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LGO.TO - Q2 2019 Largo Resources Ltd Earnings Call

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PRESENTATION

Operator

Good morning. My name is Joanna, and I'll be your conference operator today. At this time, I would like to welcome everyone to the Largo Resources Second Quarter 2019 Financial and Operational Results Conference Call. (Operator Instructions) Thank you.

Mr. Guthrie, you may begin your conference.

Alex Guthrie - *Largo Resources Ltd. - Manager of IR & Communications*

Thank you, operator, and welcome, everyone, to the Largo Resources Second Quarter 2019 Results Conference Call. Today's call is being recorded and a replay will be available starting tomorrow in the Investors section of our website at largoresources.com.

Our second quarter 2019 results press release, MD&A and financial statements are also all available on the company's website and on SEDAR.

Some of the information you will hear during today's discussion will consist of forward-looking statements, including, without limitation, those regarding future business outlook. In addition, non-IFRS financial measures such as cash operating costs, cash operating costs excluding royalties, revenue adjustment payable, revenues per pound sold, vanadium sales per pound sold, revenue adjustment per pound and estimated revenue will also be discussed during this call. Actual results could differ materially from those anticipated and risk factors that could affect results are detailed in the company's Annual Information Form and other public filings which are available on SEDAR and on the company's website.

Further information regarding Largo's use of non-IFRS measures is available in our second quarter 2019 results press release and in the company's MD&A for the 3 and 6 months ended June 30, 2019, which is also available on SEDAR and on our website. Financial amounts presented today will be in Canadian dollars, except as otherwise noted.

Market and industry data contained and incorporated by reference during this call concerning economic and industry trends is based upon good faith estimates of our management or derived from information provided by industry sources. In particular, we note that market data provided on this call is derived from information provided by TTP Squared, Inc. Largo believes that such market and industry data is accurate and the sources



from which it has been obtained are reliable. However, we cannot guarantee the accuracy of such information and we have not independently verified the assumptions upon which projections of future trends are based.

Speaking first today will be Largo's Chief Executive Officer, Mark Smith. Speaking second will be Largo's CFO, Ernest Cleave, who will provide additional detail on Largo's Q2 2019 financial performance. Following Ernest, the company's independent consultant, Mr. Terry Perles, will then provide an update on the vanadium market. Finally, we'll open the call to questions.

I will now turn over the call to Mark Smith for opening remarks.

Mark Allan Smith - Largo Resources Ltd. - CEO & Director

Thanks, Alex, and welcome, everyone to our quarterly update and earnings conference call.

Overall, let me say that I'm really, really pleased with the operational performance during the second quarter though profitability continued to be impacted by the decline in vanadium price coupled with the remeasurement of trade payables under the Glencore contract. With the expansion project ramp-up expected to conclude by the end of Q3 2019, the company is well positioned to maintain its strong operational performance in the second half of 2019.

So as I noted, I'm really pleased with the performance of our operations in the second quarter of 2019. Production for the Maracás Menchen Mine in Q2 2019 was 2,515 tonnes of V2O5, representing an increase of 20% over the first quarter in 2019 and 2% over the second quarter of 2018. V2O5 production of 926 tonnes in June set a new monthly production record following the initial expansion project ramp-up which included the start-up of the new deammoniator unit. This was then superseded in July with a monthly production record of 1,042 tonnes, representing an increase of 13% over the June record the prior month.

Global V2O5 recovery rates averaged 79.1% in the second quarter of 2019, demonstrating another quarter of strong global recoveries for the company. The good performance during the quarter is largely due to the operational stability throughout all sections of the plant and significant process control improvements made by the operations team, all of which are sustainable.

The expansion project increased production capacity by 25% at the Maracás Menchen Mine continues to progress successfully following the start-up of the new deammoniator unit. The expansion project is expected to be completed during Q3 2019 with the start-up of the new ball mill and evaporator units. The ramp-up of all areas is expected to be completed by the end of Q3 2019.

On June 19, we announced the appointment of Mr. Paul Vollant as the company's Director of Sales and Trading who will lead the development of Largo's internal sales and trading business starting in September 2019. Paul brings extensive commodity sales and trading experience with a focus in specialty metals, and we are extremely confident that his industry experience and knowledge, especially in relation to the high purity market, will be invaluable as the company evolves.

On the exploration front, we announced an updated mineral resource estimate for the Novo Amparo Norte deposit or NAN as we call it, which is located approximately 6.5 kilometers north of the company's current mining operation at the Maracás Menchen Mine Campbell Pit. The company's exploration program successfully delivered a significant increase to the overall resource base at NAN with the successful conversion of resources from the inferred category to the measured and indicated categories in addition to increasing the inferred resources. The updated resource estimate is based on approximately 12,912 meters of diamond drilling over 88 holes, which includes 5,404 meters in 47 drill holes completed in 2019 and 5,549 sample intervals across the deposit. Highlights of the updated mineral resource estimate for NAN include total measured and indicated mineral resources of 12.23 million tonnes grading 0.88% V2O5 with magnetic concentrate grade of 2.41% V2O5, inferred mineral resources of 11.33 million tonnes grading 0.9% V2O5 with magnetic concentrate grade of 2.46% V2O5.

Following the successful increase to NAN's overall resource base, the company will now focus on planned exploration of the other satellite deposits during the second half of 2019. Drilling will focus on the Gulçari A Norte mineralized zone which lies to the north of the Campbell Pit and on the Gulçari A South target which lies just south of the Campbell Pit.



