STOCKWATCH

Timminco orbit decays on disappointing second quarter

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Also Street Wire (U-TIMNF) Timminco Ltd

by Lee M. Webb

Timminco Ltd.'s stock price has plummeted as anxious investors headed for the exit in the wake of disappointing second-quarter results released on Aug. 11. The controversial solar player trading on the Toronto Stock Exchange (TSX) failed to meet production expectations on the way to posting a $7-million loss for the quarter ending June 30.

The second-quarter loss of seven cents per share was badly out of line with reported analysts' expectations. According to a Bloomberg report in advance of the financial results, the consensus of four surveyed analysts came in at a "profit" of four cents per share.

Even more troubling to many investors, Timminco only managed to produce 221 metric tons of solar-grade silicon during the quarter, far short of what the company and many starry-eyed shareholders expected.

On the strength of a great deal of analyst and media excitement about a secret proprietary low-cost process to produce solar-grade silicon at its plant in Becancour, Que., Timminco was a star performer on the TSX as it rocketed from a paltry 30 cents per share in January of last year to a lofty all-time high of $35.69 per share in early June of this year.

The stock price had already dropped to approximately $20 ahead of the company's summary of its second-quarter results, but it plunged even further on the disappointing news, leaving some investors feeling badly singed.

The numbers

For the three months ending June 30, Timminco reported sales of approximately $63.3-million, with $18.3-million of that amount attributed to the company's magnesium group.

The silicon group accounted for $45-million in sales, with $14.4-million of that revenue generated by sales of 221 metric tons of solar-grade silicon.

Including a $9.8-million charge relating to the closing of its magnesium operation in Haley, Ont., Timminco lost $7-million or seven cents per share in the second quarter. The company's accumulated deficit now stands at $89.2-million.

At the end of the previous quarter, Timminco had approximately $11.3-million in cash and no bank debt. As of June 30, Timminco's available cash, supplemented during the second quarter by a solar-grade silicon customer deposit of $7.7-million, had dwindled to only $1-million and the company was carrying $10-million in bank debt.

Timminco, which is planning a $65-million expansion to its Becancour operation, reportedly spent $11.6-million during the quarter "to support the next phase expansion of its solar grade silicon manufacturing facility to 14,400 metric tons of annual production."

Subsequent to the end of the quarter, Timminco reportedly received a further $16.2-million in deposits from customers under the terms of its solar-grade silicon supply contracts.

Timminco has earmarked the customer deposits, which now stand at $23.9-million, to help pay for the Becancour expansion. The deposits, representing non-interest bearing prepayments, will be credited against future solar-grade silicon deliveries. In the event of an early termination or completion of a supply contract, any remaining balance is payable to the customer.

The company expects to receive another $23.6-million in customer deposits during the current quarter and up to $13.5-million more through the end of the year and into the first quarter of next year.

To provide some perspective, assuming a contract price of $65 per kilogram, the total of $61-million in customer deposits that Timminco is counting on represents prepayment for approximately 938.5 metric tons of solar-grade silicon. Through the first six months of this year, the company has only produced 321 metric tons of the material.

Thanks to previously undisclosed revisions to the financial covenants of a credit agreement with Bank of America, Timminco is reportedly also able to borrow another $23-million (U.S.) during the third quarter, assuming no decrease in an obscure "borrowing base."

The customer deposits and available credit will undoubtedly come in handy. Contrary to the false and misleading promotional claims of Timminco's Amsterdam-based majority shareholder AMG Advanced Metallurgical Group N.V., the company's planned $65-million expansion at Becancour is not "fully funded" by last year's financing.

The call

The company released its summary of the second-quarter results less than 30 minutes before hosting a conference call after the markets closed on Aug. 11.

Timminco's chief executive officer Heinz Schimmelbusch, who also heads the company's majority shareholder AMG, last addressed shareholders at the solar player's annual meeting on May 29 when he opened with a boosterish comment about the share price.

"I won't apologize for the fact that Timminco's share price today, at the date of the annual meeting, has reached its all-time high and costs $30 per share," Mr. Schimmelbusch remarked to a round of applause on May 29.

Mr. Schimmelbusch had nothing at all to say about the stock price on Aug. 11.

Timminco's chief executive officer opened the call with comments regarding the second-quarter "highlights," focusing on the solar-grade silicon operation.

Putting a gloss on the disappointing Becancour output, he noted that Timminco had more than doubled its production of solar-grade silicon to 221 metric tons during the quarter. That output, which was far less than expected, was sold at an average price of $65 per kilogram.

"I think it is important to remind everyone that we are, in effect, still in the early stages of our solar-grade silicon business," Mr. Schimmelbusch said. "It has been less than 10 months since we first began commercial production and just six months since the second and the third lines went into operation.

"As we anticipated, we have encountered the production challenges that are typical during the start-up period for complex industrial processes.

"While these challenges did negatively affect second-quarter output somewhat, we have been able to address them in fairly short order."

