FINANCIAL POST

Pushing Timminco Up the Ramp

Duncan Stewart, Financial Post Published: Saturday, August 16, 2008

2008 has been a bad year for the “Tim” Index in Canada: Tim Hortons is down 8%, TimberWest has declined 15%, and Timminco is off 40%.

Now as fascinated as I am by trees and doughnuts, the Timminco story has been far more controversial.

The stock roared from $0.40 in early 2007 to over $20 by the end of the year. This January the share price collapsed on very negative stories – only to bounce back to almost $35 as the company signed large supply deals.

Late Monday Timminco reported disappointing Q2 results, and the market pulverized the share price, driving it under $13, or back to levels seen when the pessimistic stories were in full swing.

As a refresher, Timminco makes silicon for solar cells. They have a process for upgrading cheap-but-impure silicon to a level where it can be useful for photovoltaics.

The whole investment story is more complex, but I believe there are three key targets that Timminco needs to achieve: silicon of the right quality, at relatively low cost, and ramping production from very small batches (hundreds of kilograms) to very large quantities (thousands of tonnes) in a timely fashion.

Before we talk about Q2, let’s revisit the January brouhaha. Various people (some neutral skeptics, some short sellers) said that the Timminco story had more holes than a Swiss cheese. Insiders were selling, there was no process, the CEO had a bad track record, and the stock was practically worthless.

There is a debate if the criticism crossed over the line into slander or libel, but I certainly had people asking me the question “Is Timminco a real company worth $50 or a house of cards worth nothing?”

The second quarter results suggest to me that the truth is more complex. Full disclosure – I have a small 1.3% holding of Timminco remaining in my Canadian CleanTech fund – I sold most of my holding in the $30s. And the reason I sold wasn’t that I thought that the company was a hoax.

Instead, based on my experience with other start-up manufacturing technologies, I believed that it was extremely unlikely that Timminco could accomplish a low-cost, high quality, thousand-fold increase in production in the time frame the market expected.

Second quarter results demonstrate that (at least so far) TIM is having trouble with all three metrics.

Instead of producing 300 MT of silicon as analysts expected, they made 221 MT. They also said that in 2008 they will only produce 1200-1500 MT, down from earlier forecasts of 2000 MT (on the way to an eventual goal of more than 14000 MT.)

Further, the company had some quality issues. The silicon they are producing needs to be roughly 99.9999% pure, and the key impurities are boron and phosphorus. Apparently the liners for the TIM furnaces are allowing too much phosphorus into the finished product, so yields were not what they should have been.

Finally (and probably connected with that purity issue) the cost of making the silicon was way too high. Based on reported revenues and gross margins, the silicon cost TIM about $32/kg to manufacture – a far cry from the $10/kg that the optimists have been hoping for.

That is still economically viable since they were able to sell the silicon for more than $60/kg. Most analysts are expecting the price of solar silicon to drop significantly over the next few years as capacity comes on line, so it is important for Timminco to at least get close to the $10/kg level.

The thing I find interesting about all this is that it neither proves nor disproves the bulls' and the bears' arguments. Instead, it sounds almost exactly like a manufacturing company using a new process and running into teething pains as they go.

At this time I see no evidence that the company is pulling the wool over our eyes for some nefarious purpose – but on the other hand there also isn't enough proof yet that they can achieve their targets.

As an investor, I am watching the share price fall and am thinking about buying. But I will probably wait for evidence that they are making progress on at least 2 of the 3 issues before I pull the trigger.

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