAP system which happened in the fourth quarter—in October this year, and two more roll-outs happening in April and in October next year, then we will have about 75% of the Company on the SAP system. This is the year in which we'll also tackle G&A cost reduction. We haven't quantified this yet. Kobi took this on himself to tackle this, so his team is at the moment running an analysis for the Company and looking for opportunities here that will add on top.

Bromine pricing is very stable. Chinese customers have accepted this. This is making its way to the compounds. Its making its way now also into a certain number of compounds outside of Asia. I'll remind you this price increase was an Asian increase because this is where prices were the lowest. It seems to stick pretty much everywhere so that I don't expect any decline here, at least not in 2016. The challenge in bromine remains volumes and they can only be improved with new applications. We're quite encouraged with what's going on with environmental legislation, especially on mercury- Europe is pushing forward and in China this is being introduced. We are building the first pilot project of Merquel in China with local partners there in order to show the feasibility of this technology. That will be able to reduce mercury reduction in China by more than 90%, nine-zero. So this technology really works. It's just one example in addition to the battery that again before we're putting our emphasis on.

Limor Gruber:

Yes, we'll take another question from the room.

Andrew Benson:

Yes, hi. Thanks a lot. Andrew Benson from Citi. You appear to have included your Ethiopian project within your projections for 2025 but not 2020. When do you think you would start investing? What sort of time horizon are you giving yourself? What's the sort of cost to develop? Then can you just also explain the changes as you see them in the, if you like, Performance Products?

Stefan Borgas:

The second question, please?

Andrew Benson:

The second one was on the Performance Products side, the impact of the phase-out of STPP and how you see the phosphates and dishwasher and how you see the European market in total evolving?

Stefan Borgas:

Okay. In Ethiopia we have already deployed the team. We're in detailed engineering and we're building some infrastructure in order to build this mine so we're actually pretty determined to do. This is small CAPEX at the moment. It will not go into large CAPEX next year either, but then 2017 and '18 will be the big CAPEX deployment years and then part of 2019 as well. So it takes about two and a half years to build and then the real volumes will come in 2020. As I said before, we will split this total potential in two pieces. It's a total investment of around $1.5 billion, we estimate, for 1.5 million tons of potash, plus 500,000 tons of SOP, all of this together. We will split this in two. So you can more or less take this number, split it in two and we will do the first part with a partner. So the ICL portion of this will be a piece, let's say, 60% of half focused on SOP in the first half and then when we do the second half we have to decide later. This is not decided at the moment. The project's not yet approved because we don't have the detailed engineering and we don't have the detailed conditions yet in Ethiopia. We have a team that is negotiating or working this out with the Ethiopian government, so you can expect the final decision on this by let's say sometime in the second quarter of next year. This is the goal; not a decision but if we want to do this we need to do some preparatory work, so we'll move the camp site into a more sustainable area down there and we're doing little things like that.

On Performance Products, the dishwasher phase-out doesn't affect us directly so much because we hardly have any sales in this area. This was the low end of the commodities, so it affects us only indirectly as competitors who were supplying it to this market are now trying to sell their products elsewhere. That's the price pressure I mentioned before in the commodity single phosphates. Our cost position in phosphate has dramatically improved, so we're not nervous about not being competitive, but our strategy also is not to face this head-on but more to go into specialized applications in combination with whey proteins for example or other type of protein. You will see us moving into this direction as we continue with small investments and expansion of the product portfolio.

Limor Gruber:

Okay, we will now take a few questions from the line please.

Operator:

Thank you. At this time we will conduct a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad.

Our first question comes from Chris Kapsch with BB&T Capital Markets. Please proceed with your question.

Chris Kapsch:

Yes, good afternoon over there. Just following up on the commentary in the Industrial Product segment, there's been discussion about weakness late in the third quarter in the brominated flame retardants and presumably that's into the electronics industry. Just wondering if you experienced that weakness, and if so, do you have a view as to whether it was attributable to just market weakness or possibly channel inventory destocking?

Stefan Borgas:

Okay, let's test the technical installation here. We should have Charlie on the line, Charlie Weidhas who is on our Executive Committee and running this business. Charlie, can you answer this question please? Did we experience weakness in late in the third quarter in the flame retardants?

Charles M. Weidhas:

Yes. First let me confirm that you can hear me.

