

SQM - Playing the Lithium Boom Chile-Style

Research & Analysis

Ticker:SQM

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Playing the lithium boom

With the boom in global demand for electric vehicles, now may be a good time to invest and ride the trend. It's time to dig deeper what this is all about. First and foremost, we must talk price. No longer an exotic futuristic technology that costs an arm and a leg. Lithium has arrived in the realm of attainable, available, and affordable.

The impact of our obsession with lithium is changing the way we look at power. From pocket batteries to micro grid community backup, lithium is working its way into our lives on multiple fronts at a very fast pace. This is good news for Chile. This South American economic power house is the largest lithium producer in the world. Which brings us to a stock that caught our attention Sociedad Quimica y Minera de Chile ADR (NYSE:SQM). Obviously, the boom in lithium demand could be a big win for SQM and valuations tell us that this company will grow much larger. Several institutional investors agree SQM could make its way to \$60, well above the \$20 area where the stock currently trades.



Important to note is the fact that a majority of the company's sales are outside of Chile. Approximately 90% of total sales are foreign sales. The company is well diversified in several product categories. Those categories are specialty plant nutrients (potassium nitrate is the most important product in specialty plant nutrients), potassium (potassium chloride and potassium sulfate), iodine and its derivatives, lithium and its derivatives and industrial chemicals.

The lithium market has been having a positive gross margin contribution for SQM. Prices trended upward in 2015, and some possible tightness in the market due to delays in lithium projects could cause significant price increases for the rest of 2016 and well into 2017. SQM expects world demand to grow 5% in 2016 and its sales volumes to also increase.

Notable Legal Proceedings

SQM is dealing with a crucial in our opinion arbitration proceeding in relation to the lease agreement for the Salar de Atacama. The dispute is with Corfo, which is a national organization that is in charge of promoting manufacturing productivity and commercial development in Chile. Long story short Corfo owns the rights to mining exploitation concessions in the Salar de Atacama and leases the rights to SQM. Corfo is alleging that SQM Salar incorrectly applied the formulas for the lease payments and ultimately underpaid Corfo by at least \$8.9 million. A possible lease agreement termination would be the worst possible outcome for SQM since it accounts for 37.48% of total comprehensive income. Nevertheless we are optimistic on SQM for the remainder of 2016 since arbitration proceedings can take a long time in Chile before the final decision is made and especially in a case like this with such a large impact for the company in question. In our view the overall outlook for SQM in 2016 remains bullish. The company will grow aggressively based on the strength of its Lithium Segment.

Market Outlook

The global market for lithium has grown rapidly in the past and is expected to continue to grow at a tremendous rate in the future. From 2000 to 2011, global lithium prices grew from \$2,000 per metric ton to \$6,000 per metric ton, a 200% increase. According to Dahlman Rose & Co., global lithium consumption will double by 2020 and surely not only because of Tesla.

So far, demand fundamentals for lithium have significantly changed with advancements in e-mobility and upcoming Gigafactories aka Tesla. Several institutional investors anticipate that demand for electric vehicles will increase phenomenally over the next ten years, particularly in North America, Europe and North East Asia, creating a huge demand for lithium-ion batteries.

The rising number of PV installations and nuclear power plants along with the commencement of New Wind Energy Projects are anticipated to stimulate the market growth over the forecast period. Rising off-grid installations in China, U.S., Germany and India along with increasing adoption of lithium-ion batteries in medical equipment is expected to promote industry expansion over the forecast period.