Exiting the quarter, the company had a cash balance of approximately \$190.3 million. And as of July 8, 2019, the company is now debt-free following the full repayment of its outstanding senior secured notes. We are extremely pleased of this accomplishment having repaid the company's total outstanding notes in about 12 months.

In summary, as I stated at the beginning of our remarks, I'm really pleased with the operational performance during the second quarter though profitability continue to be impacted by the decline in vanadium price coupled with the remeasurement of trade payables under the Glencore contract. With the expansion project ramp-up expected to conclude by the end of Q3 2019, the company remains well positioned to maintain its strong operational performance in the second half of 2019.

With that, let me turn the call over to Ernest who will provide details on our second quarter 2019 financial performance.

Ernest M. Cleave - Largo Resources Ltd. - CFO

Thanks, Mark, and thanks to everyone for joining the call today.

The company recorded a net loss of \$20.5 million in Q2 2019 compared to net income of \$90.7 million in Q2 2018. This is primarily due to the decrease in revenues and an increase in operating and finance costs during the quarter. Following the \$46.3 million reduction in revenues as a result of the remeasurement of trade receivables/payables under the Glencore contract, the company recognized revenues of \$29.5 million in Q2 2019 compared with revenues of \$103.3 million in Q2 2018. Revenues per pound sold in Q2 2019 was \$5.39, that's USD 4.02, compared with \$18.91, USD 14.62 per pound in Q2 2018.

Vanadium sales from a contract with a customer was \$75.8 million in Q2 2019 compared to \$100.7 million in Q2 2018. Vanadium sales per pound sold in Q2 2019 was \$13.86, that's USD 10.33, compared to \$18.42, in USD 14.24 per pound in Q2 2018. This decrease is primarily attributable to decrease in the V2O5 price with the average price per pound of V2O5 of approximately \$8.59, that's U.S. dollars for Q2 2019, compared with approximately USD 15.44 for Q2 2018. Assuming the quarterly average price per pound of V2O5 of approximately USD 8.59 and quarterly V2O5 sales of 2,480 tonnes, the company could have earned estimated revenue of \$62.9 million, that's USD 46.7 million in Q2 2019.

The company's trade payable balance at June 30, 2019 was \$67.4 million and the revenue adjustment payable was \$78.9 million. Assuming V2O5 prices remain the same as at June 30, 2019, the company's total estimated revenue adjustment payable to June 30, 2019 is \$94.9 million. At the date of this press release, the company's estimated revenue adjustment payable for V2O5 sold to July 31, 2019 is approximately \$99.5 million.

Operating costs for Q2 2019 were \$33.3 million compared to \$30.2 million in Q2 2018 and include direct mine and mill costs of \$22.6 million, depreciation and amortization of \$9 million and royalties of \$1.8 million. The increase in operating costs over Q2 2018 is primarily attributable to an increase in production, the impact of the ramp-up in production following the completion of the kiln refractory replacement in March 2019 as well as increased HFO and diesel costs.

Cash operating costs excluding royalties in Q2 2019 were \$4.43, that's USD 3.30 per pound, compared to \$4.32, again USD 3.35 in Q2 2018, representing an increase of 3%. The increase seen in Q2 2019 compared with Q2 2018 is largely due to the impact of foreign exchange as well as increased HFO and diesel costs.

Finance costs in Q2 2019 were \$10.9 million, representing an increase of \$2.5 million from \$8.4 million in Q2 2018. The increase is primarily attributable to the expensing of the deferred transaction costs on the long-term debt as a result of the committed redemption of the company's 9.25% senior secured notes which were originally due in 2021. And as Mark mentioned, that was completed in July 2019.

The company generated positive cash from operating activities with net cash provided by operating activities of \$21.8 million compared to \$69.5 million in Q2 2018. This decrease was primarily due to revenues exceeding direct mine and mill costs and royalties by \$5.1 million in Q2 2019 compared with \$80.7 million in Q2 2018. This contributed to cash used before noncash working capital items of \$7.8 million compared with cash provided before noncash working capital items of \$77.7 million in Q2 2018.

Cash used in investing activities in Q2 2018 was \$19 million, representing an increase of \$13.9 million from the \$5.1 million seen in Q2 2018. This increase was primarily due to the expansion project being undertaken by the company in 2019 and which remains on budget. Expenditures of \$35.2 million were capitalized to mine properties, plant and equipment for the 6 months ended June 30, 2019, and that includes \$4.9 million of capitalized waste stripping and pushback costs.

With that, I will now turn the call over to Terry Perles who will provide an update on the vanadium market. Following Terry's market update, we will then open the call up for questions.

Terrance T. Perles - TTP Squared, Inc. - President

Thank you, Ernest.

So V2O5 production in China in July totaled 4,879 metric tons of pure vanadium, the highest production level on a monthly basis since June of '14. The first 7 months of 2019, vanadium production in China was at an annual rate of 54,363 metric tons of V versus a rate of 44,834 metric tons of V per year in the same period of 2018. That means production has increased about 21% thus far in '19 versus '18. Looking at production change from January to July of 2019, V2O5 production in China has increased 7.5%.

If we look at production of vanadium from stone coal in China, the total production in July was 538 metric tons compared with 349 metric tons in January, metric tons of pure vanadium. Vanadium production from stone coal in China has been flat basically from March through July at a rate of about 500 metric tons of V per month. And this compares with about 469 metric tons of V a month produced from stone coal in October of 2018 before the price spike really took off. So we haven't seen much increase in production from stone coal thus far through the price gyrations that we've seen.

