Johnson Matthey Plc Conference Call

Thursday, 11th November 2021

Operator: Good day and thank you for standing by. Welcome to the Johnson Matthey 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. To ask a question during the session you will need to press star one on your telephone. Please be advised that today's conference is being recorded. If you require any further assistance, please press star zero. I would now like to hand over the call to your first speaker today, Mr Martin Dunwoodie, Head of Investor Relations. Please go ahead.

Introduction

Martin Dunwoodie

Director of Investor Relations, Johnson Matthey Plc

Great, thank you. Good morning everyone. You've probably seen the announcements we've made this morning. I'll keep it very brief. I'm pleased to introduce Robert MacLeod, our Chief Executive, and Stephen Oxley, our Chief Financial Officer, who will give a short introduction and then take your questions. We have 45 minutes for the call; we've got a hard stop, I'm afraid, after that. But with that, I will hand over to Robert MacLeod.

Battery Materials Exit

Robert MacLeod

Chief Executive Officer, Johnson Matthey Plc

Thank you, Martin, and good morning everybody and thank you for joining this call at such short notice. I appreciate this is a busy time and you all have lots of other things going on. But you should all have seen the release today outlining our intention to exit our Battery Materials business and I thought that it was important to take you through the rationale and give you the opportunity to ask any questions you may have.

Changing Market Dynamics

Reduced returns

First of all, if I look at the overall market for Battery Materials it is growing rapidly as the demand for battery electric vehicles builds momentum and pace, and, as you know, it's for those reasons that we were attracted to this market. We believe that our high-quality technology capabilities could enable us to provide better solutions to our customers, such as eLNO, and this could enable us to deliver appropriate returns for our shareholders. And we've made good progress in testing eLNO, with positive independent verification and feedback from customers that our technology is strong and competitive. However, despite this, what we've seen over the recent months is that our thesis has come under pressure, given the changing market dynamics, which I'll talk through, and these have reduced the returns that we believe the business would be able to generate.

Competition and Capital Intensity

There are two specific areas where we've seen considerable change: competition in the market and capital intensity. Firstly, cell manufacturers and OEMs are driving cost down rapidly. They're doing this in a number of ways; for example, by adopting different technologies, such as mid-nickel and LFP, for certain applications and looking to drive economies of scale across the whole battery supply chain. While they're still committed to high-nickel materials, their cost-down targets are accelerating the commoditisation of the battery materials market. This is inevitably putting pressure on pricing, which is reducing the potential for us to achieve our anticipated higher returns.

High Capital Intensity

And secondly, through exploring strategic partnerships it has become clear to us that our capital intensity is too high compared with other more established large-scale, low-cost producers. The acceleration of the capacity required in the market is happening at a time when we are trying to scale-up as rapidly as possible. We're doing this with a technology and scale of manufacturing which are not our core expertise. That would be difficult at any time for anyone, but we're doing this without the benefit of learning and experience that other companies have who have been in the market for longer. This puts us at an inherent disadvantage, with no time to catch up.

Strategic Partnerships

Given the increasing pressure from these factors, that's why we announced earlier this year that we were looking for strategic partners to accelerate our way up the learning curve that I just mentioned. We've talked to a number of potential partners, but without an agreement in place, we've reluctantly come to the conclusion that we should not continue to invest in this business on our own. Fundamentally, there isn't a way for us to achieve a satisfactory return from this business, and we believe our capital is better deployed in our other higher returning growth businesses. And these exciting other opportunities are accelerating towards us. For example, the decarbonisation of the chemicals value chain and creation of the circular economy, which will both benefit Efficient Natural Resources, and the numerous opportunities within hydrogen technologies. Freeing up resources that would otherwise have been invested into Battery Materials will enable us to invest faster to accelerate our progress in these areas.