Stefan Borgas:

Great.

Charles M. Weidhas:

You can hear me, okay. So in Asia there is a slowdown in the printed circuit board business, which impacts one of our larger volume products. So whether that is destocking of inventory or a slowdown, my opinion it's more of a slowdown based on what I read coming from the PC producers and the television producers and things like that.

Chris Kapsch:

Okay, thanks. Then just there's also been some commentary about the effects on not just the bromine industry but the broader chemical industry owing to the tragic fire at the port in Tianjin. Just wondering if you saw any effect from that, and also if you have a view or if you could share any intelligence on the residual effects of bromine competitors, local bromine competitors in China being influenced by the Chinese government in the wake of that tragedy. Thank you.

Charles M. Weidhas:

What we saw was shipments getting slowed down having to be maybe moved to other ports and so definitely we saw some short term issues there. The second part of the question is, did we see some governmental action towards Chinese producers of compounds and bromine. The answer is yes, most of it anecdotal, so I'm not aware of anything that's permanent. But look, it's clear in China that standards of production, especially in bromine, are very low. You could never operate that way out of China. We anticipate that becoming more of a problem in the future for them. But in terms of what I would call a structural change in Q3 or Q4, it's too early for me to have a firm conclusion on that.

Chris Kapsch:

Okay, thank you.

Operator:

Our next question comes from Joel Jackson with BMO. Please proceed with your question.

Stefan Borgas:

Hi Joel.

Joel Jackson:

The first question on polysulphate, can you just remind us the ramp up, like how we get from whatever sales you do in 2016 to 1 million tonne in 2020. So maybe walk us through the different years. Then also, if you could talk about the investments. So £40 million gets you how much of polysulphate? Is it 600,000 tonnes or a million tonnes? Then the extra £40 million gets you I guess a million tons, the remaining half million tonnes to get a million of granular? Just want to understand sort of how the CAPEX works out to get you to 600, a million, etc.

Stefan Borgas:

Okay. The £40 million that is part of what we announced originally will get us to a polysulphate production capacity of 1 million tonnes. This will give us 55% granular and 45% powder. Maybe we can improve the mining a little bit and go to 60.40, something like this. This is very much in the realm of possibility as well. If we wanted to granulate the remaining 40 or 45% ourselves, we would have to build a granulation plant which costs somewhere around £40 million, depending on where we build. But that's not yet decided. This would be in order to make additional margin on that powder product. So we have to wait until we make the decision, until we're a little bit further in the sales.

The ramp-up of polysulphate, boy, this is mainly the biggest discussion I'm having with the Sales Team. It's extremely difficult to tell for a totally new product. I'll remind you that polysulphate as such doesn't exist anywhere in the world. This is a unique product because it's defined by the geology in this part of Britain. We are selling between 120 and 150,000 tonnes this year. Last year we were around 40. By 2020 we want to be at 1 million tonnes. We can easily be at 800,000 in 2020 but we can also be at 1.5 million. It's really difficult to say. For next year we should be able to double. That's what our target is compared to this year and then we should be able to grow again so that by '17, '18 we have reached the original 600,000 tonnes. We've accelerated that forecast. Originally we thought the 600,000 tonnes would be the 2020 number. This has now moved forward because it's going relatively well and also because potash is running out faster so we put a little bit more the foot on the accelerator. But, you know, it's difficult to commit right now how much we're going to sell exactly every year.

Joel Jackson:

Okay, that was helpful. The second question would be on potash inventories and the Chinese contract and your shipment to China. So because of the Dead Sea strike obviously your shipments to China started late. Could you give an update on how much your shipments have gone to China, how much is left? It looks like the port inventories of potash in China are high. I know your customer mix is different than some of the bigger players, but I just want to get a sense if your shipments are still coming, which would probably lead to a later Chinese contract in the new year as opposed to December or January. Thanks.

Stefan Borgas:

Yes. Our contracts are fully being honored. There's a little bit even above this from one of the customers. So shipments in China are very, very solid. Our impression is from our customers that inventories are not dramatically higher than usually they are during this time of the year. Yes, the Chinese always are building up inventory in the fourth quarter to prepare for the agricultural season but also the negotiation season. So this is always what's going on every year. Of course as this happens the inventory first goes into the port, that's why the inventories are higher there. But it's not dramatically unusual from our perspective but it's solidly moving forward.