In China, vanadium carbonitride alloy production surged in July to historical high of 3,875 metric tons of vanadium versus 2,077 metric tons of vanadium in May 2019. That's an increase of 86%. This vanadium carbonitride alloy is the alloy that's predominantly used in high-strength rebar in China.

So it seems like rebar production also is very high now in July, late June. So at June 14, rebar production in China peaked at 3.82 million tonnes and slightly lower in July. But year-to-date, rebar production in China is up about 28% compared to last year.

So in summary, China, it would seem that broader compliance with the new rebar standard combined with very high rebar production is resulting in growth in vanadium consumption while production growth has been limited due to environmental issues and relatively weak prices in the first half.

As a result of all this activity, inventories of V2O5 in China has been drawn down by 1,365 metric tons of V from the end of April 2019 until the end of July. Chinese exports of vanadium in June totaled 571 metric tons of V. That's up from May levels by 28%. If we look at total exports in the first half, the rate was 7,800 metric tons of V per year, and that's down by 12% from the same period of 2018.

On a global basis, Vanitec reports global vanadium production slightly surpassed vanadium consumption in the first quarter of 2019 for the first time in many years. On a cumulative basis, vanadium inventories globally have decreased by 12,000 metric tons of V, approximately 1.5 months' worth of consumption from the beginning of 2017 to the end of Q1 2019. For 2019, we're projecting total vanadium production of 102,800 metric tons of V and we're projecting consumption of 104,000 metric tons of V. Our projections assume all the previously announced expansion plans of vanadium production in China actually occur throughout this year and next year. We also project ongoing increases in consumption as adaptation of the new rebar standard becomes universal.

We project the need for 9,200 metric tons of V of Chinese exports in 2019 to maintain a balanced market. In first half of 2019, exports were at a rate of 7,900 metric tons of V, and we expect that rate to drop in the second half of the year.

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Looking at pricing in China, from July 16 through August 6, Chinese V2O5 prices rose about 16% from USD 8.12 per pound of V2O5 to \$9.39 per pound of V2O5. Prices in China over the last week had been relatively stable pretty much either side of \$10.

In the West, the prices reported by Metal Bulletin have risen from the midpoint of \$6.45 per pound of V2O5 on July 31 to USD 7.25 per pound of V2O5 last Friday. We do anticipate the Western prices will follow Chinese prices up in the coming weeks. Over the balance of the year, we expect upward pressure on vanadium prices globally as Chinese consumption continues to expand with limited supply increases possible in the near term causing further depletion of inventory and further tightness in the market.

So I guess the takeaway is, we did see production surpass consumption in the first quarter. We still have a massive amount of inventory that's been depleted from the system globally. And looking forward, we're seeing consumption accelerating now in China and supply is very, very slowly increasing. And we do expect a deficit again this year.

And I think that's all I've got, Ernest, Alex.

Ernest M. Cleave - Largo Resources Ltd. - CFO

Thank you.

Alex Guthrie - Largo Resources Ltd. - Manager of IR & Communications

We'll turn the call over to the operator and open the call up to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question is from Heiko Ihle from H.C. Wainwright.

Heiko Felix Ihle - H.C. Wainwright & Co, LLC, Research Division - MD of Equity Research and Senior Metals & Mining Analyst

Congratulations on being debt-free and thank you, Terry, for the additional color.

Just a bit conceptually here. I mean we're looking at cash operating costs of \$3.54 a pound. Pricing isn't quite where we'd like it all to be. And some of the recent geopolitical turmoil that we're seeing around the world is probably going to scare at least some large-scale investment. Obviously, you still sold for about \$10 per pound in the quarter. And frankly, I mean, we cover precious metals, most precious metals firms would do anything to margins even close to yours. But I mean, the stated quotes right now are \$7, \$7.50 a pound. So just conceptually, is there ever going to be a market at which time tougher decisions regarding production, capital investments and overhead are needed? And if so, what kind of price is that? Is there any more color you can provide regarding your thoughts on this?

Mark Allan Smith - Largo Resources Ltd. - CEO & Director

Heiko, I'll start out. This is Mark. First of all, every single one of the capital expenditures, strategic decisions related to sales and production are all taken seriously regardless of price. We go through those things quite thoroughly at the management level and the Board level.

I think part of your question is really -- I'm going to go back to the Glencore contract because it's very hard to make these decisions given the Glencore contract and the remeasurement of trade payables that we have right now. It complicates those decisions immensely versus what market

prices are. And so it really makes that decision that much more difficult, but I think that we are really at this point in time and effective today, we have 9 months left on that Glencore contract. We are very focused on getting ourselves ready to go with our own internal sales team where we can make decisions based on market pricing rather than on a Glencore contract pricing mechanism. And I think you'll see a lot more opportunities available for the company because we don't have to be so conservative with our cash given the payables that we have to Glencore right now.

So hopefully that helps answer it a little bit. I would welcome thoughts that you may have on it as well, Ernest.

Ernest M. Cleave - Largo Resources Ltd. - CFO

It's an interesting question, Heiko, thank you. I go back to the fact that if we're not the lowest because we always grapple with this, but if we're not the lowest, we're one of the lowest-cost producers of vanadium in the world. So I think Largo will react to market conditions only in the most extreme situations. I mean, I think, if anything, we should anticipate that Largo will be the survivor in adverse market conditions. So we're not looking to change our strategy. But to follow on with what Mark was saying, I think the major opportunities for the organization lie in being able to capture additional margin through our sales and marketing division. So hopefully that's enough of an answer.