Timing

And lastly in terms of timing. You might ask why we're making this decision now. Well, the answer's quite simple. In programmes like this, you have various stage gates and go, no-go decision points, and we're at such a point now. We were facing some very big investment decisions with significant further costs in the near future, such as the ongoing ramp-up of our plant in Poland, the commitment to build a larger plant in Finland and the signing of long-term nickel and cobalt supply agreements.

Summary

So, to summarise the factors that have led us to this point, our technology is good and well-received by our customers, but the market is commoditising quickly and is clearly moving towards a low-return scale play. Capital intensity has increased and we're too far behind on the experience curve to be able to catch up anytime soon. And, finally, we're at a point now where, if we were to continue, we would have to commit to further large-scale investments without adequate returns. Whilst this is a difficult decision to take and painful for all those in the business who have worked hard to make it succeed, the board and I believe it is the right decision to make for our shareholders.

Looking Ahead

So what happens next? We've informed our teams of the decision that we have made today and, at the same time, we've stopped any significant capital spend. As mentioned in our release, we're looking at ways to sell all or parts of the business, and we'll pursue all options and hope to have an agreed way forward as soon as possible.

Full-year trading outlook

You'll also see that we've provided a short trading update for our full-year results, highlighting three factors affecting our business. You'll be well aware of the impact of microchip and other shortages on the automotive industry that are affecting volumes in our Clean Air business. These also have a knock-on consequence on precious metal pricing, particularly for rhodium and palladium, that is impacting our profits in Efficient Natural Resources. And in common with other US healthcare businesses, we're also experiencing acute labour shortages in health that are impacting our ability to manufacture and ship product. As you know, this business is subject to a strategic review. Taken together, these mean that our full-year trading will be towards the lower end of the consensus range.

New CEO appointed

And, lastly, we've also announced the appointment of Liam Condon as my successor from the 1st March next year. After nearly eight years as Chief Executive, the time is right for me to move on and I look forward to working with Liam to ensure a smooth handover.

So hopefully that gives you some context for the decision on Battery Materials today, and we're now happy to take any questions on the line.

Q&A

Operator: Thank you. As a reminder, to ask a question you will need to press star one on your telephone. To withdraw your question, press the pound key. Please stand by while we compile the Q&A roster.

Robert MacLeod: Okay, any…

Operator: Once again, if you would like to ask question it is star and one. Yes, sir. Yes, stand by as one of my colleagues will compile the Q&A queue to get the names.

Robert MacLeod: Okay.

Operator: Thank you.

Robert MacLeod: Can we have – is the first question ready?

Operator: Yes, sir, but we still don't have the name. Oh, there is one, it's from the line of Nicola Tang. Thank you, please ask your question.

Nicola Tang (Exane BNP Paribas): Hi everyone, good morning. Thank you for taking my questions. I'd like to ask about – well, actually, I saw the announcement that you have committed to spend £1 billion on the hydrogen side, you announced earlier this week. In the context of the cancelled spending on Battery Materials, can you talk a little bit about where you'll deploy that CAPEX, which was initially intended for Battery Materials? That's the first question.

Robert MacLeod: Look, I think that the two announcements are not entirely linked, they're not linked at all. I mean the announcement around Battery Materials is separate around our return expectations for the Battery Materials business. I think our announcement about hydrogen was a cumulative investment over the period through 2030, from capital and R&D, and it's basically a long-term commitment and expectation about the opportunity for the whole industry, and obviously this announcement around Battery Materials gives us the opportunity to further accelerate our investment in this area. This hydrogen investment was blue and green and fuel cells, so it's the entirety of the hydrogen opportunity. But we absolutely have the opportunity to accelerate that.

Nicola Tang: Okay, great. And then the second one was around – you talked earlier about you'd talked with strategic partners around how you could develop eLNO. I was wondering if you could give a bit more detail as to what kind of discussions you were having, in terms of which route – you know, what potential options were on the table? And then when we think about your exit, you know, again, what kind of potential route could you go down in terms of the exit?