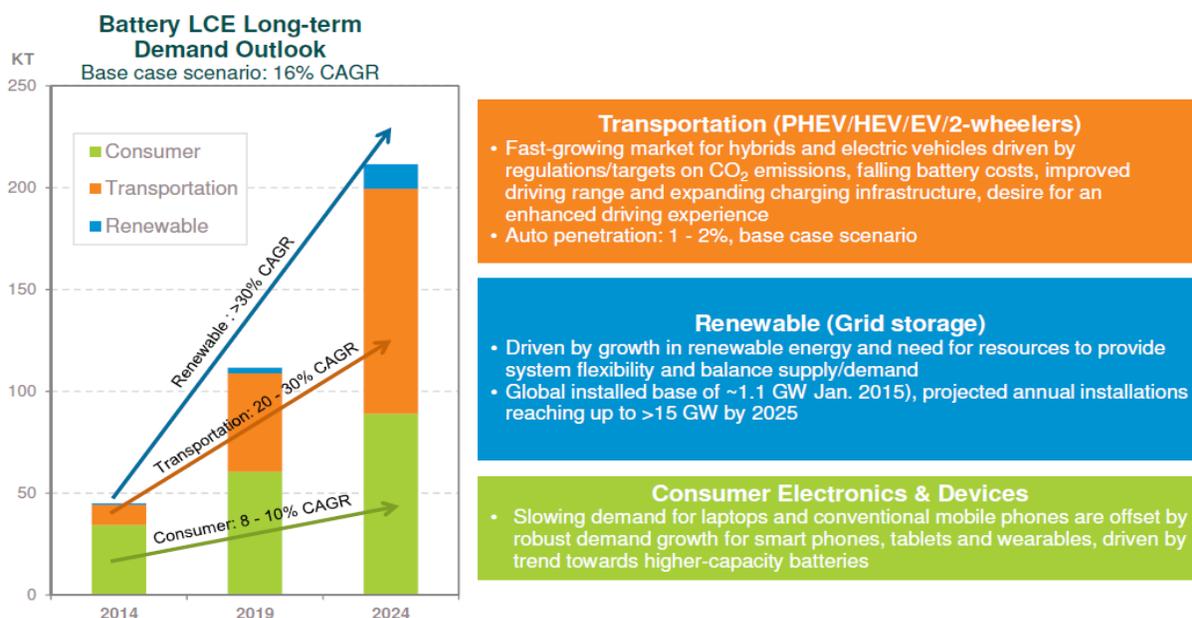
Long term we are positive on the sector outlook driven primarily by our 30% CAGR for lithium demand in New Energy Vehicle (NEV) batteries out to 2021 which will further strengthen the position of SQM.

Based on our detailed supply/demand analysis, we believe that having gone into deficit last year the market will remain tight through 2016 and 2017, despite more supply coming from Australia, Argentina and Chile. As a result, we are bullish on lithium on a 12 month view.

Lithium supply & demand

Demand	2015	2016F	2017F	2018F	2019F	2020F	2021F
Batteries	55,242	62,819	77,652	92,340	105,706	122,946	141,955
Non-battery	118,511	121,765	125,767	129,617	133,581	137,713	141,811
Total	173,754	184,584	203,418	221,958	239,287	260,660	283,766
YoY	8%	6%	10%	9%	8%	9%	9%
Supply	2015	2016F	2017F	2018F	2019F	2020F	2021F
Argentina	19,210	29,453	33,869	34,828	35,299	35,781	36,276
Australia	58,261	64,327	80,635	90,156	92,332	92,332	92,332
Chile	58,437	61,893	66,806	74,860	80,735	83,578	83,578
Other	24,065	24,370	24,720	24,970	25,220	25,470	25,720
Total	159,972	180,043	206,029	224,814	233,586	237,161	237,905
YoY	0%	13%	14%	9%	4%	2%	0%
Additional supply required	13,781	4,541	-2,610	-2,856	5,702	23,499	45,861
Spare capacity at existing assets			66,619	57,160	50,489	47,007	46,512
Planned from most likely projects			0	43,718	99,666	132,766	146,766

In a world where many commodities are struggling for any consumption growth, we believe lithium has the most compelling demand story. We forecast a CAGR of 12% to 2021. New energy vehicle batteries are the essence of the story and we forecast demand from this sector grows at a 30% CAGR to 2021, at which point they would account for one third of all lithium demand versus just one tenth today. You can do the math but we think you got the point.



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