Event Transcript

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Start of Transcript

Operator: Ladies and gentlemen, thank you for standing by and welcome to the Galaxy Resources 2019 full year results conference call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question and answer session for analysts and institutional shareholders. To ask the question during the session, you will need to press star, 1 on your telephone. Please be advised that this conference is being recorded. I would now like to hand the conference over to your first speaker, Simon Hay. Thank you. Please go ahead.

Simon Hay: Good morning everyone and welcome to the call. Joining me today is Alan Rule, Chief Financial Officer. The format of this call will follow the full year results presentation that was released on the ASX this morning. I'll begin the call by touching on the operational highlights for 2019, then pass to Alan to discuss the financial results. I'll then come back and provide a short update on what we can expect to see in the coming months.

As usual, we'll follow the call with a Q&A session for analysts and institutional shareholders, however, we recognise the ongoing interest of our other investors and stakeholders and so we'll be setting aside two hours immediately after this call to address their questions. For those who want to take up this invitation, please ring our Perth office line between 9:30am and 11:30am Perth time, where Phoebe and I will be available to field your questions. Before we begin, just a reminder that today's discussion will include forward looking statements that are subject to various risks and uncertainties concerning specific factors. Information presented represents our best judgment based on today's information, actual results may vary according to these risks and uncertainties.

So, firstly to sustainability on slide 3, which is a key focus in all our operations and our corporate strategy. In 2019, we started to align our environmental, social, and governance practices with international frameworks. The preparation of our first sustainability report is well advanced and we will be releasing this in April. From a safety perspective, our operational mine at Mt Cattlin still remains LTI free. In 2020, we'll be refreshing our safety programs with the objective of improving our safety outcomes.

Our efforts to create positive relations with leaders in neighbouring communities in Catamarca, Argentina is advancing. Our CSR projects are on track and the local communities are very engaged with and grateful for our initiatives. I recently met with the new governor of Catamarca and the new federal mining secretary where we discussed meaningful ways in which they can support the development of the Sal de Vida project and we're quite hopeful of positive advances in that front in coming months.

Moving on to slide 4, strategy. November last year, we released a corporate strategy that focuses on accelerating our growth plans and we remain on track with the timings communicated at that time. Mt Cattlin's new operational plan kicks-off this week and Sal de Vida's pilot program and works required to reach a final investment decision on stage 1 are progressing well. I'll touch on both those subjects later in the call.

Market and financials on slide 6. Galaxy performed well in areas within our control. Mt Cattlin achieved records across many key performance indicators in 2019, including record spodumene production of 191,000 tons, a 22% increase compared to 2018 and unit costs at US$391 per dry metric tonne were a 13% reduction year-on-year. This reinforces that we're a low-cost producer and have the operational capability to deliver robust production volumes of high-grade lithium concentrate.

Looking back at the year, it's fair to say challenging market conditions prevailed in the lithium sector, particularly in the second half due to lower than expected demand in China, coinciding with an increase in supply of lithium from both brine and spodumene producers. Due to the declining market conditions, our financial performance deteriorated significantly compared to 2018 and our net loss of US$283.7 million is disappointing. The major contributor to this loss was the decline in spodumene price, which necessitated the write down of inventory impairment of Mt Cattlin carrying values and derecognition of deferred tax asset leading to a combined negative impact of US$245.9 million.

Pleasingly, our balance sheet remains very strong with cash and financial assets of US$143.2 million at year end. In addition, we hold inventory of 65,000 tonnes of final product and we'll seek to monetize this across 2020. I'll now hand over to Alan for the review of the financial results in more detail.

Alan Rule: Thank you Simon, and good morning everyone. Before looking at the financial performance in detail, I would like to provide some background to two items that are key components of the financial performance for the year, namely the write-downs, impairment and the fixed rate note. If we look at page 8 on the write-downs and impairments, the accounting standards required a non-cash write down and impairment due to subdued spodumene prices. Looking at the inventory on hand. Due to current weaknesses in spodumene prices, the forecast net realisable value of inventory on hand at the end of December, when it is sold, is forecast to be less than the total cost of goods sold, which includes both cash and non-components. As a result, a further impairment at the end of December of US$10 million is required, taking the total impairment of inventory or a total write-down of inventory for the year to US$23.6 million.