Joel Jackson:

And on your shipments, how much of your shipments remain on the 2015 contract?

Limor Gruber:

As Stefan said, we have a contract of 1.1 million tonnes for the year. This is the contract of firm volume, not including optional volumes which will probably not be utilized, but the contract of the firm volume will be fully utilized by the end of the year. Sometimes a little bit is spilled over to January but it will be fully utilized.

Operator:

Thank you. Our next question...

Nissim Adar:

We will complete all the contracts by the end of the year or even a little bit more.

Joel Jackson:

Okay.

Stefan Borgas:

That was Nissim Adar who runs the business, who's pretty bullish on the contract fulfillment as you heard.

Operator:

Thank you. Our next question comes from Matthew Korn with Barclays. Please proceed with your question.

Matthew Korn:

Hello everyone. Good day to you. So the question's on the JV with YPH. Congrats on getting that completed. As that ramps up and as you show it's going to add 850,000 tons of fertilizer, 115,000 tons of specialty fertilizer, I guess first, how much of all this production is presumed to be consumed domestically there in China? Then when we do look at the market today we see the increased exports out of China put pressure on global prices. What's the concern that the growth profile for the domestic Chinese market there in phosphates may be more relatively soft and continue that way for some time to come and perhaps limit the op income contribution? Thank you.

Stefan Borgas:

Okay. The whole idea about this whole concept of strategy of this joint venture is to build a phosphate business in China for Southeast Asia, including China, of course. So more or less you can assume that 60 to 70% of the sales of this operation will be in China and the rest will be in Southeast Asia. But this is the first concept. The second concept is to take this operation, which makes about $450 million sales with about 5, 6% EBIT, and to move it from a commodity business, now it's an almost 100% commodity MAP, DAP and by-products business, and to transform to at least 40% specialties over the course of the next few years. That's why we don't expect any softness of demand because we will get out of the commodities step by step as we build this specialty plant and we upgrade the existing plant to higher quality and better capability and more better stability. There's an R&D effort linked to this. We have an R&D center that we built together with our Chinese partners, with 80 scientists already working now, and for the first 10, 12 projects already in development in order to support this transition from commodities to specialties. That will improve sales to something like $650 million in five years from now with margins which will be high single-digits, probably higher than this, but that's the forecast at this point in time.

The Chinese market by itself will be very, very stagnant when it comes to commodity phosphates because the agricultural policy in China is limiting the growth of nutrients overall in agriculture and that will have a dampening effect on single nutrient usage, much more dramatic even for ammonium, nitrogen and not so much on potash because they're still in underutilization there. So there's a huge demand, there's a huge hunger among Chinese distributors and agricultural players for these more sophisticated products because they utilize nutrients much more efficiently. That's why we did this because the market needs this. So we don't expect any issue here. If there's a challenge then it'll be pricing of commodities because of the Chinese exports.

Matthew Korn:

Thank you, that's very, very helpful. Let me switch over just to ask on the Industrial Products side. I'm interested you mentioned on the biocides, on the competitors who did not register to comply with the regulation in Europe. I am curious, is there a window for them to do so now effectively shut for them? Do you have several months or a year or more as like a head start to take share? Just asking how that works and what's the revenue opportunity there.

Matthew Korn:

Right, you mentioned that there's an opportunity, a business opportunity because you've had several competitors who did not register with the European regulators and can participate in that market.

Stefan Borgas:

Oh, this is not on biocides, this is on polymeric flame retardant for construction installation foams. This is a product that we call FR122P. There's a regulation in Europe that for bids they previously used flame retardant. This will be outlawed and usually—originally this was supposed to happen at the beginning of 2016. This is now postponed until '17. Despite that, all the manufacturers of these installation foams are switching already to the new technology because they have prepared this and it's just a more environmentally friendly product. Yes, this is a patented product, but the IP belongs to DOW Chemicals. They have licensed this as far as I know to three players until now. You need pretty sophisticated production chemistry for this and of course you need bromine for this so the competition field is going to be limited. The major difference here is going to be one-to-one replacement on the volume side, more or less, but this product of course has much higher value. The old product was sold at somewhere between $4, $4.50 per kilo and this product is sold over $10 per kilo, and here you can see some of the value creation.

Matthew Korn:

All right. Thank you.

