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Q3 2019 AMG Advanced Metallurgical Group NV Earnings Call

Oct 31, 2019 (Thomson StreetEvents) -- Edited Transcript of AMG Advanced Metallurgical Group NV earnings conference call or presentation Thursday, October 31, 2019 at 8:00:00am GMT

TEXT version of Transcript

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Corporate Participants

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* Eric E. Jackson

AMG Advanced Metallurgical Group N.V. - COO & Member of Management Board

* Heinz C. Schimmelbusch

AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO

* Jackson M. Dunckel

AMG Advanced Metallurgical Group N.V. - CFO & Member of Management Board

* Michele Fischer

AMG Advanced Metallurgical Group N.V. - VP of IR

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Conference Call Participants

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* Andreas Markou

Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst

* Frank Claassen

Banque Degroof Petercam S.A., Research Division - Analyst

* Henk Veerman

Kempen & Co. N.V., Research Division - Research Analyst

* Krishan M. Agarwal

Citigroup Inc, Research Division - Analyst

* Martijn P. den Drijver

ABN AMRO Bank N.V., Research Division - Analyst

* Stijn Demeester

ING Groep N.V., Research Division - Research Analyst

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Presentation

Operator [1]

Good day and welcome to the AMG Earnings Q3 2019 Conference Call. Today's conference is being recorded. At this time, I would like to turn the call over to Michele Fischer. Please go ahead, madame.

Michele Fischer, AMG Advanced Metallurgical Group N.V. - VP of IR [2]

Welcome to AMG's Third Quarter 2019 Earnings Call. Joining me on this call are Dr. Heinz Schimmelbusch, the Chairman of the Management Board and the Chief Executive Officer; Mr. Jackson Dunckel, the Chief Financial Officer; and Mr. Eric Jackson, the Chief Operating Officer. AMG's Third quarter 2019 earnings press release issued yesterday is on AMG's website.

Today's call will begin with a review of the third quarter 2019 business highlights by Dr. Schimmelbusch. Mr. Dunkel will comment on AMG's financial results and Mr. Jackson will discuss operations. At the completion of Mr. Jackson's remarks, Dr. Schimmelbusch will comment on strategy and outlook. We will then open the call to take your questions.

Before I pass the call to Dr. Schimmelbusch, I would like to comment on forward-looking statements. This conference call could contain forward-looking statements about AMG Advanced Metallurgical Group. Forward-looking statements are not historical facts, but may include statements concerning AMG's plans, expectations, future revenues or performance, financing needs, plans and intentions relating to acquisitions, AMG's competitive strengths and weaknesses, reserves, financial position and future operations and development, AMG's business strategy and the trends AMG anticipates in the industries and the political and legal environment in which it operates and other similar or different information that is not historical information.

When used in this conference call, the words expects, believes, anticipates, plans, may, will, should and any similar expressions and the negatives thereof are intended to identify forward-looking statements. By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, and risks that exist that any predictions, forecasts or similar projections contained by such forward-looking statements will not be achieved. These forward-looking statements speak only as of the date of this conference call. AMG expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement contained herein to reflect any changes in AMG's expectations with regard thereto to any change in events, conditions or circumstances on which any forward-looking statement is based.

I will now pass the floor to Dr. Schimmelbusch, AMG's Chairman of the Management Board and Chief Executive Officer.

Heinz C. Schimmelbusch, AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO [3]

Thank you, Michele. We are focused on operating efficiency to counteract the environment of continued extremely low prices. During the third quarter, we have made substantial progress in risk reduction and strategic value creation. With regards to risk reduction, besides the long-term agreement with Genco to supply 100% of AMG's vanadium, available ferrovandium production from both the existing and the new plant, which is under construction in San Ville, Ohio. We will double by this new plant, the Cambridge production from 30,000 tonnes to 60,000 tonnes.

We have closed on a new tax-exempt [form] facility that generated EUR 325 million of proceeds for the financing of this plant with very favorable terms. We have signed an agreement with Shell Catalysts & Technologies for the formation of Shell & AMG recycling B.V. This agreement, by the way, is still subject to regulatory approvals.

That joint venture will provide a long-term sustainable solution for reclamation and recycling services to the global refinery industry. We are very excited about this joint venture, given the rapidly expanding demand for fresh catalysts and spent catalyst reclamation and recycling services. The production of ferrovandium based on recycling spent catalyst is not only the lowest-cost ferrovandium production route but also saves substantial amounts of CO2. It used to be seen in the context of AMG's overall product portfolio, which enables our customers to reduce CO2.

We are also preparing our plans to build a lithium hydroxide refining plant likely to be located in (inaudible) in East Germany. That plant will be engineered to service the European lithium hydroxide battery grade market, hence we'll open that market for the plant lithium hydroxide technical trade facility at AMG Mineracao in Brazil. We will also comment on this when announcing the opening of our new lithium battery Materials laboratories in Frankfurt later this year.