Heiko Felix Ihle - H.C. Wainwright & Co, LLC, Research Division - MD of Equity Research and Senior Metals & Mining Analyst

I think that's extremely helpful and thank you for the color there. And just one quick clarification I have for you. In the release, you stated that with the new resource base for NAN, you're now focusing on the other satellite deposits. Can you just provide some incremental color on your drilling program regarding expenditures, people, meters and maybe what you're expecting to see at the Gulçari A Norte and Gulçari A South.

Mark Allan Smith - Largo Resources Ltd. - CEO & Director

The initial sampling that we've done out in those areas are very attractive to us. We like the ore grades we're seeing. We like the initial results we're getting from the concentrate grades as well. And hopefully, as we've tried to educate people on the processing of vanadium, everyone realizes the importance of that concentrate grade because that's where we really excel compared to any other vanadium company in the world right now. And that's what really keeps our costs as low as they are.

But we have some pretty high hopes for those areas. We really wanted to focus on NAN to start with, Heiko, because we had a lot of data out in that area to start and we wanted to demonstrate to the world that we have a resource base out here that we think is going to be available to us for a very, very long time. So the work on NAN was focused because we had a lot of data there already. But as we do this preliminary drilling in these other areas, we're seeing things that attract us even more and we're having some second thoughts about maybe we ought to drill those areas out a little sooner than what we thought because those initial results look that good.

And so we are redirecting the drilling program to some extent. And last year I think I had mentioned this, we've put together about a 5-year drilling program for the site. And it just means kind of moving some of those parts around and doing something sooner than others is all it means, but we're still on course for a 5-year drilling program that will really start to define what we think is probably one of, if not the largest resources for vanadium in the world.

Ernest, do you want to talk about the dollars and cents involved?

Ernest M. Cleave - Largo Resources Ltd. - CFO

Sure, Mark. We did about 12,900 meters on NAN. I think over the remainder of the year, we'll do another, give or take, 8,000 between the various deposits. Again, as you elucidated, we have to continue defining and expanding and actually refining our operational plans, but we're going to be in the region of another \$2 million, \$3 million spend over the remainder of the year. Again, they're not big dollars, but they're certainly far more than we've historically spent, and that's about it.



Operator

Your next question is from Gordon Lawson from Paradigm.

Gordon Lawson - *Paradigm Capital Inc., Research Division - Senior Research Associate*

Two quick questions for you. So first, can you please talk about any planned maintenance for the remainder of the year? And also, to hit your production target of 1,000 tonnes per month at around 1.5% effective grade, would an assumption of 2,500 to 2,700 tonnes per day be in line with the ramp-up target?

Mark Allan Smith - *Largo Resources Ltd. - CEO & Director*

Ernest, you want to answer that?

Ernest M. Cleave - *Largo Resources Ltd. - CFO*

Yes. So I don't have a maintenance number for you. We could certainly take that offline. I don't mind sharing that. They're not big dollars. We've got sustaining CapEx expenditures, I'll give it to you in U.S. dollars, of between \$6.3 million to \$8.5 million over the remainder of the year. And no, that's not maintenance. Our maintenance is fairly de minimis over the remainder. And in terms of your tonnages, that sounds about in the range as well.

Mark Allan Smith - *Largo Resources Ltd. - CEO & Director*

The one thing that we're pretty proud of obviously Gordon is, we've already exceeded the design rate per month in July. So we are anticipating very similar, if not better, results throughout the rest of the year.

Operator

Your next question is from Lee Cooperman from Omega Advisors.

Leon G. Cooperman - *Omega Advisors, Inc. - President, CEO & Chairman*

If you don't mind, I have like questions that will be interesting to everybody. So let me just put them out there and you handle them in any order you'd like.

First, maybe to Terry, in every cyclical business, there's a concept of peak, trough and average. I'm just curious if you have a view. I assume peak when we saw the price of vanadium at \$30 a pound that, that probably represent the peak. What do you think the trough is? And looking at the year, where do you think the normalized price of vanadium is likely to be? That's question number one.

Question number two, we obviously have a nice spread between our production cost and our selling price even at today's low price. And our problem has been this damned remeasurement contract which is sucking out our cash. What would you guess would be the low cash position of the company given current prices and your obligations to Glencore on the remeasurement contract?

And then next question would be your comfort in replacing Glencore. We're all looking forward to getting rid of Glencore which is sucking our blood out. But are we comfortable that when they're gone that we could perform their role effectively with very little incremental risk?



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And finally, a tough question for you is, we're talking with a company here that's got one commodity. If I look at an unrelated company but close to home, Sierra has got copper, zinc, lead, gold, silver, et cetera. Have you ever thought about the virtue of diversifying your shareholder risk by being part of a larger company that might have -- committed to the metals business? And by the way, congrats as you guys have done a very good job in running the company and this Glencore contract is what it is, but help me on those questions I just asked.

Mark Allan Smith - *Largo Resources Ltd. - CEO & Director*

Thank you, Lee, and again, thanks for joining the call. Terry, you want to start out with question one on peak, trough and average?

Terrance T. Perles - *TTP Squared, Inc. - President*

Sure. Thanks, Lee. I think we can be pretty sure that the \$33 price you saw in China in November was probably the peak. But as I do my analysis of the market, I look at a few things. When we look at the long-term market equilibrium price, I look at the inflated average monthly prices over the last 15 years. And if I look at a distribution chart, I'm going to see a major peak at \$6. And in that environment, when supply meets demand and cost of production drives the market clearing price, I think there's a reason that, that number, the \$6, is probably the long-term price if we look back. It might be larger going forward that long term market clearing equilibrium price is moving up if, in fact, this vanadium battery takes off, but I guess we'll have to wait and see what happens there.