Looking at property, plant and equipment and right-of-use asset, I'd like to clarify what is meant by a right-of-use asset. Galaxy adopted the new lease accounting standard at 1 January 2019, resulting in the right-to-use underlying assets within a lease being recognised as an asset on the balance sheet. At Mt Cattlin the leases that form part of these right-to-use assets include the power plant and crushing circuits that are provided by contractors. A liability for future lease payments was also recognised. Thus, an asset and liability for each qualifying lease are recorded on the balance sheet that almost offset each other. The balance sheet was grossed up by US$31 million at 1 January 2019. The right-to-use asset forms part of the Mt Cattlin cash-generating unit when assessing any impairment. Therefore, under the accounting standards we are required to pro rata any impairment across the entire Mt Cattlin cash-generating unit including write-off assets. As you are aware, we impaired the Mt Cattlin cash-generating unit by US$123.5 million at the half year.

At the end of December, the current forecast spodumene prices for the remaining life at Mt Cattlin, from a basket of analysts and forecasters, were lower than the spodumene prices used at 30 June 2019 in the impairment assessment. This resulted in an additional impairment of US$65.4 million of the Mt Cattlin cash generating unit at 31 December 2019. Interestingly if we'd used the price forecast that we had at the 30 June impairment assessment review, the impairment at the end of December would have been less than US$10 million. The deferred tax assets were derecognised at 30 June due to insufficient forecast taxable income available to utilise previously capitalised carry-forward tax losses.

In summary, each of these items is non-cash and if in future periods prices improve and medium-term forecasts return to stability then a reasonable portion of this impairment to property, plant and equipment and the right-of-use assets may be reversed through the P&L and if there's a forecast tax payable amount, the deferred tax asset would be re-recognised to the extent required to offset any taxable amount.

Moving on to page 9, the purchase of a fixed rate note. In August 2019, Galaxy Sal de Vida purchased 12-month Argentinian peso or ARS denominated US$50 million fixed rate note. The primary drivers of this purchase were firstly to generate stronger returns from funds held by Galaxy Sal de Vida to fund monthly cash requirements in Argentina, secondly to retain a principal amount of about US$50 million within Galaxy Sal de Vida to show commitment to the project and thirdly to eliminate the risk of any tax leakage in Argentina at 30% on any unrealised FX gains on US dollars held. The equivalent amount on this US$50 million of tax would have been at US$4.5 million. Also, to prevent any further dividend withholding tax of 7%, equivalent of about US$3.5 million in Argentina if this amount had been paid as a dividend within the Galaxy Group. During the year, Galaxy Sal de Vida paid a dividend of $107 million before withholding tax to its Galaxy parent company in Canada. That resulted in a dividend withholding tax of $7.5 million being paid to Argentina. So we left US$50 million in Galaxy Sal de Vida and moved $107 million out via a dividend.

The key commercial terms of the fixed rate note is set out in the presentation but it includes a coupon of 45.62% paid monthly on the ARS principal in US dollars at the prevailing exchange rate on the date of payment. The accounting treatment of the fixed rate note is not a traditional mark-to-market valuation of the fixed rate note, as it does not take into account the interest to be received from 1 January 2020 until maturity of the note in August 2020, nor does it adjust for the forward curve exchange rate.

The accounting treatment that we have applied in these financial statements is to recognise interest every month in the profit and loss on an accrual basis. We have thus recognised US$6.7 million in interest income from August to 31 December of which US$5.8 million had been received by early December, with the next interest payment received around 10 January. We revalued the principal of ARS$2.2 billion at the spot rate at 31 December which was 59.92 compared with 44.08 on the issue date. This resulted in an unrealised FX loss of US$13.2 million. Thus, the net impact through the P&L is a net loss of $6.5 million, made up of the unrealised FX loss of US$13.2 million and the interest received of US$6.7 million.

Depending on the ARS/ USD FX rates on the date of payment each month for the period 1 January to 10 August, we will receive between $9 million to $10 million in interest income. If the interest rate stays at around 60, we'll receive about US$10 million, if it moves to 70 we will receive about US$9 million. When Galaxy Sal de Vida made the initial purchase in August 2019 it was not expected that the exchange rate would collapse to the extent that it did from 44 at the time we purchased to 59 within the space of two weeks. In summary, Galaxy will receive US$9 million to US$10 million in interest income during the period January to August 2020, that will be used to fund a substantial portion of expenditure at Sal de Vida during the period.

If we move on to page 10, the P&L, the key items to note is revenue was impacted by a 46% reduction in the average realised selling price and a 17% reduction in sales volume compared to 2018. EBITDA of US$6.8 million before inventory write-down and as a result of the significant impairment, future earnings will be positively impacted by materially lower depreciation and amortisation in coming periods.