On October 9, we also signed a definitive agreement to acquire the assets of international specialty alloys, ISA from Kennametal. That business is located in Newcastle, Pennsylvania, and it is a major step to add United States based production capabilities for alloys used in the aerospace industry.

I would now like to pass the floor to Jackson Dunkel, AMG's Chief Financial Officer. Jackson?

Jackson M. Dunkel, AMG Advanced Metallurgical Group N.V. - CFO & Member of Management Board [4]

Thank you, Heinz. I'll be referring to the third quarter 2019 investor presentation, which we posted yesterday on our website.

Starting on Page 3 with an overview of the financial highlights of the quarter. On the top left of the page, AMG's revenue for the quarter decreased by 18% to \$270 million, due primarily to lower average prices across all 7 business units versus Q3 of last year. However, although all of our business units experienced price decreases, this was offset by 5 out of 7 of our business units experiencing flat or increasing volumes.

EBITDA decreased by 59% to \$24.4 million in Q3 2019 from \$59.1 million in Q3 of last year. This was primarily due to lower vanadium profitability. Net income attributable to shareholders for Q3 decreased to a loss of \$17.8 million, compared to income of \$29.9 million in the prior year. However, net income adjusted for the inventory cost adjustment and the asset impairment expense was a \$2.4 million loss in Q3 and totaled \$25.6 million for the 9 months ended September 30, 2019.

Now I'll turn to a review of our 2 segments, starting with AMG Critical Materials, which is shown on Page 4 of our presentation. On the top left, you see that Q3 revenue decreased by 25% to \$165 million versus prior year. This decline was largely driven by lower average ferrovandium prices. But critical materials experienced lower prices in all 7 of its business

units. These price decreases were offset by higher volumes in chrome metal and in spodumene and volumes were stable across the rest of the critical materials portfolio. Critical materials Q3 gross profit on an adjusted basis decreased by \$32.5 million or 61% compared to last year's third quarter. The reduction in gross profit was largely driven by lower vanadium profitability.

Critical Materials Q3 SG&A expenses remained at \$19.6 million, consistent with the third quarter of 2018. EBITDA for Critical Materials was \$8.8 million or 78% lower than 2018, with an EBITDA margin of 5%.

Moving on to AMG Technologies, on Page 5 of the presentation. Starting again on the top left of the page, you can see that revenues slightly decreased in Q3 2019. This was due to lower prices and volumes in the titanium alloys and coatings business and was partially offset by the favorable finalization of an outstanding large nuclear contract in our engineering business during the quarter. Third quarter gross profit decreased slightly by \$0.6 million year-over-year, and gross margin was 25%, consistent with Q3 of last year.

SG&A expenses decreased slightly to \$15.5 million in Q3 2019, primarily due to lower variable compensation expense. AMG Technologies Q3 EBITDA decreased by 15% or \$2.7 million to \$15.6 million from \$18.3 million in Q3 2018 due to lower prices in the titanium alloys and coatings business.

The company signed \$79.5 million in new orders during the third quarter of 2019, representing a 1.2x book-to-bill ratio, the highest since the second quarter of 2018. The high order intake was largely driven by strong orders of turbine blade coating furnaces and induction furnaces for the aerospace market.

Turning now to Page 6 of the presentation. On the top left, you can see that AMG's third quarter 2019 SG&A expenses were \$35.1 million, compared to \$35.6 million in the third quarter of 2018. This decrease is primarily due to lower variable compensation expense. AMG's third quarter 2019 net finance costs increased to \$5.9 million, compared to \$4.7 million in the third quarter of 2018.

Third quarter 2019 includes additional interest expense associated with lease liabilities due to the adoption of IFRS 16 on the 1st of January of 2019. AMG recorded an income tax expense of \$1.5 million in the third quarter of 2019, compared to a tax expense of \$10 million from the same period in 2018. The decrease was primarily due to losses in the United States related to the decline in vanadium profitability.

AMG paid taxes of \$7.2 million in Q3 2019, compared to tax payments of \$6.3 million in Q3 2018. As a result of the year-over-year volatility in income and the timing of cash tax payments, the present cash tax rate is not indicative of the current year performance as our payments in the current year are reflective of the income in 2018 and not in 2019. Once earnings have stabilized, we believe that the cash tax rate is the more meaningful metric with regards to AMG's taxes due to the volatile nature of the company's deferred tax balances.

Turning to Page 7 of the presentation. You can see on the top left, the cash used in operating activities was \$5 million in Q3 2018 compared to cash generated from operating activities of \$23 million in Q3 last year. This decrease in operating cash flow was mainly due to acquiring

high-priced inventory, which was then sold at lower market prices for limited profitability. AMG's annualized return on capital employed was 16.1% for the first 9 months of 2019.

