Israel Chemicals Ltd.

Third Quarter 2016 Conference Call

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Executives

Limor Gruber - Head-Investor Relations

Asher Grinbaum - Acting CEO

Kobi Altman - Chief Financial Officer

Hezi Israel - Vice President, Business Development and Strategy

Charles Weidhas - COO

Nissim Adar - President, ICL Essential Minerals

Analysts

Milan Shah - BMO Capital Markets

Gilad Alper - Excellence Nessuah

Andrew Benson - Citi

Stephanie Bothwell - Bank of America/Merrill Lynch

Ella Fried - Bank Leumi

Operator

Ladies and gentlemen, thank you for standing by. And welcome to the ICL Analyst Conference Call. At this time, all participants are in a listen-only mode. There will be a presentation followed by a question-and-answer session. [Operator instructions] I must advise you the call is being recorded today, Wednesday, November 23, 2016. I would now like to hand the conference over to your first speaker today, Limor Gruber, Head of Investor Relations. Please go ahead.

Limor Gruber

Thank you. Hello, everyone in the room and on the line. Welcome and thank you for joining our third quarter 2016 conference call. Earlier today, we filed our Q3 2016 report 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. 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 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 Slide number two with a 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 expectations, and are not guarantees of future performance. Today, we will start with a presentation by Asher Grinbaum, our acting CEO, followed by Kobi Altman, our CFO. In addition, ICL’s executive committee members are either here or on the line, and we will all be available for questions following the presentation. Asher, please.

Asher Grinbaum

Thank you, Limor. And good morning, or good afternoon everyone. After 40 years of serving in several executive positions at ICL, including over eight years as the company's COO, four years as the CEO of ICL Global Fertilizers segment and nine years as the CEO of ICL Global Industrial Products segment, ICL Board of Directors asked me to serve as Executive CEO of the company until the position is permanently staffed. ICL management has been working diligently to navigate a difficult fertilizers price environment and build momentum in our specialty solution division. The executive management team views the deployment of capital as one of our top responsibilities and it is critical that we make adjustments to our plans as market conditions evolve. With this in mind, we consistently examine our growth plan and investments in an effort to enhance our cash generation, maximize growth and improve efficiency, all within the framework of our capital allocation strategy.

During the third quarter, we had several of these adjustments and after thorough examination some tough calls were made. These decisions include the termination of the Harmonization project as we identified substantial risks related to the project's readiness which significantly impacted its future course and timeline. We also decided to terminate the Ethiopian potash project following the Ethiopian government's failure to provide the necessary infrastructure and regulatory framework. The return on these projects simply did not justify their continuation and their termination is expected to save hundreds of millions of dollars in future CapEx.

Despite these necessary adjustments, our direction and path to the future remains intact. We will continue to focus on improving our business balance by the diversification into specialty solutions and improving the competitiveness of our core assets, particularly at our Dead Sea operations. In my long career with ICL, I have always found these unique assets to be strengths of our company. Our mineral assets are the primary competitive advantage to our specialty solution division where we have developed a wide range of proprietary and customer-centric solutions which provide compelling opportunities for innovation and decrease our reliance on commodity pricing. This is quite evident in the past few quarters as ICL's performance in a very difficult pricing environment has been quite resilient relative to the broader fertilizers market.

Now let's move to our third quarter results. In Q3 2016 we recorded a loss of $340 million due to the write-offs following the termination of the Harmonization and Ethiopian potash project. On an adjusted basis, despite the weak environment in the commodity market we demonstrated once again the resilience of our business model.

Our specialty solution division recorded another quarter of strong performance with broad-based growth across most of our end markets and 30% bottom line growth helping to offset more than a third of the reduction we experienced in our essential minerals business. Implementation of efficiency measures continues to further improve the cost structure of our competitive mineral assets.

We put a lot of focus on cash flow generation and reducing our net debt level. Efficiency measures we have taken to manage our working capital and our disciplined CapEx approach helped us to achieve another quarter of positive free cash flow in the amount of $96 million higher sequentially and compared to a negative cash flow of $40 million in the third quarter of 2015. Our efforts have not gone unnoticed by the rating agencies which continue to appreciate our robust cash generation and are confident that we will be able to improve our financial position despite the tough situation in the commodity markets. Kobi will elaborate on that later on.

Turning to developments by division, I will begin with essential minerals. Following the signing of contracts with Chinese and Indian customers we took advantage of the inventory accumulated at the Dead Sea during the slow period as well as our logistical advantage which are reflected in our quick time to market.

Efficiency improvements and the higher share of the Dead Sea in our sales volume resulted in about $15 reduction in the cost per ton year over year and sequentially. As a result, the potash stand-alone profit increased by 25% vs. Q2 2016, despite more than a $20 reduction in average FOB price.