Stefan Borgas:

All right. Next question please?

Operator:

Our next question comes from Jonah Weisz with HSBC. Please proceed with your question.

Yonah Weisz:

Hi there. I was just going to ask you...

Stefan Borgas:

Hi Jonah.

Jonah Weisz:

May I ask a question on potash volume. In the third quarter in your printed MD&A you talked about India demand being weak. I believe on the call in your initial remarks Kobi mentioned that (inaudible)

Limor Gruber:

Yonah, are you on speaker or something because we hear you very bad. It's not clear at all. So if you can repeat and not from a speaker? Thanks.

Jonah Weisz:

Okay, is it better?

Limor Gruber:

I think so.

Jonah Weisz:

Okay.

Jonah Weisz:

Okay, let's try again. A question on potash. In your printed MD&A you talked about India reducing purchases and in the comments earlier Kobi mentioned Chinese VAT leading to lower purchases in the third quarter. So I'd ask in terms of volumes over the fourth quarter and perhaps into next year, first of all you'd be reducing your price to India in 4Q to restart there, and how do you see VAT essentially affecting the Chinese demand in 2016?

Stefan Borgas:

Okay. The VAT introduction in China we don't expect this to influence demand very much at all. This has more or less gone through the system. The potash importers have been able to sell the old volumes with a reduced VAT. They have done this. The new imports now are sold with a full VAT. Initially they passed on the pricing partially then they changed that; now they passed on the pricing fully. On the phosphate side the VAT was passed through to customers immediately. So in China it seems like this VAT change is more or less through the system. I don't expect this to impact demand. It's going to—if you're a local producer with a long local value chain it'll actually make you more competitive. So on the phosphate side for us this is more an advantage rather than a disadvantage. In the importer side we're as good as anybody else or as bad as anybody else. So not a big impact here.

In India, we have the same trend than anywhere else. Indian importers are asking for price concessions. We talk to them, we discuss with them, we haven't done anything yet. It depends really on the large players. I think you'll read this as early as we will read this because as you know we're a price taker.

Jonah Weisz:

Okay. Another question if I may on the UK and polysulphates. So will you have any asset retirement cost in the switchover from potash to polysulphate? Secondly, if I'm not mistaken, there is a competitor or a potential competitor right next door to you, Sirius minerals also trying to develop a large polysulphate reserves. So I'm wondering how you're planning your production with a potential for additional competition and how that interplay works?

Stefan Borgas:

Yes. Look, this is a new market, a totally new market. The challenge is marketing. If there's a new player coming into this it will be two of us offering this product and that would be fantastic. That would be great. So I would very much welcome Sirius to build this mine and to also help us to develop this product. The cannibalization with potash is relatively small. There's going to be some but not very big because it doesn't go into the same applications. There's a bit of that, there's a little bit of cannibalization with SOP, especially the higher cost SOP. But in principle this is a new product replacing cocktails or other ingredients.

Jonah Weisz:

And actually if I may ask. Asset retirement obligation or asset retirement cost for changing over from potash into polysulphate.

Limor Gruber:

So it's not very significant because we are moving to polysulphate. It's only the depreciation that will be faster in the next three years and this is $12 million per year of additional depreciation cost.

Kobi Altman:

And no write-off, no write-offs.

Stefan Borgas:

What we did is we took all of the assets of this mine—you know, it's an old mine so it's anyway relatively low asset base and we split them into those assets that are strictly dedicated to potash, mostly the surface facilities, those assets that are strictly dedicated to polysulphate and those that are used by both and the fourth category is those that are dedicated to potash but can be reconfigured to be used by polysulphate. If we do this and if you do this reclassification you end up with a faster depreciation of the potash only assets which gives us these $3 million per quarter or $12 million per year until 2018.

Jonah Weisz:

Thank you very much.

Stefan Borgas:

Next question please?

Operator:

Thank you. At this time, I would like to turn the meeting over to Management for any closing comments.

Limor Gruber:

Thank you very much. Sorry that we didn't have time to take all of your questions, but please contact me or somebody from our team directly we will take it offline. Thank you again for joining us and see you next quarter.

Stefan Borgas:

Thank you very much.

Kobi Altman:

Thank you.

Operator:

This does conclude today's teleconference. You may disconnect your lines at this time and have a great day.