Robert MacLeod: Sure. Look, we had a number of good conversations with a number of parties, largely existing cathode active material players and cell manufacturers, because we believe that they could help us scale-up more efficiently and more rapidly, and that was the learning curve I talked about, they would help us get up that learning curve more rapidly. They are interested in coming into Europe now, but in many cases they wanted to leverage an existing manufacturing base with supply contracts to scale-up in the region even quicker than we could offer. And when they looked – as well, they looked at our capital intensity and they confirmed that it was too high, and also the fact that we didn't have existing supply contracts in place. This wasn't a commentary about eLNO itself or our capability, it was more around where we are in the market and our position in the market.

Looking at where we are and what's next, obviously we will – we've been talking to a few people already about a possible sale. Obviously, today's announcement will give us the opportunity to broaden this to a wider group of people. We'll make – we need to move quickly and, as I mentioned already, we'll move as quick as we possibly can and come back to you when we know more.

Nicola Tang: Okay, thank you.

Robert MacLeod: Thanks Nicola.

Operator: Our next question is from the line of Sebastian Bray from Berenberg. Thank you. Please ask your question.

Sebastian Bray (Berenberg): Hello and thank you for taking my questions. My first one is on the growth profile for this business now, ex-Battery Materials. Is Johnson Matthey a company capable of growing its operating profit at the mid-single digit percentages guided previously without the growth driver of Battery Materials? And aside from fuel cell components and blue hydrogen and electrolysers, what are the growth areas towards which additional capital might be allocated?

My second question is on the potential size of investment or impairment if the battery is written off. I think you've provided a guidance of £340 million of net assets. Is that roughly the same as the total amount invested in the Battery Materials business since inception or is it more than that? Thank you.

Robert MacLeod: Thank you for your questions, Sebastian, and good morning. I'll let Stephen answer the question about the balance sheet. Look, for JM looking forward, in some ways over the next few years we saw the Battery Materials business as, actually, a drag on profit growth because we were investing in that business and as you start – as the business started to scale, the losses would have increased for a short period of time before, in the middle of the decade, it would start to become, potentially, profit-generating.

So I think in the short run, from a profits point of view, this decision to exit the business will allow us to accelerate profit growth. Obviously, the biggest – one of the biggest areas of growth potentially for us, you've already mentioned, is hydrogen, and I think that's a really exciting opportunity, the hydrogen technology space, where we have leadership positions. I think we shouldn't forget though about the potential growth that we have in Clean Air through Euro 7 and the tighter regulations in China that are coming through, and obviously that – but that's very much a strong cash-flow generating business and we're running that business for cash. But the whole decarbonisation space and the world's need for circularity gives us growth opportunities that we will accelerate and can further provide even more focus on as a result of this decision. So absolutely, I still think we have growth ahead of us for the business. Stephen, do you want to just talk a little bit about the balance sheet?

Stephen Oxley: Yeah. Good morning, everybody. Good morning, Sebastian. So you're right, we've set out a number of £340 million which is the assets on the balance sheet. It will be no surprise that that is a combination of the assets that we're constructing the technology centre that we've established in the quarter, the intellectual property that sits on the balance sheet.

Sebastian, I'd see that as the – clearly as the worst-case balance sheet exposure but of course the question is what is that worth to somebody else? And we'll see as we go through the sales process.

Sebastian Bray: Thank you. And on potential other strategic reviews for sales process. Does this change your opinion of whether it's wise to potentially divest Health or not, given that you might have more capital available? Or is that process independent of whatever decision you've made on battery materials?

Robert MacLeod: Yes, Sebastian, very much an independent decision. We are working through that strategic review looking at that business in isolation, and we will, of course, come back to you with a news on that as soon as we can.

Sebastian Bray: Thank you for taking my questions.

Robert MacLeod: Thanks, Sebastian.

Operator: Our next question is from the line of Andrew Stott from UBS. Thank you. Please ask your question.