In phosphates, the stabilization and beginning of a recovery that we are experiencing in the potash markets is still not visible. Price pressure continues and, as a result, our Chinese JV recorded an operating loss of $15 million, similar to the previous quarter as efficiency measures caught up with the impact of price decreases.

In our specialty solutions division, cost efficiencies, geographic expansion and new products all contributed to a 30% increase in profit, while margins improved from 17% to 21%. In ICL Industrial Products, we continue to successfully shift to advanced products. We also maintained our strong pricing in the bromine value chain, and our superior service and quality helped to increase volume.

In advanced additives, a strong fire safety season and cost reductions helped mitigate the competitive pressure in the phosphoric acid market in the US and Europe. In Food Specialties, the successful integration of the dairy protein business, as well as growth in demand for our new products, resulted in bottom line growth.

In Specialty Fertilizers, price pressure due lower commodity fertilizers prices, was partially offset by higher volumes of products sold in the specialty agriculture markets.

Developments over the past 3 years since we introduced our strategy prove the importance of strengthening our specialty business. Our goal is to have a balanced business in the long term, reaching equal contribution from both divisions to the operating income. With that I would like to conclude and pass the floor to Kobi. Kobi, please.

Kobi Altman

Thank you, Asher. Good day everyone.

This was an eventful quarter for ICL, in which we had to take some tough decisions, which resulted in the net loss we reported. Total adjustments in the quarter, in the amount of $495 million include, among other, write-offs of $282 million related to the termination of the Harmonization Project, a $202 million related to the termination of the potash project in Ethiopia and $36 million related to prior years' royalties, of which $26 million are in the financial expenses.

Moving to our on-going business now, we are pleased with our performance achievements in the Specialty Solutions division and in the cash generation we demonstrated.

As in the first two quarters of the year, the third quarter continued to demonstrate the balancing effect of the growing Specialty businesses amid the challenges of our Essential Minerals division which is reflected in the difficult pricing environment.

The measures we have taken to reduce our costs and working capital, along with our disciplined approach to Capex, have made it possible to record another quarter of positive free cash flow in contrast to the broader commodity sector, which resulted in a reduction in net debt.

Looking at the fourth quarter, we expect the impact of unfavorable seasonality and a very challenging comparison due to an exceptionally strong Q4 2015 when we emerged from the strike, to be reflected in the year -over -year performance. Nevertheless, we will continue with our efforts to achieve a positive operating cash flow in Q4 as well.

On the sales level, increase in quantities of fertilizers and organic growth in our specialty products more than offset the negative impact of unfavorable commodity prices. At the adjusted operating profit level, the impact of prices was more significant so higher quantities and lower expenses only partially offset the impact.

G&A expenses were 4% lower compared to Q3 2015. Excluding the expenses generated from the YPH JV, the reduction was 8%. This puts us on target to achieve a 10% reduction in overall G&A expenses vs. 2015, with a further reduction targeted for 2017. Our CAPEX level this quarter is consistent with our target not to exceed $650 million for the year.

In this quarter we announced a dividend of $60 million, or 5 cents per share, which brings us to a cash distribution of $220 million in 2016, or $0.17 per share. We believe this level represents a higher than average dividend yield, consistent with our capital allocation approach to balance between solid dividend yield, reduce net debt and drive long term growth.

On slide 8, these two graphs demonstrate how the specialty business has provided a balancing effect to the volatility of Essential Minerals.

The blue line represents our commodity businesses, and red line represents our specialty division. And you can see here that the huge volatility on the commodity side has been balanced by the increasingly solid performance of the specialty businesses. This highlights why ICL is in a unique position as we differ from most competitors. Our business diversification is a big advantage, especially during downturns and volatility that characterizes the Ag cycle.

We believe that our Specialty Solutions business will continue to act as a stabilizing factor as we continue to focus on commercial excellence, new products, geographical expansion and improved competitiveness.

Turning to slide 9 for a closer look at our Essential Minerals segment, the late signing of potash contracts in China and India resulted in increased shipments to these markets, while low pricing environment of both potash and phosphates negatively impacted the division's performance. This was partially offset by lower raw material and energy prices.

The division results benefitted from lower expenses, partially due to our efficiency efforts. We continue to focus on what we can control in a very volatile commodity market.

Turning to slide 10, we had a very different picture in our Specialty Solutions division. In the third quarter, 3 out of 4 of the division's units had a positive contribution to sales and operating profit. The majority of growth came from organic growth in bromine derivatives, dairy proteins, more than 100% increase in new products sales in Food Specialties, fire safety products in Advanced Additives and increased sales to specialty agriculture in our Specialty Fertilizers unit. Lower commodity prices had two offsetting influences – a negative impact on the sales prices of the value added specialty products, and lower raw materials costs for the division. The result is an increase of nearly 30% in the division's adjusted operating profit.