According to Mr. Schimmelbusch, the company encountered contamination issues, but identified solutions during the second quarter. Unfortunately, he said, those issues lowered output by approximately 70 metric tons and will also negatively impact third-quarter production.

He went on to say that the necessary changes will be implemented in the third and fourth quarters and incorporated into the new production lines.

"We will gain substantially greater flexibility in the production process once additional furnaces are installed," Mr. Schimmelbusch said.

Timminco's leader said that the company's "internal plan now provides for the approximate doubling of production in each quarter" for the balance of the year. The company's full-year target is now in the range of 1,200 metric tons to 1,500 metric tons, down from the 2,000 metric tons he was touting a few months ago.

"Essentially, while this is equivalent to a delay of one quarter in the process of implementing Timminco's plan, it does not affect Timminco's long-term value proposition," Mr. Schimmelbusch said.

"Despite this delay, we have made significant improvements in quality, which is paramount to our success," he continued, going on to outline the reduction in the boron and phosphorous content of the company's solar-grade silicon.

Mr. Schimmelbusch then recapped Timminco's solar-grade silicon contracts, including extensions to existing contracts.

"These agreements continue to validate both our process and our material," Mr. Schimmelbusch stated, echoing a claim he has made before.

Notwithstanding Mr. Schimmelbusch's repeated claim, it is still a stretch to suggest that supply contracts validate Timminco's black-box project.

"By extending their agreements, our customers are providing further evidence that Timminco's product is a viable low-cost alternative to polysilicon for the manufacture of solar-grade silicon," Mr. Schimmelbusch went on.

Mr. Schimmelbusch moved on to a brief review of Timminco's struggling magnesium operations, which the company hopes to unload. He then handed off to Timminco's chief financial officer Robert Dietrich, who followed the script as he summarized the second-quarter results.

After Mr. Dietrich ran through the numbers, Mr. Schimmelbusch offered some happy thoughts on Timminco's future prospects before inviting questions.

"In conclusion, based on the experiences we have gained, the refinement that we continue to make to our process and the momentum that we are building -- both output and new customer contracts -- we believe that we are well on the way to achieve our goal of becoming the leading provider of low-cost solar-grade silicon," Mr. Schimmelbusch said.

The questions

Clarus Securities Inc.'s bullish analyst Carolina Vargas opened with an upbeat comment about Timminco's progress in reducing the boron and phosphorous impurities in its solar-grade silicon before she lobbed a few gentle questions.

In response to a question about yield, Mr. Schimmelbusch assured Ms. Vargas that the targeted yield levels "will be reached and even overachieved in certain ways" as the company works out the bugs in its process.

Mr. Schimmelbusch went on to say that the company's management did not really want to discuss the bugs, but he could confirm that one of the production lines at Becancour was down because of a furnace lining problem that he cautiously suggested was attributable to operator error.

Timminco's chief executive officer added that, given his 35 years of experience, the production startup problems did not come as a surprise to him.

"We, internally, are very happy that we have doubled the production in the second quarter -- we (will) try our best for the third and fourth and the first two quarters of 2009," Mr. Schimmelbusch said.

While Timminco is still working out bugs as it ramps up its first 3,600-metric-ton operation and is just in the early stages of its planned expansion to 14,400 metric tons, the very optimistic Ms. Vargas wanted to know about the company's expansion prospects after that.

Mr. Schimmelbusch suggested that it was perhaps a bit early to answer that question, but he went on to give it a shot.

According to Mr. Schimmelbusch, Timminco's foray into solar-grade silicon production involved a "binary" approach. In simple terms, the plan evidently consisted of first selling the company's planned production and then building out to meet its commitments.

Mr. Schimmelbusch went on to say that the response to Timminco indicated that there was "substantial potential for further penetrating the market."

"We, of course, have certain resources available to us to look at expansion possibilities without burdening the management of Becancour with that," Mr. Schimmelbusch said. "In this context, without any details, I would like to point to the fact that we acquired a 32,000-ton silicon metal facility in Germany."

In fact, as Mr. Schimmelbusch would have to subsequently explain to another caller, it was Timminco's majority shareholder AMG that acquired the German silicon metal operation.

After receiving an assurance that Timminco would be able to meet its supply commitments through 2009, Ms. Vargas gave way to Rupert Merer of National Bank Financial.

Mr. Merer wanted some more detail regarding the changes that Timminco would be implementing as part of the process of working out the bugs as it ramped up production.

Mr. Schimmelbusch said that the company had identified a number of design and operational items that he was reluctant to discuss, particularly since he is not an engineer. He handed off to Rene Boisvert, head of the company's Becancour operation.

"One thing, Rupert, that I may add is that the changes going forward do not involve replacing any major part of the equipment," Mr. Boisvert said, adding that it was just a matter of adapting the equipment that was not originally designed for silicon production.

According to Mr. Boisvert, the contamination issue that negatively impacted second-quarter production stemmed from a refractory problem.