Page 11 has got the cash flow analysis. There's a fair amount of detail on this page, I would prefer to focus on the next page, which is the waterfall of the cash from December last year through to the cash and financial assets at December 2019. The key items to note are the receipt of proceeds of US$271 million from the POSCO transaction, less income tax paid during the period on the sale. As we've said previously we've got a significant inventory build-up of 65,000 tonnes of spodumene concentrate. The cash component of that build up is US$27.6 million that will be monetised as these stockpiles are drawn down in 2020. The closing balance of US$143.2 million includes the closing balance of the fixed rate notes of US$36.8 million, which is included in financial assets.

Moving on to the balance sheet on page 13, you can see the impacts highlighted of the adoption of the new accounting standard AASB 16 Leases that has effectively grossed up the balance sheet and the impact of impairment in fixed assets, property, plant, and equipment.

Finally, Alita. As you're aware, after purchasing the debt, Galaxy undertook a detailed assessment of Alita and proposed a deed of company arrangement to the administrator, competing third-party DOCA accepted by the administrator providing the funding required to repay the debt facility to Galaxy. This was completed in December after Galaxy was not prepared to amend the offer terms of its proposed DOCA. Galaxy's debt was subsequently repaid in full, leaving this company debt-free at the end of December. Thank you, Simon.

Simon Hay: Okay. Thanks, Alan. Look, it's worth reiterating on all those financial results, the write-downs and impairments are due to the impact of pricing, whereas the controllable areas of production and unit cost had positive outcomes in 2019 and made no contribution to the write-downs and impairments. Moving on to the outlook, Slide 16. Firstly for James Bay this week the Cree Nation and the Quebec provincial government signed a C$4.7 billion alliance agreement which is to cover road, rail, power and port infrastructure in the James Bay region. Whilst we're awaiting further details in regard to timing and project specifics, this is bound to be a positive development for the James Bay project. Our relationship with the Cree Nation and the negotiations on the Impact Benefits Agreement are both on a very sound footing. Elsewhere on the project, site geotechnical works are gearing up as part of the value engineering phase which will run for the remainder of this half.

Mt Cattlin, slide 17. Last month, we provided guidance on our operational settings for 2020 which attempted to adapt to current market conditions. Our new operating plan complements our current inventory levels, prioritises low-grade stockpiled ore and can be swiftly ramped up in response to increased market demand. Plant operations recommenced earlier this week on plan after a scheduled break over the Christmas period and our new mining contractor is mobilising to site with load and haul operations to commence early next month. Construction of the ore sorter project is mostly complete and commissioning has commenced and a reminder that this project enables the upgrading of low grade stockpiled ore for processing.

Moving on to Sal de Vida, slides 18 and 19. Our focus this year will be on the staged development of Sal de Vida and the project remains on track to meet the major milestones required to arrive at an investment decision on stage 1, in early H2 2020. Front end engineering and design and major packages is gearing up, with tenders out on ponds and wellfield package and the process plant package will follow shortly. Other work fronts like logistics and energy are advancing through the definition phase.

On site, the camp upgrade has been completed and works on the ponds is advancing rapidly. 14 of 31 ponds have been lined and 4 have been filled with brine. Installation of the pilot plant is also going well and commissioning will start next week, enabling the refining of operating assumptions and allow for customers to trial the primary lithium product. On the sell down process of a minority stake in the project, this continues on schedule, counterparties remain fully committed to the process and we're at final due diligence stage.

Moving on to the market, the start of 2020 has seen our customer base in China affected by the impacts of the coronavirus. In January, we reported that a number of sales negotiations were at an advanced stage. This continues to be the case. However, customers are not in a position to conclude purchases due to the constraints on many aspects of their business. This includes the shutdown of most of the conversion facilities in China. There is little visibility on when regulators will allow restarts, although we do note positive recent comments on other industries resuming work this week and next in provinces other than Hubei.

Port and logistics functions are also hampered due to a large portion of the workforce in quarantine or not having returned to work. The situation is changing daily and therefore we will I not be providing sales forecasts at this time until some clarity returns to our customers and the market in general. A reminder that our 2020 production is fully contracted in terms of volume and once clarity returns to the market we expect customers to confirm shipping schedules. The prices will continue to be on a spot basis for H1 2020 at least.

On macro industry trends, we've seen further positive demand indicators to support the long-term growth of the lithium sector. For example, it is widely reported that Britain brought forward the banning of the sale of new petrol/diesel and hybrid cars by five years to 2035, one example of many new programs underway. On the supply side, we continue to observe rationalisation. Yesterday, Eramet announced their Centenario Ratones project in Salta Province was placed on hold and earlier in the month, Tianqi reported the commissioning at Kwinana was delayed. I think most supply-demand models would have banked both these projects in, so we expect these delays to have a positive impact on medium-term pricing forecasts. For Galaxy, both developments continue to support our approach, which is to invest counter-cyclically and the belief that when we bring Sal de Vida online in approximately two years' time, it'll be in far more positive market conditions. I'll now hand back the call to the operator for Q&A. Thanks, Iva.