AMG finished the third quarter of 2019 with \$154 million of net debt. The increase versus year-end levels was mainly because AMG returned \$89.9 million of cash to shareholders through the share buyback program and made dividend payments of \$16.7 million during the year. It was also due to capital expenditures related to our expansion projects at AMG's vanadium, titanium aluminide, lithium and heat treatment facilities.

In terms of liquidity, AMG's balance sheet is strong, and we are in full compliance with all debt covenants as of September 30, 2019. AMG had \$399 million of total liquidity at the end of the third quarter of 2019.

That concludes my remarks. I would now like to pass the floor to Eric Jackson, AMG's Chief Operating Officer.

Eric E. Jackson, AMG Advanced Metallurgical Group N.V. - COO & Member of Management Board [5]

Thank you, Jackson. Prices for all of our products continued to weaken in the third quarter. This resulted in compressed margins and lower earnings as we sold higher-cost inventories. We continue to focus on shortening our inventory cycles to reduce the impact of falling prices and also on reducing costs. We are in the process of strategically improving efficiencies throughout all operations of AMG.

AMG Vanadium signed an offtake agreement with Glencore that will substantially reduce inventory levels and price risk going forward. This will result in our being able to deliver closer to run rate profitability on a quarterly basis and substantially reduce earnings volatility.

As Heinz mentioned, Cambridge 2 is progressing on schedule, and we've also signed a joint venture with Shell Catalysts & Technologies to expand globally. AMT Brazil's spodumene production has reached full production capacity and our incremental cost of producing spodumene is approaching our targets. Our profitability in Brazil, however, has weakened as both spodumene and tantalum prices have fallen. The financial performances of our other critical materials business units have similarly been impacted by falling prices, most dramatically in chrome and silica. We do believe, however, that these businesses are low-cost producers when compared to our peers and using publicly available information.

AMG Technologies delivered solid results in the quarter with after sales service and [turbine] lease holdings being particularly strong. The integration of AMG Titanium Alloys & Coatings and AMG Engineering is progressing and the acquisition of International Specialty Alloys will strengthen our North American business and provide us with a number of opportunities to gain efficiencies and expand our market share in North America.

I would now like to pass the floor to Dr. Heinz Schimmelbusch, AMG's Chief Executive Officer.

Heinz C. Schimmelbusch, AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO [6]

Thank you, Eric. The unprecedented fall in all critical material prices across the AMG portfolio has been a major challenge. The negative trend appears to be bottoming out as higher cost producers are experiencing negative cash flows in the vanadium, tantalum, silicon, metal and spodumene industries. We continue to focus on the things we can control. We have made significant strategic achievements in the quarter, which included signing a long-term offtake agreement with Glencore, as mentioned, mitigating our sales exposure and securing a tax-exempt from generating \$325 million to finance the building of a second catalyst recycling facility in Ohio. And we signed a joint venture agreement with Shell Catalysts & Technologies for the global expansion of spent catalyst recycling services. And we are closing soon on the acquisition of International Specialty Alloys, incorporated as a platform to produce several of our advanced metal alloy product lines in the United States.

Operator, we would now like to open the line for questions.

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Questions and Answers

Operator [1]

(Operator Instructions) Our first question for today comes from Martijn den Drijver.

Martijn P. den Drijver, ABN AMRO Bank N.V., Research Division - Analyst [2]

Martijn den Drijver, ABN AMRO. I have 4 questions, please. The first one is on -- could you give an update on your IPO plans for technologies planning, especially in light of the developments at GM? The second question is, in your press release, you state in the technology section, that there was a favorable finalization of an outstanding large nuclear contract. And I was wondering whether that has an EBITDA impact? And if so, what was the magnitude of that EBITDA component?

The third question is -- relates to the GM strike. If I understand it correctly, that impacted your Q3 by at least 2 weeks. So could you elaborate on the impact on EBITDA, if any? And the fourth question is, you had an environmental provision in the third quarter of \$0.5 million.

We haven't had it for a couple of quarters. Should we expect a similar amount for the fourth quarter or not?

Heinz C. Schimmelbusch, AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO [3]

As regards to the IPO question. We have formed AMG Technologies a few months ago. We are integrating the 2 business units, AMG Engineering, headquartered in Hanau; and AMG Titanium Coatings in Nuremberg, that under a common management structure -- a newly formed management structure. We are working on it and completing and advancing the business plan for this joint unit, which is cost oriented. And investing on several initiatives, which are in several stages of completion.