The distribution chart will also show very interestingly a second peak at \$14 to \$15. And I do believe that demonstrates a stable point on the price spectrum. When you're in a situation like we are now where supply is really struggling to keep up with demand, we get prices much above that. We do see some destructive loss of market share through substitution. And we see some very high cost, strange new sources of production coming in. So I don't see a lot of stability above that level, not that it can't go there temporarily.

And on the downside, again, history would tell us that the price in the last 15 years, we have seen prices just below \$3. And that's an environment where everybody is losing money, but that's what the historical data would tell us.

Just a comment maybe on the question about replacing Glencore. I'm pretty confident that Largo is going to be able to be very effective and in fact, more effective going into the market directly than via Glencore. There's a number of conflicts that don't allow Largo to reach out particularly to some of the higher-margin, high-purity applications. Having Glencore standing between Largo and the customer base doesn't create an environment where Largo can put their best foot forward. And I'm sure in that market there's going to be an opportunity to dramatically improve things. And as far as the commodity side, the steel side of the industry, that Mark's really in touch with all the major consumers for the past several years and they are ready, willing and able to discuss contracts from the ArcelorMittals, to the Nucors of the world. We've been in discussion with those people and they're ready to sit down with us. So I don't have any concerns about Largo being able to go to the market directly.

Mark Allan Smith - *Largo Resources Ltd. - CEO & Director*

Yes. Just to follow up on that, add to it. Paul Vollant, who we've brought on now as our Director of Sales and Trading, as I've mentioned in my remarks, actually has a tremendous level of experience in the marketing of high-purity V2O5 in particular and knows the master alloy business and the contacts in that business exceptionally well. And that really bodes well for our overall sales strategy, which is going to be to maximize high-purity sales and then fill up the rest of the sales with ferrovanadium in the steel industry.

So I, like Terry, am extremely confident in our ability to take over those sales if that's the course that will ultimately take place. And we have been preparing ourselves for this for over 3 years. So this isn't something that has just hit us right now. We've been preparing for it and I'm very confident the number of customers that are already contacting us directly really amazes me. And that's a guy that's got 38 years of being in this business. I am utterly amazed at the number of large offtakers who are contacting us already. We have multiple traditional trading companies, et cetera, that are also interested in helping us down the road. And we certainly know how to negotiate offtake contracts a lot better, and we will learn very well from that Glencore contract. So I'm very encouraged by that.



Thanks for those comments on that, Terry. Ernest, do you want to handle the second question which is the low cash position we expect?

Ernest M. Cleave - Largo Resources Ltd. - CFO

Absolutely. Just start off with some opening commentary, the one thing to think about looking at the financial statements is we record the obligation of the remeasurement in each particular period. But as you can appreciate, the repayment of that obligation, so when we actually physically give the money back, happens on a slower pace. So if you look at the cash balance at the end of Q1 versus Q2, you'll find that it basically didn't move. I think we were in \$190 million at the end of Q1 and we remain at \$190 million. So my answer to the question is, for the remainder of the year towards year-end, you should expect the cash position to remain neutral.

Then separately from that looking at the revenue adjustment payable, as we now call it, we have \$190 million on the books right now. We've guided the market based on the current price assumed over the remainder of the year that, that payable -- and these are Canadian dollars as well -- currently is \$99.5 million. So you can see, we have a lot of headroom there to actually make good on our obligation from a cash perspective, but in terms of what you should expect over the remainder of the year is effectively a cash neutral situation because we do not repay that obligation as quickly as it comes to the balance sheet.

Leon G. Cooperman - Omega Advisors, Inc. - President, CEO & Chairman

I guess what I'm trying to look at, if you looked out over 6 to 9 months until this contract from hell is gone, the cash in July 31 was CAD 90 million, USD 67 million, would you expect that number to be higher or lower or about the same between now and let's say, the end of the contract? And then just going on the basis that the price of vanadium stays where it is. So assuming a constant price of vanadium, would you expect your cash to bottom out around USD 67 million or CAD 90 million or would you expect it to go lower?

Ernest M. Cleave - Largo Resources Ltd. - CFO

Okay. So it's CAD 190 million which is about USD 146 million, I guess.

Leon G. Cooperman - Omega Advisors, Inc. - President, CEO & Chairman

USD 142 million.

Ernest M. Cleave - Largo Resources Ltd. - CFO

Yes. I just use CAD 1.3 exchange. So by year-end, that cash balance should be approximately the same, again, approximately. By the time the Glencore contract is extinguished or that we actually transition to selling ourselves, at that point then assuming the same prices, the cash balance will be lower, but I can't guide what that number will be but we have...

Leon G. Cooperman - Omega Advisors, Inc. - President, CEO & Chairman

I'm confused. Ernest, I'm confused a little bit. The cash balance of \$190.3 million was at the end of, I guess, the second quarter. What I'm really looking for is the number after you pay off Glencore and that liability is extinguished.

Ernest M. Cleave - Largo Resources Ltd. - CFO

I understand.

Leon G. Cooperman - *Omega Advisors, Inc. - President, CEO & Chairman*

That number now is CAD 90 million, USD 67 million. Do you have any sense if the price of vanadium stayed where it is whether that number at the end of the contract will be higher or lower? You're obviously generating earnings because you're selling the commodity at a higher price than your production cost. On the other hand, you're giving back money to Glencore. Do you have any idea or you just can't answer that, you just don't know the answer?