Operator: Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. If you are an analyst or institutional shareholder and wish to ask a question, please press star-1 on your telephone keypad and wait for your name to be announced. If you wish to cancel your request, please press the pound or hash key. Your first question comes from the line of Rahul Anand from Morgan Stanley. Please ask your question.

Rahul Anand: (Morgan Stanley, Analyst) Hi, Simon and team, thanks for the opportunity. If I can start with mine life at Mt Cattlin and what your focus is going to be going forward post Alita, how do you view the assets and the longevity? That's the first one. Second one is around costs at Mt Cattlin, are there any other actions that can be taken or have been identified already that could potentially help the cost base lower on a permanent basis? Then third and last question is related to the markets, in terms of inventory levels, how are you viewing the market? I know it's a bit early, especially given the coronavirus, but have you had any conversations outside of that in terms of how demand is evolving for the rest of the year?

Simon Hay: Okay. Thanks, Rahul. Taking your questions in order, longevity of Mt Cattlin, this year we are operating at half rate effectively, so that does obviously push out the mine life by the same amount of time. This year as you know we are bringing in the low-grade stockpiles that have already been mined so that helps our mine life. We have an exploration program that we've talked about a little bit last year, we have fine-tuned the program and have a couple of targets that we'll be going after, probably this year and we'll start communicating a little bit about that once we finalise our program. But, overall, the mine life, no real change.

Rahul Anand: (Morgan Stanley, Analyst) So you said you've identified some drill targets etc so that's not part of your current budgets, right? You're going to provide those to the market as and when you've identified an appropriate target set?

Simon Hay: Correct. It will be moderate expenditure, less than $5 million.

Simon Hay: On costs, certainly a strong focus in my time but pre that as well. We have had a range of successes that we have managed to achieve with contract renegotiations across the board from marketing through to the other services that are provided at Mt Cattlin, that work will continue. The best thing we can do about our unit cost this year is get more of the low-grade stockpiles through the ore sorter, that's going to be our key focus area is running that aspect of the project really hard and running the rest of our plant really hard in that restricted time frame that we have where we're approximately two weeks on one week off on the operating side of things.

In regards to the market we haven't seen any price deterioration since last year. The contracts that we are very close to signing with were at the same price or even marginally above where we were at the end of last year, which is quite positive. Certainly the shipping costs have come way down with all the coronavirus impacts, we're navigating through that because it comes with extra conditions, however net price to shippers seems to be coming well down. Demand, we as I said remain fully contracted in terms of volume for all our production, the discussions with the customers remain positive outside of the coronavirus. We have to navigate that through over the next few months, longer term to medium-term for this year in front of us our volume commitments from the customers appears steady.

Rahul Anand: (Morgan Stanley, Analyst), In terms of James Bay, seems to be quite welcome news. When do you expect to hear more about this infrastructure program and what parts of the region are covered?

Simon Hay: Firstly, on the region it is all around James Bay and Quebec. If you read some of the announcements, they specifically mentioned lithium projects and we know ours was one of those that they mentioned so we are pretty certain that it will be beneficial. We know the road that they're talking about upgrading, that goes right to our site. The railhead is 380 kilometres south of the mine site and they're talking about pushing that further north, again in all our preliminary planning we expect to use that rail head, so if that comes closer to the mine site it can only be beneficial. Power is a key input into the mine site and that was also mentioned in the infrastructure package. So, look too early, Rahul, We will be paying close attention to further detail around those announcements and the specifics around the infrastructure projects that are to be covered, once we understand those implications, we'll be communicating that further.

Rahul Anand: (Morgan Stanley, Analyst) Perfect. Thank you.

Operator: Thank you. Your next question comes from the line of Reg Spencer from Canaccord. Please ask your question.

Reg Spencer: (Canaccord, Analyst) Good morning, guys. Firstly, how do I get my hands on one of these Argentinean fixed rate notes returning 45% in 12 months? I am being a little bit facetious about that, but it looks like there'll be a pretty useful mechanism for you in Argentina. Just confirming that the coupon or the interest from that fixed rate note remains in Argentina and that's not going to change? You're not going to look to repatriate any of that?

Simon Hay: No, that's right, Reg and that's what's used every month to fund the in-country cash requirements.