Turning to slide 11, as we approach the completion of our current efficiency initiatives, we are satisfied with the accomplishments which resulted in a contribution of $400M compared to 2013. This quarter we were able to reduce the full cost per tonne of potash. ICL Dead Sea is one of the world's best in class potash assets and we continue to improve its competitive advantage. Our bromine operations especially in Israel but also globally are showing cost improvements as well. We continue to work on future efficiencies.

And finally on slide 12, I would like to provide an update on our balance sheet and financial position. As a result of lower commodity prices, credit ratings in our industry have been under pressure. While our international credit rating was reduced by one notch to BBB-, we were pleased to maintain our investment grade rating with a stable outlook. Notably, we expect this will have no impact on future financing expenses. Maintaining the local rating at ilAA provides us with a strong advantage. This provides us with the necessary financial flexibility, even as we work diligently to reduce our aggregate debt level.

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

Question-and-Answer Session

Operator

[Operator Instructions] The first question today comes from the line of Milan Shah from BMO Capital Markets.

Milan Shah

Hi thanks. This is Milan in for Joel. You talked about potash costs, they're quite impressive, obviously quite low in the quarter. Is this the right level to think about through Q4 and how does this start to change as you wind down the UK potash production?

Nissim Adar

Okay, if I understood your question correct, you asked about the UK mine. So as we informed in the past, we are exhausting our reserves in the mine in UK. But just to emphasize, at ICL-UK we are in transformation from potash production to polysulphate production. And here in the polysulphate we are successfully penetrating to the market, and this year we will double the quantity compared to the previous year.

In regard to cost per ton, we will continue to work and to apply all the methods which we know under the umbrella of operational excellence in order to reduce our costs in all our sites. So this we do in our site in Dead Sea and Kobi showed how we are reducing the cost, we are doing the same in the UK, and we are doing the same in Spain. So all in all OE, operational excellence, in this segment is one of the main activities which we are busy with.

Milan Shah

And then on the polysulphate you talked about doubling volumes, what were volumes like in Q3 and what sort of price you’re selling for right now?

Nissim Adar

As I said polysulphate sales were progressing nicely according to plan and I cannot talk about specific quantities, but we are doubling the quantity from year to year. Prices depend on the quantity you buy but it’s about $100 per ton.

Operator

[Operator Instructions] The next question comes from the line of Gilad Alper from Excellence.

Gilad Alper

Hi thanks for taking my question. The strategy of the previous CEO was clear -- for better or for worse it was clear: basically cut costs, streamline as much as possible and then do aggressive expansion outside of Israel because of the issues that ICL is having with Israeli state. So part of what he did went well, part of what he did apparently didn't go so well and you scrapped it. So the question is what is the strategy now, because costs are -- have been cut off, still being cut, the stalemate with the state of Israel continues. Apparently you can't develop a significant potash sources outside of Israel. China is apparently still losing money, so there are a lot of limitations on how much money you can spend. So what is it that is left to do? Is there any way to come up with a new strategy something that's going to, I don't know, significantly change you situation or is it just sitting and waiting for the market to reverse and for the state of Israel to change its mind? Thanks.

Limor Gruber

Hi Gilad. Hezi, our executive VP for strategy, will take your question.

Hezi Israel

Thank you. So Gilad, when we announced about ICL’s strategy in 2012 Next Step Forward, we defined that we would like to go in our core business. The core business is agriculture, food and engineered materials. At the same time we declared that we would like to exit the non-core activity which we have done very successfully. We would like to work on cost leadership in our mineral chain and we are doing that, and to have one global ICL. So, if you see the development of ICL over the last four years we’re actually working on this strategy and this is the future direction. So moving forward we would like to grow the mineral business to make it stronger on the upstream position and to go the downstream application of ICL. So the core competence of ICL from specialty minerals to downstream application, this is the future direction, and actually you can see that in the results which make us very confident that we'll continue with that.

Operator

[Operator Instructions] The next question comes from the line of Andrew Benson from Citi.

Andrew Benson

Thanks very much for taking the questions. Can you give us more detail on the bromine business, and the outlook you expect from that? Can you give us any sense? You talked about very strong volumes last year and so not expecting so strong this year. What are your expectations for fourth quarter and the potash is likely to be – are there any signs – any crystal ball gazing that gives you ideas about how the Chinese are likely to approach their needs in 2017? And what is the plan to – I understand the long term plan on the phosphate business is to go into specialties, but what is the plan in the short term to stem the losses in the Chinese joint venture? Thanks.

Charles Weidhas

This is Charlie Weidhas and I'm filling in for Mark Volmer and will address the question on bromine. The market right now is very stable and stable in a good place. Our pricing strategy continues to go well. We see demand in our end markets, including plastics and Merquel™ are being very stable, in fact, strong in some areas. And as the year has gone on we have seen a slight improvement in demand even in the oil and gas business. So when we look at bromine in general we see a very stable and profitable business going forward. What I'll do is I'll now hand it over to Nissim to address the potash question.