We are very happy that we had chances to acquire the platform in Ohio -- or in Pennsylvania, ISA, which is a very important cornerstone of the growth strategy of AMG Technologies. So that's work in progress. We are talking to several financial advisers, different advisers for the different venues. One is, of course, Frankfurt, the other is Amsterdam. And the third one is New York. New York, because of the aerospace-oriented U.S. market, most of our end customers are having large U.S. components.

The Amsterdam, because we are in Amsterdam, technically probably easy; and we are in Frankfurt because the main assets are in Frankfurt and the names -- the companies have been operated for 100 years and they are household names in the technology community in Germany.

As you know, the market for IPOs lately has been shaky, but from our advisers, we know that the IPOs, which are planned to go, for example, after August, more than half of those have been canceled. And the ones which went, were nothing to write home about, so to speak.

We are very much dependent, of course, in such an exercise. And by the way, we went public. We know what that means to go public because AMG went public. And so we are very much dependent on the market, of course. So there are 2 conditions here to be met: one, the completion of a convincing business plan convincing growth story for the company, which is proceeding well. And the other one is, we want to have an effective market condition. And as you know, the aerospace market lately had to [sew up] (inaudible) billion dollar problems in market capitalization of participants in that industry for special events. So right now, the market is not receptive for that. And we are not in a rush, we are not in a rush.

We want to -- we have no room for error here. We want to -- want this to be a perfect exercise.

The second question, you mentioned NOX. In general terms, NOX is a type of nuclear fuel, where we help customers such as Department of Energy in the United States or the government of China to produce special kinds of nuclear fuel. We are the sole technology owner in the world-scale for that. The -- you mentioned a small extraordinary or special earnings component of that. It's small, less than EUR 5 million. It is for the completion of the

concept for the Department of Energy in the United States for a plant in South Carolina. That was part of a very large contract over many years and we are presently in a very large contract over many years in the early stage. So that's the closing stage. And we are in an early stage in China.

Just for -- because we are very, very focused on our impact on climate. This plant in China will enable China to reduce CO2 by 12 million tons per year. So it's a significant plant for us because -- it is actually [3 --]yes?

Martijn P. den Drijver, ABN AMRO Bank N.V., Research Division - Analyst [4]

Did I understand you correctly because -- yes, I'm sorry to ask, but you mentioned that this -- the impact was around EUR 5 million.

Heinz C. Schimmelbusch, AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO [5]

[No more than 5.]

Martijn P. den Drijver, ABN AMRO Bank N.V., Research Division - Analyst [6]

Less than 5. Okay.

Heinz C. Schimmelbusch, AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO [7]

[significantly lower. It's less than] 3 to 4 [points.] So I talked about NOX. Yes, and the GM strike is over. Of course, we are servicing the certain sectors of the engine parts of GM, but it is not a significant thing, and especially, it's over. So talking about future, it doesn't really impact us anymore.

And then there was...

Martijn P. den Drijver, ABN AMRO Bank N.V., Research Division - Analyst [8]

Yes, but the strike lasted 6 weeks, of which 2 in Q3 and 4 in Q4. So you did have a bit of headwind in terms of EBITDA from that strike. If you could quantify that.

Heinz C. Schimmelbusch, AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO [9]

No, we don't quantify that. But of course, it was -- it had an impact. But it's over.

Jackson M. Dunkel, AMG Advanced Metallurgical Group N.V. - CFO & Member of Management Board [10]

And then environmental, that was a minor remediation at our Nuremberg plant, and it's not going to be repeated in the fourth quarter.

Operator [11]

We will now take our next question from Stijn Demeester.

Stijn Demeester, ING Groep N.V., Research Division - Research Analyst [12]

I have 3, I will ask them one by one, if I may. So the first one is on your outlook. You seem to have become more cautious in your 2020 outlook versus 3 months ago in the light of continued weak metals prices. How should we see your current rather broad guidance of increased profitability versus your estimate of a run rate EBITDA of around EUR 150 million at spot prices at the end of July? Is it possible to do this exercise again at this point in time with the current spot prices?

Heinz C. Schimmelbusch, AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO [13]

The spot prices, to give you just a rundown on September 25 to October 24. In that month, only in that month. You have like 10% fall in vanadium, 10% in molybdenum. You have 20% in vanadium pentoxide, 13% in tungsten. It's just an incredibly continuation of the fall. It seems to have stopped.

When you -- I have been in this for 40 years. If you are in such unprecedented movements in the commodity price history, it always turn. However, it is not possible to precisely time or predict the time of that turn. It happens suddenly and you can't predict it. Everybody who says you can predict it is a dreamer. You can't. So therefore, we cannot predict when this turn will happen. It will happen, we can predict that. And we also are pretty certain that we are bottoming, that this has -- it literally many of the you can analyze the single product producers in various commodities, which are publicly listed. And when you do that, you will find that these single product producers are also all in loss-making territory.