Ernest M. Cleave - *Largo Resources Ltd. - CFO*

No, no, I can answer it. If the price remains as is, it shouldn't really fundamentally change from that \$99.5 million. So remember that we've bifurcated that part, what we call the revenue adjustment payable out of our total receivables/payables. So that \$99 million as of today doesn't change, we will pay that back over the course of this year and the remainder of next year, but I don't see that changing if this one product doesn't go down from this point forward.

Leon G. Cooperman - *Omega Advisors, Inc. - President, CEO & Chairman*

Got you. Okay. And at what price would it have to recover to where that would no longer -- remeasurement would not even be an issue? If we got to, Terry said to the second peak at \$14 and \$15. If we got to \$14 and \$15 vanadium basically, would the remeasurement not be an issue anymore after you pay off majority of.

Ernest M. Cleave - *Largo Resources Ltd. - CFO*

No, because largely most of that is already baked in candidly. So yes, you're going to maybe grow the receivable side over time which is really just a period of time that you are waiting to get paid by Glencore. But looking at the payable side that we've sort of, I wouldn't say accrued, but became obligated for up to this point, that's not going to change dramatically. If the price went up very suddenly over the next couple of months, we probably cover them a little bit, but I wouldn't expect too much. So for conservatism, I will just stick with that number and assume that, that's getting paid back between now and the end of May 14.

Leon G. Cooperman - *Omega Advisors, Inc. - President, CEO & Chairman*

Let me elaborate on the fourth question which you have not gotten to but you're about to get to. You guys have done a good job in running the company. You have what looks to be like a strategic asset of high-quality vanadium, long life reserves. And it seemed to me that one way of diversifying the shareholder risk is to be part of a company where they have multiple commodities they sell rather than being reliant upon one commodity. What do you think the attitude is of the Board and management towards a strategic combination assuming you can get a reasonable price for the assets? Does that make any sense to you guys or you'd rather just go it alone?

Mark Allan Smith - *Largo Resources Ltd. - CEO & Director*

I think we would serve our shareholders, Lee, in the best way possible and we would evaluate any offer that was brought in to us particularly by a sophisticated mining company who's looking to diversify. So we will try to maximize shareholder value, period, in all of our decisions, including potential offers from other companies. But along the lines of a single commodity, we don't talk about it very much, but in our ore deposit, we also have titanium and we also have iron ore. And the company internally is working on multiple programs to recover that titanium and make it available for sale. And that is a very sought-after product. And we think that we can probably potentially get into the TiO2 pigment business where the pricing of that material is quite favorable.



We're also working very hard on trying to clean up the iron ore enough so that we can optimize pricing for that iron ore as well. So we are looking at trying to expand our product base, and I think that we've got some very good projects that are being worked on right now that all have very good indications for success but the metallurgy takes a little bit of time to figure out on these things. And we're going to continue to work on those and hopefully have some good news in the near future on some additional products for us.

Operator

Your next question is from Brian Nunes from Gramercy.

Brian Nunes - Gramercy Funds Management LLC - Senior VP & Research Analyst

Just on Page 19 of the MD&A, I'm trying to reconcile the -- or maybe you can just help me understand. The vanadium sales from a contract with a customer is listed as 5,467 thousand pounds, but then the V2 sold subject to remeasurement in thousands of pounds is 4,564 in Q2. And I'm just trying to understand why only 83% of the V2 sold is subject to remeasurement. Is that just the price it was sold or based on the year-end -- the quarter end mark? And we can just hopefully understand that.

Ernest M. Cleave - Largo Resources Ltd. - CFO

You're looking at different periods. So the one you're looking at was actually sold in the reporting period. The remeasurement relates to adjustments for sales that were made in prior periods. And they could be across many periods. So as a consequence, there's no comparability between those 2 numbers. And so I'll just make that note there in our various documents as well. But there, if you try to do it on a unit basis then, for that reason alone it won't sum. But if you just look at it on the dollar basis, obviously, it does work. But that's the reason, Brian.

Brian Nunes - Gramercy Funds Management LLC - Senior VP & Research Analyst

I'll call you offline. I don't want to take up other people's time on this. Just want to say a follow-up. In terms of your high-purity sales, they're basically flat year-over-year. Just wonder what activity the company is taking to prequalify with because you've received a lot of inbound inquiries. Is there a prequalification process that you're going through that can potentially help increase those high -- well, all your stuff is high purity, but at least V2 sold as high purity.

Mark Allan Smith - Largo Resources Ltd. - CEO & Director

Brian, there are 4 master alloy producers that take high-purity V2O5, alloy it with aluminum in the world, and we are qualified at all 4 of those entities. We've been qualified for 1.5 years to 2 years now. So we got that done very early. The part that we have 0 control over right now is how our material, once we sell it to Glencore, they get to take it upon themselves to figure out how they want to sell our high purity to those customers and we have very little influence over that. But 9 months from today, we'll have a lot of influence over that.

Operator

Your next question is from Randy Rochman from West Family.

Randall I. Rochman - West Family Investments, Inc. - Analyst

Congratulations, Mark and Ernest. A wonderful job handling the things you can control. And as Lee said, we can't wait to get out from under this contract from hell with Glencore. So I want to follow up on Brian's comments regarding the high-purity segment. I was recently talking with some people from Stratcor and looking at different premiums that higher-premium vanadium end product receives, gets. And I've seen numbers in



between \$5 and \$15. Obviously, it's got to undergo some chemical transition. And from what I understand right now is, you're sharing basically about a \$2 premium on, as you just commented on, a very low quantity as permitted by Glencore. So how do you envision that changing come May of next year?