Andrew Stott (UBS): Yeah. Morning. It's Andrew Stott from UBS. Two questions, if I could. So what will JMAT gain by way of savings? So what was the – what's the OpEx that's running through the Group now on a '22 annualised basis from the battery material assets?

So I'm just trying to think if the benefits in new markets, the benefits to corporate costs, just trying to – yeah, get a sense of sensitivity, that would be great.

And just back to your comments, Stephen, on the £340 million in net assets and some of that being goodwill. Are you at liberty to share that number? So I'm just trying to get a sense of what's the value of the physical assets as you see them? Thank you.

Robert MacLeod: So I'll go with the first one. Good morning, Andrew, by the way.

Andrew Stott: Good morning, Rob.

Robert MacLeod: First one. Look, I think it's the – on a full year annualised basis, it's several tens of millions and it would've gone up over the next three or four years, but for the fiscal year '22, the year we're in at the moment, several tens. Stephen, do you want to give a bit more breakdown on the balance sheet?

Stephen Oxley: Yeah. Just to add to that, actually, clearly we will see what happens with our Health strategic review. And you've seen that our previous announcements and discussions around simplifying the portfolio. If we do end up with a simpler group, then we'll obviously look at our wider cost base as well.

Just on the specifics of the £340 million, there isn't any goodwill. This is a business that we are building rather than a business that we've acquired. So the intangible assets that we have are all around the development of the products and the intellectual property. That number, Andrew, is about £75 million of the £340 million. The number that's gone into Poland is bigger. Might say that's about £200 million. And then the other assets that we've built – you can imagine we have pilot plants, we have the application centre, that is the balance.

Andrew Stott: And sorry, just to follow-up on that. Where are you with the Finnish project?

Robert MacLeod: So we are very, very early stages in the project in Finland, very early stages.

Andrew Stott: The amount of capital committed to Finland is immaterial or -

Robert MacLeod: Absolutely immaterial.

Andrew Stott: Yeah. Okay, perfect. Sorry, last question. I know I'm stealing a few. But the labour shortages in the Healthcare business, I wasn't aware actually, I'll be honest, if you mentioned that it was across the Healthcare industry. Could you just describe those issues and how they've become resolved?

Robert MacLeod: So, look, I think there's a huge churn of people post-pandemic across many countries, but also in particular in the US in the health sector. And as I said, it isn't just affecting us. It's affecting a number of people.

We operate in the Northeast of the US and there's a number of players that are stepping up and then really trying to build businesses in there. And that's created a bit of a rotation. It will settle down over time. But at the moment it's impacting.

Now, one of the big things that impacts us is training. When you hire somebody, you've got to – because it's a regulated industry, you've got to make sure they're appropriately trained before you can "let them loose", in inverted commas, on the plant. So that takes about three months to train somebody. So essentially when somebody resigns – let's say somebody resigned on Monday and you hired somebody else on the Monday, you still – the same day, you still lose three months worth of productivity.

And, of course, unfortunately you never quite get the two things to handover on exactly the same day. And that three months loss of productivity at the same time with the significant churn of people is what's hurting us and hurting our ability to manufacture. But it will, over time, we expect normalise.

Andrew Stott: Okay. Thanks very much for taking all the questions.

Operator: Okay. Our next question is from the line from Mubasher Chaudhry from Citi. Thank you. Please ask your question.

Robert MacLeod: Good morning.

Mubasher Chaudhry (Citi): Hi. Morning. Hi. Thank you for taking my questions. I just wanted to touch a little bit on your comment around the commoditisation. I think is that the commoditisation that you're seeing in this generally kind of the NMC market and that cost-cutting down much faster than you'd anticipated? And was that because you're seeing the LFP take-up coming from in Europe much faster? Just wanted to get a bit of clarity around, would be helpful.

And then I think historically we've talked about the fact that JMAT did need scale for the returns to work. Is the case we hear that regardless of the kind of scale you were getting to, they did pace of commoditisation has just [inaudible] very small. It's – you will never really catch up for that kind of return profile?