So it's that cash loss. So if you're [high in] that, then this is a very strong indication that this is bottoming out. But as I said, we can't say when. The present price level is completely unsatisfactory, and therefore, we are cautious. That's all, we are cautious. Why would I -- so nothing has changed as regard to the fundamental production capabilities and the solidity of our assets. We are the low-cost producer in most of these things, practically all of these things. Low-cost producer.

So we actually, most of our units are in positive cash flow territory. We just have to wait until these prices lift off from this unprecedented low level. This, by the way, is not anymore the price risk because that's -- I mean, you can't go negative prices. That would be -- that's the next step, but it will turn.

We don't know when. So please don't try to force me to predict the month or the quarter, when that will happen. But I predict it will happen and then fasten your seat belts.

Stijn Demeester, ING Groep N.V., Research Division - Research Analyst [14]

Okay. That's helpful. So second one is on the Glencore supply deal. In the press release, you stated it will improve working cap management and reduced market risk -- market risk. Can you somewhat more elaborate on the structure of the deal and how it will benefit your operation? For example, how is it any different from the contracts with the steel producers that you have today? And is it -- does it work at spot prices? Does it include a take-or-pay provision, et cetera? Could you give a little bit more guidance on this one, please?

Eric E. Jackson, AMG Advanced Metallurgical Group N.V. - COO & Member of Management Board [15]

Sure. This is Eric Jackson. It's a long-term agreement to purchase our monthly production. So unlike our -- the industry norm, when we sell to the steel industry, we [peak] sales and it's dependent upon their requirements. So it's an enormous improvement for us in liquidity. There's a guaranteed monthly offtake agreement.

So that's -- we, of course, had significant losses in 2018 because we built up inventories based on the slowing of demand to the end market, and that will be eliminated going forward. So we see it as a significant positive.

Heinz C. Schimmelbusch, AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO [16]

Just a second. Then you have a spike like in the vanadium -- unprecedented spike, every 10 years or so. But this spike has, of course, slowed demand. So we had a spike, price rises and higher inventories. And then the positive spike was followed by a negative spike. And then we are sitting on high-priced inventory. That cannot happen. We -- I'm not -- I make my own calculation, me and my Chief Financial Officer always tries to prevent that answer that I go in detail. But I think in -- with this spike followed by a negative spike has cost us operating cash flow to the tune of EUR [17] million. Going forward, that risk is gone because we sell our inventory on a monthly basis. As Eric said, we don't incur inventory. We sell. And therefore, this portion of the price risk is gone.

Of course, we have an index price because the contract is indexed according to the commodity price. But the quantity risk that we are incurring inventory cycles, that's gone, and that is a major achievement in this [quarter.]

Stijn Demeester, ING Groep N.V., Research Division - Research Analyst [17]

Okay. That's very helpful. The last question is also on vanadium, but then with regards to the joint venture with Shell. I understand now that it's a 50-50 JV. But yes, sort of, could you give a bit of more guidance on the time line, the possible reach of this joint venture?

Heinz C. Schimmelbusch, AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO [18]

Well, first of all, we cannot, it's under strict discipline to comment on this because we are still subject to regulatory approval in several anti-trust regions. So having said that, in general, the idea here is to build Ohios outside the United States. We are experiencing -- or the world is experiencing a very large demand for fresh catalysts. So Shell is, of course, a major producer of fresh catalysts for the refinery industry. That is a very large trend. This fresh catalyst demand because of -- partly because of the IMO 2020 legislations, the ruling out of high sulphur oil into the shipping, into the maritime industry. So that has created a shift in demand of fresh catalysts. And 18 months after employing fresh catalysts, you have spent catalysts. So totally parallel to that shift is another shift, and that's the shift of spent catalyst. And when you have a lot of spent catalysts, the question is how to recycle that.

We have done a worldwide planning exercise, where those recycling opportunities appear. And there are several projects in this regard. And we -- AMG is simply -- the growth opportunity here as such as we mentioned that we -- it could be completely unrealistic to address this as a company the size of AMG.

So therefore, we have teamed up with Shell. We're extremely happy about that Shell has chosen us. We have been doing recycling services for Shell over 10 years. And therefore, we have a very solid cooperative style and the cultures here are very consistent. And the joint ventures of that nature are then able to address the world market instead of the United States market, which is still 100% AMG exercise.

Operator [19]

Our next question comes from Frank Claassen.