Mark Allan Smith - Largo Resources Ltd. - CEO & Director

Well, there's a couple of points there. You're being a little bit generous. From what we understand, the premium is actually about \$1.45 right now that Glencore negotiated with their customers and we get half of that right now. So what changes, Randy, when we no longer are under the Glencore contract is, first of all, whatever the premium is, we get 100% of it rather than 50% of it, and we'll be in a better position to negotiate that premium differently. And there are different sectors of high-purity uses where the premium can be significantly greater. That \$2 figure and the \$1.45 figure that I'm talking about is really in the master alloy sector of the business. When you start getting into some higher-purity requirements because of chemical, catalyst production or something like that, the premiums can actually go up more. And they can get upwards of \$3 to \$4 per pound.

Terry, you're on the line. You've done this for 30 years. Do you want to maybe expand on that a little bit?

Terrance T. Perles - TTP Squared, Inc. - President

Yes. So I think you're right, Mark. On the titanium side, there's more consumers of V2O5 that use it to produce vanadium aluminum alloys for the titanium industry. And we're in a position right now where Glencore, some of their production will meet the requirements but not all of it. But they control the channel, they control the negotiation and the relationship with the customers so we get whatever they can't supply, basically. And when Largo is going directly, that dynamic changes.

The other markets for high purity are typically chemical and catalyst applications where they need a powder. Largo does have a powder product and it is suitable for many of those applications, not all of them. There's some that maybe Largo can't meet, but there are a huge number of opportunities in the chemical and catalyst area. And the premiums there differ depending on the quality requirements. If you're looking at something that's lower on the one of specification requirements, the premiums are going to be down closer to that \$1, \$1.50 area. There's some V2O5 grades where premiums are \$4 to \$5. And then there's opportunities to take the V2O5 powder downstream into other chemical derivatives if that made sense: chlorides, oxalates, sulfates. Those are all very, very high-margin products. And then, of course, after that it takes off, the opportunity to take that powder into electrolyte for the battery is also there so.

I think right now Glencore doesn't sell a powder product. They don't know anything about that market. The market is very fractured with hundreds of users. So there's a lot of work involved in going out and getting on top of that market and that's not their cup of tea. So I think when the situation changes, we're going to have a much better opportunity to present ourselves to that market.

Randall I. Rochman - West Family Investments, Inc. - Analyst

So can anyone want to make any guesses on when left to your own devices and doing this yourself as opposed to relying on Glencore, what kind of percentage volume we might see going to these markets in total?

Mark Allan Smith - Largo Resources Ltd. - CEO & Director

Again, Terry, can answer this with a lot more specific information than I can, but these markets that we're talking about that use high-purity V2O5, if you combine all those markets together, I mean, we don't produce enough to fulfill all of those markets. So from my perspective, there's plenty of room in the market and it's just a matter of taking the time to work out the specifications that these different high-purity users require because they are very, very different in each situation that we will want to build up our sales over time. And our whole goal, Randy, is to maximize high-purity

sales. And if I can ultimately get our sales division to sell 100% of our material as high purity, then that's what we're going to do because that's where the extra money is.

Terrance T. Perles - TTP Squared, Inc. - President

I might argue very slightly with Mark and suggest 80% to 90% is a good target. It's always nice in a market like you saw last fall to be in the commodity side a little bit. And the commodity side does help you deal with variations in demand or production month by month where the chemical and the titanium customers are going to want assurance of delivery. And so you need some way to manage the business. And having 10% or 20% that's more or less on a spot basis into the commodity market gives you the ability to ramp sales up or down to manage inventories.

Mark Allan Smith - Largo Resources Ltd. - CEO & Director

Yes. Terry knows I agree with him on that. I think it will be very difficult to achieve 100% of our sales for high purity anyway, but we definitely want to minimize all the risks as we move forward and having a good split will be part of that minimization.

Operator

Your next question is from Jim Young from West Family.

James Young - West Family Investments, Inc. - VP & Investment Analyst

I got several questions. First off, just as a continuation of the question about the high-purity sales. Can you help us understand the process going forward? As I recall, there's some conferences upcoming this fall and the like in these negotiations that will take place to get a better sense as to what the 2020 contract and outlook looks like for Largo.

Mark Allan Smith - Largo Resources Ltd. - CEO & Director

Jim, let me start out by saying that, we have had an unbelievable number of potential customers contacting us since the early part of this year because they know that May of 2020 is the end of that Glencore contract. So they started contacting us very early on in the year about starting discussions for direct offtake with us. And so we've been having those discussions. Terry and I actually spent a week over in Europe visiting all of those folks who are interested in that. So the discussions have been going on for some time.

But the part that you're talking about is kind of the normal contracting process in the vanadium industry where the first industry conference occurs in China the second week of September, then there's another conference in Chicago the last week of September, then we get into conferences in Miami and another one in Budapest. And these are all conferences where negotiations will be occurring this fall for those direct offtake agreements starting for us at least in May of 2020. And we will be heavily participating in those conferences. In fact, we are a sponsor at the Budapest conference, a very large sponsor in that Budapest conference and trying to get a very prominent role speaking and meeting-wise and name-wise, marketing-wise to make sure that we get out there in a prominent way. And our new Director of Sales and Trading will be in all of these conferences. I will be at most of those conferences. And Terry will be in most of those conferences as well. So we're anxious for that process to get going and we're setting up meetings for all of those conferences as we speak because the customer base is that excited to start talking to us directly.