And I guess what was the kind of the reason for not foreseeing this earlier and something that have taken a little while to kind of catch on to that. There will be commoditisation in the market when the whole supply chain has to come down on cost. So just some comments around that would be helpful.

Robert MacLeod: Yeah. Thank you for your questions. I think I picked them up. The line was not perfect, but I think I got them up. On commoditisation, look, this is very much in – as I said in my talk a second ago, it's very much in the recent periods; we're seeing a huge drive as this market scales and grows for the OEMs and cell manufacturers to really drive those costs down rapidly. And it's a combination of factors.

I talked before about the need to drive economies of scale, that whole scale play, driving – that's what the OEMs are pushing for across the whole battery supply chain, not just in the cathode active materials providers. But also the different technologies such as LFP as we know and mid nickel. And all of that is basically putting a squeeze on the high nickel space, where we thought we could achieve a higher premium than we now think we can achieve. So that premium has been eroded because of all these other factors.

Now, on the scale point, look, you have to have scale to compete in this business as it commoditises. I don't think we were uncomfortable about building scale. What – but what's happened over the recent months is we have seen – we got more evidence of the acceleration of the pace of activity of the build-up of this market, and therefore, we would – we have to accelerate and continue to drive at pace the capital to move forward. We would have to continue to move forward with the capital investment at real pace, which would've meant that our ability to get the learnings to drive cost down in our whole capital infrastructure would've been significantly constrained.

And therefore, we would have locked in significant capital inefficiencies compared to our competitors. And it was interesting in the whole discussions that we've had with some of our – some of the solid potential partners. One of the partners said to us, 'You are where we were five years ago.' So it's not saying that eLNO is inherently uncompetitive, inherently has a high capital intensity. It doesn't. It just means that these scale plans – these people have been into the market for longer than us, they've got the experience, they've moved forward and they've got an embedded advantage that we can't catch up with. And that's why – and this has changed rapidly over the last few months and a year or so.

Mubasher Chaudhry: And just as a follow-up, are you able to comment on the kind of players that you have been talking to. Is that kind of cell manufacturers, OEMs who are the interested parties, or is it the kind of the cathode material companies?

Robert MacLeod: Well, I think I mentioned before, it's largely the people that would give us the opportunity to get up the learning curve, which are existing cell – sorry, existing cathode active material players and cell manufacturers.

Mubasher Chaudhry: Understood. Thank you very much.

Robert MacLeod: Thanks very much.

Operator: Our next question is from the line of Chetan Udeshi from JP Morgan. Thank you. Please ask your question.

Chetan Udeshi (JP Morgan): Yeah. Hi. Morning. I was so just thinking, should we think about any read across from what's happened with the battery materials business to the new hydrogen business? Do we see or do you guys see any risk that eventually we'll see the similar dynamics play out? And I'm not talking here about the hydrogen catalyst business, which is clearly immature. You guys haven't established position. I'm talking here about the hydrogen catalyst, both for fuel cells and electrolyser market. Can market evolve in this way in the future when everybody tries to scale that business up? Or is there a reason to believe there are more barriers to entry in that business than is the case here with batteries?

Robert MacLeod: Stephen?

Stephen Oxley: Yeah, let me pick that one up. We don't think there is a read across for the reasons that Robert has described in relation to the characteristics of the battery materials markets and that level of capital intensity. In the other growth areas that we have in front of us, of course, they're core to Johnson Matthey. They're core to Johnson Matthey's history. They are technologies and markets that we are already in. And they're just to lowest scale of capital as well, where we expect to make high returns, hence, the pivot that we're essentially talking about here.

Chetan Udeshi: Understood. And apologies if this was sort of addressed previously, but now with the capitals sort of untied from the battery materials going forward, I think the – clearly the more obvious question then is how should we think about the capital allocation going forward? Is it going to be a case of higher capital coming to investors over the next few years, or are you guys looking at some other opportunities to deploy the capital on growth overall?