Frank Claassen, Banque Degroof Petercam S.A., Research Division - Analyst [20]

Frank Claassen, Degroof Petercam. Three financially related questions, please. First of all, on the net debt, I noticed that it was quite up quite a bit during the quarter. Of course, we had the dividend and the tax payment, but what were other important drivers for the net debt increase in the quarter? And secondly, on CapEx, it's still down year-on-year. What is your CapEx budget for this year? And when can we expect the big pickup related to Cambridge 2 on CapEx? Some words on that, please. And finally, your latest acquisition, International Specialty Alloys, can you say anything about the size, how much revenues or profit it will add?

Jackson M. Dunkel, AMG Advanced Metallurgical Group N.V. - CFO & Member of Management Board [21]

Thanks, Frank. So on net debt, the increase in net debt was really driven by capital expenditures as well as the dividend as well as the tax payment. So I think that -- combine that with the operating cash flow, and you get to that level of increase. And obviously, we finalized the buyback during the quarter as well. So all 5 of those items caused the net debt to increase.

In terms of capital expenditures, we'd expect to end the year roughly at \$70 million of capital expenditures. That indicates the beginning of very strong spending with regard to Cambridge 2 in the fourth quarter. So we are beginning to build that plant, and we will be making capital expenditures on it.

Frank Claassen, Banque Degroof Petercam S.A., Research Division - Analyst [22]

And sorry to go back, so the run rate of Q4 on Cambridge 2, is that a, let's say, linear thing? Can we continue that run rate going into 2020? Or will it be sort of hockey stick? Or how does that work?

Jackson M. Dunkel, AMG Advanced Metallurgical Group N.V. - CFO & Member of Management Board [23]

So for 2020, about \$250 million of capital expenditures, the majority of which will be on Cambridge 2.

Heinz C. Schimmelbusch, AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO [24]

On the acquisition?

Jackson M. Dunkel, AMG Advanced Metallurgical Group N.V. - CFO & Member of Management Board [25]

On ISA, yes.

Heinz C. Schimmelbusch, AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO [26]

ISA is a traditional producer of titanium alloys in the United States Aerospace industry. We are also a producer of that industry consolidation. We expect the market share of that company to increase. We expect the diversification into other alloys, which we produce in other places, and therefore, we'll relocate or will add U.S. production capabilities to it, which is very important for our U.S. customers. There are certain analysts, which are being transferred, business plans for that is in the works. We expect this to be a high [cost] exercise. It was a unique opportunity and fits perfectly into our business plan for AMG Technologies.

Frank Claassen, Banque Degroof Petercam S.A., Research Division - Analyst [27]

And could you say how much -- roughly how much revenues they currently make? Is that -- could you say anything on that?

Heinz C. Schimmelbusch, AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO [28]

No. We don't want to say that, but you can expect high costs.

Operator [29]

We will now take our next question from Krishan Agarwal Krishna.

Krishan M. Agarwal, Citigroup Inc, Research Division - Analyst [30]

Yes. Most of my questions have been answered, but a follow-up on the U.S. acquisition. I mean, more of a housekeeping question. When do we see the contribution on revenue and then EBITDA to start flowing through in the P&L? Is it fourth quarter? And also the cash outflow on the acquisition, is it okay for us to assume it is fourth quarter? That's number one.

Heinz C. Schimmelbusch, AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO [31]

That's correct, but we are still a few days away from closing the acquisition. So that will happen. Then of course, then starting immediately, there will be a consolidation. Half of our consolidated financial statements then, of course, essentially starting in the new year.

Krishan M. Agarwal, Citigroup Inc, Research Division - Analyst [32]

Okay. And then can you also give us an update on the SP1 ramp up, as you mentioned that the costs are sort of running or closing closer to your target? So the target, if I'm correct, was \$200 per tonne of cash cost and then the freight cost of around \$40 to \$50. Is that the right number for us to look at? And secondly, what was the capacity utilization in the quarter? And when we should assume the sort of 100% utilization from the SP1 plant?

Eric E. Jackson, AMG Advanced Metallurgical Group N.V. - COO & Member of Management Board [33]

Actually, our production in Q3 was just above 85%, and we've operated at full capacity in the last little while. You're correct on the targets, that freight target you gave was for an FOB Brazil price, and our sales, our SIP China, you can work out the numbers from the FOB pricing.

Krishan M. Agarwal, Citigroup Inc, Research Division - Analyst [34]

I understood. And then, finally, a question for Jackson. Is there any further working capital we should bake into our model for the fourth quarter, given the pricing [efforts any] lower?

Jackson M. Dunkel, AMG Advanced Metallurgical Group N.V. - CFO & Member of Management Board [35]

Well, as Heinz noted, the October drop in prices was roughly 10%. So obviously, any kind of --

Heinz C. Schimmelbusch, AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO [36]

Unexpected.

Eric E. Jackson, AMG Advanced Metallurgical Group N.V. - COO & Member of Management Board [37]

Unexpected. Any kind of inventory cost adjustment is valued at the last day of the quarter. So I'm not sure where the last day of the quarter end. But prices have gone down since September 30.