James Young - West Family Investments, Inc. - VP & Investment Analyst

Okay. Great. And then my second question pertains to the recovery rate. In the June quarter, you posted a global recovery of 79.1%, yet for the month of June was 80.9%. And the question is, has that trend continued in July or even improved? And how is it even performing into August so far month-to-date?

Mark Allan Smith - *Largo Resources Ltd. - CEO & Director*

Yes. Recoveries continue to perform exceptionally well. And remember, the early part of the second quarter is when we were finishing up the kiln refractory replacement job. And so there was some instability in the kiln as you go through the refractory replacement and then start it up. And we have now in the last couple of months, 2 to 3 months actually, the stability of the plant has actually been, what I would call, remarkable. I mean, we are seeing some of the best stable performance out of this plant that we have seen. Of course, my hope is, is that recovery continues to increase because that just means lower unit cost at the end of the day for us, but I would say 80-plus percent is certainly world-class right now. And the additional increases that I hope to see will be minimal just because you do get to kind of an asymptotic curve at a point in time and we're pretty quickly approaching that. But our operations team remains extremely motivated, extremely energized. It's amazing to me what they come up with for new ideas to increase overall recoveries not just in the kiln, but overall recoveries and again placing us in that world-class position.

James Young - *West Family Investments, Inc. - VP & Investment Analyst*

And on that kiln recovery rate though, in the first quarter was 89.2%. The second quarter, you posted 88.8%. Now that the kiln work is all completed, what's a normalized recovery and sustainable kiln recovery rate going forward?

Mark Allan Smith - *Largo Resources Ltd. - CEO & Director*

87% would be more of a typical rate. And what I'm intending to say when I provide that number, which is lower than what you had indicated that we're achieving is, our operations team never accepts the status quo. They continue to look for ways to improve things. And they're doing just that. And they're achieving recovery rates out of that kiln on a sustainable basis of 88% and higher. That's remarkable. There are not many vanadium kiln operators that can talk about recovery rates that are that high in that section of the plant.

Terrance T. Perles - *TTP Squared, Inc. - President*

Mark, I might just add. So I might just add that typically, if you're running a roasting operation using slag, which is from order of magnitude a higher concentration of vanadium, but a typical recovery for those guys from the kiln right through to V2O5 is going to be 82%.

James Young - *West Family Investments, Inc. - VP & Investment Analyst*

Okay. And then my next question is regarding your cost guidance. For the full year of 2019, your guidance excluding royalties is \$3.45 to \$3.65, yet in the first quarter you reported \$3.41. And then most recently, you did a great job in bringing it down to \$3.30. So the question is, either why are costs expected to increase in the second half of the year, else are you in a position to formally lower your cost guidance at this time?

Mark Allan Smith - *Largo Resources Ltd. - CEO & Director*

Ernest, I'll have you answer that after I provide a little color on that. Jim, we have a group of people out at the plant that just never stop trying. And as the CEO of the company, my job is to continue to push and push and push and get the maximum performance out of our operations team that we can. And so we will be striving to continue to lower those costs day in and day out. But then we also have the public company side of our business and I'll have Ernest talk to kind of why we say what we say in our financial statements and our MD&A because we have to be conservative, I think, by definition. But Ernest, do you want to maybe opine on that?



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Ernest M. Cleave - Largo Resources Ltd. - CFO

Yes, Jim. So the 6-month number on unit cost ex royalties is \$3.35. So we're about \$0.20 off our midrange. I think we're going to take a little bit of a wait-and-see approach here for a while longer and see how it goes as we run the operations at 1,000 tonnes or more, but we'll have another look. But I don't think you would begrudge us the \$0.20 buffer that we have right now. So we'll take it under advisement.

James Young - West Family Investments, Inc. - VP & Investment Analyst

Okay. Great. Then my last question is, when I Googled Glencore and litigation corruption scandal, there's a litany of examples that are both past and present confronting Glencore. And I recognize the strategic importance and the partnership that you've had with Glencore with your business, but I'm kind of curious as to the price discrepancy that's posted by Fastmarkets Metal Bulletin every Friday and the actual V2O5 transactions that you're seeing in the marketplace. And from your perspective, what accounts for those differential and how does it impact Largo at this time?

Mark Allan Smith - Largo Resources Ltd. - CEO & Director

I think that your question is very interesting, Jim, and very educated. I think our best position right now is probably not to comment on that issue and instead to make sure that we comply with our contract with Glencore to the fullest extent for the next 9 months and then move on. That's what's going to be best for the company. Let's not forget, as difficult as all this Glencore issue is, it was that offtake agreement that really kind of helped secure the financing to construct the project. So I guess one could say, it's a little bit of a price to pay to get that financing in place, but we also feel like we've paid the price and it's time to move on. But they've been a very good partner in terms of sending us the payments that they owe us when they are due. Never had any problems with that. There's just certain provisions on the contract that obviously are not necessarily in our favor and we've had to pay the price but we're just about done. We got 9 months left.

Operator

Thank you. There are no further questions. You may proceed.

Alex Guthrie - Largo Resources Ltd. - Manager of IR & Communications

Thank you, operator. And thanks, everyone, for joining the call today.

As we noted, Largo's second quarter 2019 results press release, financial statements and MD&A can be found in the Investor Relations section of our website at largoresources.com.

And with that, that concludes our call. Have a great day, everyone.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines.



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