Reg Spencer: (Canaccord, Analyst) Okay. Just a question on the market, everyone is talking about coronavirus. I 'm not sure if you caught the news or there is discussions or speculation, if you will, around China extending subsidies for new energy vehicles in China. Have you heard any more about this from your customers? Could that, let's call it, post-virus stimulus, do you think that's going to have a meaningful impact on demand at any stage in 2020?

Simon Hay: Look, we haven't heard specifically, Reg. We're reading lots, and staying in touch with many people inside the country. There is a range of stimuli that have been suggested but, look, nothing that we've heard confirmation of and it's a very fluid situation, it's changing daily, so no, nothing specifically on EV subsidies.

Reg Spencer: (Canaccord, Analyst) Just lastly, the fluid situation that you referred to, you haven't made any concrete changes to your production plans this year, but given the uncertainty that's prevailing, would it not be better to extend the processing shutdown and look to monetise some of those spodumene stockpiles that you've got or you're still playing it day by day and that may be a decision that you could make it at some point in the not-too-distant future?

Simon Hay: We are monitoring the impact on a regular basis and in daily communication with a number of our customers and their volume requirements remain the case. So at this stage we're not going to trim back anything. Of course, there will be a short-term interruption with Q1 shipments, but longer term the customers are not in panic mode by any stretch.

Reg Spencer: (Canaccord, Analyst) Okay. None of your customers are in Hubei?

Simon Hay: No they're not in Hubei, they're in surrounding provinces

Reg Spencer: (Canaccord, Analyst) Okay. That's great. Thanks very much, guys. Appreciate it.

Operator: As a reminder to all analysts and institutional shareholders, if you wish to ask a question, please press star one on your telephone keypad now and wait for your name to be announced. Your next question comes from the line of Warren Edney from Baillieu. Please ask your question.

Warren Edney: (Baillieu, Analyst) Hi, probably a question for Alan. If I just wanted to normalise the profit or the results for the write-downs, what sort of tax rate would I use? Because last year, the effective tax rate was around 36%, this year it's 22%. If I wanted to back that out, Al, can you give us any guidance on that?

Alan Rule: The effective tax rate on normalised earnings should be 30%.

Warren Edney: (Baillieu, Analyst) So I can just apply that to the $245 million?

Alan Rule: Yes.

Warren Edney: (Baillieu, Analyst) Okay. Thank you. That’s all.

Simon Hay: Okay. Thanks Warren.

Operator: Your next question comes from the line of Nick Herbert from Credit Suisse. Please ask your question.

Nick Herbert: (Credit Suisse, Analyst) Good morning, gents. Thanks for the presentation. An easy one from me also please. Just after some Capex guidance for the coming year. I think in the December quarter you mentioned around US$2 million to US$3 million for Mt Cattlin, it sounds like potentially up to US$5 million for exploration, Sal de Vida was US$20 million to US$25 million subject to any investment decision, so just wondering if there's any changes to that and also what's allocated to James Bay?

Alan Rule: Yes. Nick, no change to that. James Bay is $4 million to $5 million.

Nick Herbert: (Credit Suisse, Analyst) Okay. Thank you.

Simon Hay: Sorry, Nick. Exploration, that would be over two years and the upper end would be $5 million. You'd probably put a number like $2 million in for this year.

Alan Rule: But no decision been made on that yet.

Simon Hay: Correct. Yes.

Nick Herbert: (Credit Suisse, Analyst) Okay. Great. Then Do you mind just reminding me on that $4 million to $5 million on James Bay, where does it get you to in terms of studies there and just timing around those?

Simon Hay: In regard to timing, by the middle of the year we will complete the value engineering phase, complete the ESIA, and hopefully have that signed off with the government. We're well advanced in that, we're in the second round of queries at the moment. Also, we expect that the IBA with the Cree Nation would be close to being finalised, if not finalised in a provisional form. That puts the project on a much firmer footing in regard to making an investment decision. It's really around developing an outlook for what the project looks like, I'm not saying we're going to update a feasibility study or do anything like that, but we'll certainly be much closer to final capital and operating costs.

Nick Herbert: (Credit Suisse, Analyst) Okay. Great. Thanks guys.

Operator: As a final reminder to all analysts and institutional shareholders, if you wish to ask a question, please press star one on your telephone keypad now and wait for your name to be announced. We have no further questions from the telephone lines. I would now like to hand the conference back to your presenters. Thank you and please continue.

Simon Hay: Thanks everyone for your time today and a reminder to our other investors, we'll be taking calls for the next two hours and to call our Perth office line. We'll answer calls in the order received. Should we have a lot of interest, we'll record numbers and get back to people promptly. So thanks very much everyone for your attendance today.

Operator: Ladies and gentlemen, that does conclude our conference for today. Thank you for your participation. You may now disconnect.

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