Krishan M. Agarwal, Citigroup Inc, Research Division - Analyst [38]

But this would mean that there should be a release of working capital?

Jackson M. Dunkel, AMG Advanced Metallurgical Group N.V. - CFO & Member of Management Board [39]

Yes.

Operator [40]

We will now take our next question from Henk Veerman.

Henk Veerman, Kempen & Co. N.V., Research Division - Research Analyst [41]

Some follow-up questions on the topics already discussed. So firstly, on the vanadium business in your first plant, which is currently already in operation. From what I've understood, you're also renegotiating some contracts there with regards to pricing, but also the timing of when the pricing is being fixed. Maybe you can elaborate on that because I think that's going to potentially also eliminate a lot of volatility and results? That's my first question.

Heinz C. Schimmelbusch, AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO [42]

Yes, we are not renegotiating. We are negotiating prolongations. And given the market conditions, the so-called tipping fees or recycling fees, which is the most important element of our cash flow generation, is going up. And that is a very important point because we even thought we should rename the operation from AMG Vanadium into AMG Recycling, because it is more a recycling activity than a commodity activity.

So also, you are correct that we are compressing the period in which we are incurring price risk when the transfer is down from the supplier to us, then there's a certain point where we incur whereby the price is fixed. And from then, there is a period until the sales occur.

Now we have that price risk period has been down, negotiated down considerably. And that -- and a part of that strategy, which is having several components. Of course, because we produce 3 different metals, and so that has been very successful. That exercise to reduce our risk.

And by the way, we are the world's lowest cost producer of ferrovanadium. We also are starting to produce a different vanadium product. Again, the low-cost producer in that. And so we experienced low profit margins, but we are profitable even when the prices fall further, which is not expected.

Henk Veerman, Kempen & Co. N.V., Research Division - Research Analyst [43]

Perfect. Second question on the Shell agreement, I appreciate that there are no forward-looking statements here. But maybe you can elaborate a bit on what the current activity are in

the JV. Should we think about like the planning is already ongoing? Or is it a little bit of a sleeping JV until a certain point where Shell says, "okay, we have built a certain factory. So now we can start the process of building a -- like an Ohio-type plant."

Heinz C. Schimmelbusch, AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO [44]

This is other than -- everything else but sleeping. When you look at my travel schedule and the travel schedule of Eric Jackson, this is an exercise which is very much alive and the market -- the market in fresh catalyst is actually exciting. And you just have to analyze the IMO legislation. The consequence of the IMO legislation as regard to heavy fuels or heavy oils picking a new home having lost the market for maritime applications.

The IMO legislation speculates that the sulfur content of the maritime oil cannot exceed 0.5%, down from 3.5%. There are different estimates, but a few hundred million tonnes of oil are looking for a new home. It's the biggest single structural exchange in the oil industry as far as I can remember. And therefore, (inaudible) units and other technologies are being activated in order -- and these de-sulfurization units and refineries have to be fitted with fresh catalysts. So there is this shift, it's literally a shift, a capacity shift in such catalysts, which 1:1 leads to spent catalysts. Spent catalysts, for example, in the United States are [half of our weight]. We are the world's leading technology owner. We are the owner of the world's leading technology to environmentally completely safely to extract the metal from those streams of waste. And our technology provides a 99.8% purity. So we eliminate whatever is hazardous here into commercial products. And that is, therefore, an excellent market. It will change many things. It will also be, of course, a very low-cost exercise as regard to the production of vanadium because of the fees. Fees which essentially cover the operating costs.

Henk Veerman, Kempen & Co. N.V., Research Division - Research Analyst [45]

Perfect. Two remaining questions. So firstly, on the lithium chemicals, construction of that plant. There's still no contract in place, no uptake agreement, whereas from the comments made earlier this year, you've hired a team of senior like experienced people, the Ecopro negotiation have also turned quiet. Could you maybe give an update on that? And is there still -- are there still negotiations ongoing? Or how should we see that?

And then secondly, maybe just one for Jackson. When you look at the cash flow statement, if you look at the working capital inflow in the third quarter, I would have expected that to be a bit higher. Could you comment on that? And also, where does the noncash inventory adjustment has to be made also net working capital line?

Heinz C. Schimmelbusch, AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO [46]

As regard to the issue, there's not really a change. The change is that what we got planning to maybe conceptually planning to build in Korea is now to be built in Germany. What we are doing is, there is a plant under feasibility studies to produce battery-grade hydroxide in Germany. The market, the movements in the market from the demand side for cathode materials in Europe is very, very alive. And we want to be a very early entrant into providing hydroxide for that market.