Nissim Adar

Okay. China and India were late this year signing the contracts. So obviously quantities to China will be lower compared to year before. This in my opinion will help the Chinese to do next contract. Anyhow, the rumors from the market are but the supply chain is not so full as it used to be in 2015 and this also will support early Chinese contract signing.

In regards to our joint venture in China, I would like to remind again that our strategy is to move this joint venture from commodity-centered to a more specialty-centered and we are sticking to this strategy and we will continue to do it. In parallel we work to improve the efficiencies and the productivity of the site in order to make it much more competitive than today.

Andrew Benson

Okay. When do you expect to be in profit in the joint venture?

Nissim Adar

It will take two to three years I believe.

Operator

[Operator Instructions] We have a question here from the line of Stephanie Bothwell from Bank of America.

Stephanie Bothwell

Yes thanks and good afternoon. Thanks for the opportunity to ask my question. Really I just wanted to ask about the European markets, and whether or not post the end of Q3 you've seen any positive pricing momentum on MOP on sales into Europe? And my second question was on China. We are hearing that the Chinese are lobbying for removal of the export tariff on NPKs. I wonder whether or not you had a view on that and the potential impact it could have on global trade flows of MOP going forward? Thanks.

Nissim Adar

Okay, in the last few weeks we see positive momentum in Europe and after price declining we see price increases in different places. We also announced in few places increased prices and this is a positive momentum for us.

In regard to China exports tariff, I would say that China is self-sufficient, so I don't see here a difference or big difference.

Stephanie Bothwell

But on the NPK side if there was removal of the export tariff, do you think of any significant implication on global trade flows of MOP?

Nissim Adar

Please remember the logistic cost is a major issue and the prices outside of China in this moment are not so good to absorb more material. So I don't see here a big impact in my opinion.

Stephanie Bothwell

Okay, thanks and just going back to on your earlier comments on Europe. Can you give me an idea of what sort of price momentum you're seeing? You noted increases in prices. Can you give me some kind of quantum on euro per ton?

Kobi Altman

I cannot say exactly the price per ton because it's different from place to place, from customer to customer, the quantities – there are many factors here. But the momentum is positive and I see €10, €20 per ton more in different places.

Operator

Thank you very much. The next question today comes from the line of Eric Jaroslaw Pominkiewicz from Deutsche Bank.

Unidentified Analyst

I have two questions; one actually is a follow up to a point that was made a few minutes ago. Question number one is about specialty solutions and how much seasonality there is in more than sales in this segment. And question number two relates to the JV in China. You mentioned that you don't expect them to profit in the JV over the next two to three years. So essentially just to confirm no positive contribution at EBIT level from that JV going forward, is that correct? Thank you.

Charles Weidhas

This is Charlie Weidhas. I'll address the question around specialty. If you look at the total portfolio the area where you see the most seasonality is in our advanced additives business. And this is related to our wildfire safety business. Most of this is occurring in the United States on the West Coast and it occurs during the hot months. So that's probably the area with the highest amount of volatility.

Nissim Adar

Now in regard to JV in China, as I said we will transform this site from commodity to specialty. This will take around two to two and a half years. And then based on what we know on partly commodity, partly specialty, we will see much better results and would be out of the wave of the commodity. Now is the scenario that if the positive momentum of prices will continue, then we see much more and faster good results. So if you follow what is going on in the supply side in the phosphate markets there are some things which are in place and this can improve the price momentum in the commodities and then the results will be much better.

Operator

Thank you very much. The next question today comes from the line of Ella Fried from Bank Leumi.

Ella Fried

Good afternoon and thank you for taking my question as well. And can you tell us in terms of CapEx what to expect and also relating to the last question in terms of including the investments in China that are still expected, let's say if the price environment remains on the current level?

Kobi Altman

Ella, this is Kobi. I hope I got right your second question. With regard to the first one, CapEx we expect this year to close at around $650 million as we indicated. Obviously the discontinuation of Harmonization and the potash project in Africa will save a lot of CapEx for the next few years. So we expect the CapEx for next year to be lower than that amount.

And with regard to the joint venture in China, if I understood correctly the question, as Nissim indicated we are on our journey to transform this operation from a pure commodity to a balanced model of a commodity and specialty. But this does not require a very significant amount of capital investment.

End of Q&A

Operator

[Operator Instructions] Thank you very much. There are no further questions today. Please continue.

Limor Gruber

Thank you, Steve. Thank you everyone for joining us today. We are happy to discuss further, so please don't hesitate. And we're looking forward to talk to you and see you soon. Good day.

Operator

Thank you very much. That does conclude the conference for today. Thank you for participating. You may all disconnect.

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