Michael Willemse of CIBC World Markets was next up, asking for more information about how the company resolved the phosphorous contamination problem that apparently cropped up in the second quarter.

"We don't want to get into the details of technical discussions here which are highly complicated," Mr. Schimmelbusch began. "As Rene mentioned, the contamination resulted from linings which are designed for a different purpose, namely for metallurgical operations in the aluminium industry."

According to Mr. Schimmelbusch, the linings are now being adjusted to avoid the phosphorous contamination problem and the new furnaces will be redesigned before they are brought online as part of the planned expansion.

Mr. Willemse pressed on, asking when the new linings would be in place.

"We don't want to comment on that," Mr. Schimmelbusch replied tersely.

The CIBC analyst then asked when the company planned to hit its nominal production of 300 metric tons per month.

Sounding a tad exasperated, Mr. Schimmelbusch stumbled out a response involving several scenarios and the average of those scenarios, retreating to earlier comments about doubling production in each quarter before telling Mr. Willemse that he could figure it out himself.

A more responsive Mr. Boisvert chimed in to simply say that Timminco now planned to hit production of 300 metric tons per month in the fourth quarter.

Cormark Securities analyst MacMurray Whale wanted to get some idea of any changes to the planned capital expenditures. According to Mr. Dietrich, no changes had been made to the budgeted expansion costs.

In a similar vein, he asked about any changes to feedstock costs and was told that there were no significant changes to those costs.

Mr. Whale also asked about exactly what was included in the ramp-up costs.

"Ramp-up costs are the costs that we would expect to dissipate as volumes increase to the nominal capacity of the plant," Mr. Dietrich offered.

A Credit Suisse analyst asked what would happen in the event Timminco could not meet its contracted solar-grade silicon supply commitments.

Mr. Schimmelbusch replied that the company anticipated meeting all of its commitments, adding that there were no penalty clauses in the company's contracts.

"This is a company that does not like to go short in any way," Mr. Schimmelbusch remarked, perhaps getting a dig in at short sellers.

The analyst later asked whether Timminco was providing upgraded metallurgical silicon to LDK Solar, a company that had just reported that it was using the material to produce wafers for the solar industry.

"I don't think we want to comment on that," Mr. Schimmelbusch replied.

Mr. Boisvert jumped in with a comment of his own.

"We might just say that, in general, we are very happy that LDK reported producing using upgraded metallurgical silicon," Mr. Boisvert cheerfully said.

That prompted another remark from Mr. Schimmelbusch.

"I am chief executive officer of this company, but I can never control what Rene is saying," Mr. Schimmelbusch said. "His degrees of freedom are remarkable when I think about it."

Ms. Vargas was among the analysts who had some follow-up questions, first asking about the progress with "in-house ingot manufacturing."

As part of his response, Mr. Schimmelbusch remarked that Timminco's parent AMG was the leader in producing the vacuum furnaces for that process and had fast-tracked the delivery to Becancour.

"We should be producing our first ingots before the end of August," Mr. Boisvert said when prompted by Mr. Schimmelbusch.

Mr. Schimmelbusch subsequently remarked that importance of that development "is not to be underestimated."

Oddly, while Mr. Schimmelbusch has previously made at least passing reference to the possibility of installing the equipment at some point, that development has been remarkably understated.

Indeed, Stockwatch was surprised at a report in the June issue of PHOTON International, a solar industry trade magazine, disclosing that AMG planned to install the directional solidification furnace at Becancour in July.

In an Aug. 5 e-mail that was sent to Mr. Schimmelbusch and copied to Mr. Dietrich, Stockwatch asked who would own the furnace, how much the installation would cost and how it would be funded. Neither of the Timminco executives has replied.

Returning to the conference call, Ms. Vargas finished up with a question that invited a reassurance that Timminco would have the money to pay for the planned expansion to 14,400 metric tons.

Mr. Schimmelbusch obliged, assuring Ms. Vargas that the company was quite confident that it had "a very safe liquidity status."

The conference call wrapped up a short time later.

The reaction

In the wake of the second-quarter results and conference call, the optimistic Ms. Vargas of Clarus Securities stuck to her bullish price target of $50 per share.

Marvin Wolff of Paradigm Capital, another Timminco booster, modestly trimmed his target from $50 to $45.

Mr. Willemse of CIBC World Markets also cut his target by $5, lowering it to $25. Mr. Merer of National Bank Financial similarly dropped his target to $25.

Cormark Securities analyst Mr. Whale, who already had a bearish $19.50 target on the high-flying stock, dropped his target down to $11.50.

Investors have now weighed in with their assessment of the results, hammering the stock.

On Aug. 12, more than 4.5 million shares traded as Timminco shed $4.87 to close at $15.10.

The meltdown continued the following day as more than 2.1 million shares changed hands and Timminco dropped another 59 cents to close at $14.51 on Aug. 13.

Comments regarding this article may be sent to lwebb@stockwatch.com.