Battery grade, the concept here is to transfer lower-quality lithium hydroxide, regular technical trade materials out of spec grade hydroxide into battery grade [homogeneous] qualities, which are then addressing the cathode materials market.

That is a very safe strategy because there are -- there's a need for such a quality [homogenizer] is obvious. And that was the same essential thought in Korea, but it's now happening in Europe, that also has to do with the need to provide very fast deliveries of such battery-grade materials which have extreme difficulties to be transported over long distances.

So that's underway. And you mentioned that we have new management that's here for that, with people who have done this before. And in Brazil, this will be then supported by technical grade, So not battery grade, but technical hydroxide. It lowers the investment needs in Brazil. And has an outlet for the -- so we will be our own customers to a certain extent, but the capacity in Germany will be larger than the capacity in Brazil, as we expect to feed the plant also from users around the world, which need to be -- which want to be in the European market, but don't like the quality here.

It's in a level of strategy for our investor decisions will be done in the first quarter. Second quarter, maybe March, as [past a] month for investor decisions, both for the Brazilian chemicals and German part. We are in negotiations about the financing of that. So all of that is in good shape.

Jackson M. Dunkel, AMG Advanced Metallurgical Group N.V. - CFO & Member of Management Board [47]

In terms of the cash flow, you can see a \$10 million cash flow from working capital. The components of that, if you look at the balance sheet, are a drop of \$74 million in inventories, which does include our noncash inventory cost adjustment. However, that is offset by a \$70 million decrease in accounts payable due to the lower prices that we are purchasing for our raw materials and also increased by the increased advanced payments which you can see moved -- increased by \$7 million, which is associated with our very large order intake in Engineering. So if you add that all up together, it's roughly \$10 million.

Operator [48]

On that regard, next question comes from Andreas Markou.

Andreas Markou, Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst [49]

Pretty much all my questions have been answered, except one. Maybe if you can comment a little bit on the outlook for the vanadium market. So I know you don't want -- or you can't really say about your expectations about prices. But how do you see demand changing on the vanadium market? And when would you expect a stricter implementation of the REBA standard in China?

Heinz C. Schimmelbusch, AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO [50]

We believe that the enforcement of the REBA legislation was slowed down when the [buy] price spike occurred. So there are probably relationships between the various decision-makers in China and there was pressure, for steel produces to slow down. If this is, however, corrected. And we believe, lately, we had big conferences in China, and we saw the market is actually that this is now happening, the REBA legislation, and that is a major shift.

If enforced, that will be correcting the whole scenery in the vanadium industry. Now that's demand. Demand also is affected by the demand from the battery sector which is starting to be a factor. And don't forget supply. The supply is now -- the Chinese supply is not growing. Several sources in China, which were activated, stone coal-based producers, which are activated by the spike in prices have -- are on their way out because they are losing money.

So this spike has disturbed -- has reinforced itself and then collapsed, and that eliminates certain marginal producers. And you can analyze that, as I said, in the public -- in the publicly listed related companies. So we believe there's a price correction in place. It always happens. It will happen again. As I said, I can't predict timing.

Andreas Markou, Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst [51]

But you are not confident about this implementation happening potentially in the short-term from your analysis?

Heinz C. Schimmelbusch, AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO [52]

So no. I'm confident that it happens short term. It was only interrupted in this price spike because it was too hurtful for many producers, but this is not as hurtful anymore because the prices fallen dramatically. I mean, when you look at this price spike, it went up at 70% and down by 70%. I mean, this is unprecedented.

Operator [53]

Thank you. We do have one more question queued up at this time. Up to the presenters if they wish to take it.

Michele Fischer, AMG Advanced Metallurgical Group N.V. - VP of IR [54]

Yes, Last question.

Operator [55]

We will now take our last question. It comes from [Jack Miller].

Unidentified Analyst, [56]

Just on the -- regarding the comments about the IPO market in general. Would there be -- would you consider any other options given how -- given the market's hard work? I mean, would you consider a trade sale or anything like that if there were interested parties?

Heinz C. Schimmelbusch, AMG Advanced Metallurgical Group N.V. - Chairman of the Management Board & CEO [57]

Well, we are targeting -- if this investment occurs, we are targeting a minority stake of the aerospace activity. That's the base case. Never say never. If other opportunities occur, we will carefully analyze them and (inaudible) impact is significant.

Michele Fischer, AMG Advanced Metallurgical Group N.V. - VP of IR [58]

Okay. Operator, please end the call.

Operator [59]

Thank you. This will conclude today's Q&A session. Are there any closing or additional remarks from the presenter's side?

Michele Fischer, AMG Advanced Metallurgical Group N.V. - VP of IR [60]

No.

Operator [61]

Thank you. Well, ladies and gentlemen, this will conclude today's call. Thank you all for your participation. You may now disconnect.