Robert MacLeod: Chetan, it's an interesting question. I think probably given the other announcement today about my departure, probably I'll hand it over to Stephen. So Stephen give a view.

Stephen Oxley: Yeah, thank you. So look, we clearly are excited about our other growth opportunities and everything we're hearing at the moment look at COP that the world is moving more quickly hopefully, and that plays right into our strengths. So we have considerable opportunities that we think have attractive yields. We obviously will look at bolt-on acquisitions and infill acquisitions we've talked about before. But as you'd expect, at anytime, if we feel we have excess capital, then we'd be open-minded about returning that to investors.

Chetan Udeshi: Thank you.

Operator: For participants who would like to ask questions, again that is star and one.

Robert MacLeod: Sounds like there are no more questions. So, any more questions? Two more questions, sorry.

Operator: Just a moment sir. We will just compile the names, please. Thank you. Our next question is from the line of Sebastian Bray from Berenberg. Thank you. Please ask your question.

Sebastian Bray (Berenberg): Yeah. Just a practical one for adjusting forecast. I suspect that battery materials was about £200 million to £250 million of the underlying CapEx of £500 million to £600 million, so that's analysis having consensus for the next few years. Is the correct approach just to take that out and assume nothing replaces it, or how should we be thinking about that?

Stephen Oxley: Hi, Sebastian. Look, we announce the half yearly results in a couple of weeks' time. I'll come back to capital then. Unsurprisingly, the number will be lower than the amount that we guided to previously, and I'll come back to that in more detail.

Sebastian Bray: Okay. That's understood. Thank you.

Operator: Okay. Our next question is from the line of Rob Hales from Morningstar. Thank you. Please ask your question.

Rob Hales (Morningstar): Good morning. Thanks for taking my question. I was just curious; I've read a few comments that maybe were perhaps the worst in terms of the microchip shortage in automotive. I'm just wondering if you would agree with that or where you can't see it that how that plays out?

Robert MacLeod: Rob, thanks for your question. Look, I think we'll cover some of that in more detail at the results in two weeks' time. Look, I think there are supply chain shortages throughout the whole automated supply chain, but some of these things are getting a little bit better in places, but it's far too early to say whether we've got a trend of improvement yet.

Rob Hales: Okay. Thank you.

Operator: Our next question is from the line of Lacie Midgley from Panmure Gordon. Thank you. Please ask your question.

Lacie Midgley (Panmure Gordon): Hi. Thanks. Thanks, guys, for taking my question. I just wanted to confirm the CapEx spend in eLNO to-date, if you can give that number for a rough idea. But you can give more colour, please.

Stephen Oxley: Well, the – hi, Lacie. Well, the capital spent to-date will be the amount that's on the balance sheet, the £340 million, will be the total incurred to-date.

Lacie Midgley: Okay. And you've just said for the half year that you've given guidance on CapEx, so probably you'll announce this. But Robert pointed to the ramp-up in Poland, loop-on in Finland, supply agreements therefore being a significant cost to come in the future. Will that be deployed elsewhere or is that just going to come out of the budgeted CapEx going forward?

Stephen Oxley: Well, we'll look independently obviously at all of our individual opportunities that we have. This decision obviously will mean that we can accelerate our investments in those other areas, those higher capital return and lower intensity opportunities that we're facing.

Lacie Midgley: Understood. Thanks guys. Cheers.

Robert MacLeod: Very good. I think –

Operator: It looks like we don't have any further questions. I'll hand back over to Mr Robert MacLeod.

Robert MacLeod: Thanks so much everybody for joining. Apologies again for the short notice. And we'll see you all again in a couple weeks' time where we'll be going through our half year results. It's actually just under a couple weeks. It's a week on Wednesday and we look forward to talking to you then.

Robert MacLeod: Thanks very much everybody. Goodbye.

Operator: This concludes today's conference call. Thank you for participating. You may all disconnect.

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