

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

SWC - Q2 2014 Stillwater Mining Co Earnings Call

EVENT DATE/TIME: JULY 31, 2014 / 4:00PM GMT



CORPORATE PARTICIPANTS

Mick McMullen *Stillwater Mining Company - President, CEO*

Greg Wing *Stillwater Mining Company - VP, CFO*

CONFERENCE CALL PARTICIPANTS

John Bridges *JPMorgan Chase & Co. - Analyst*

Sam Crittenden *RBC Capital Markets - Analyst*

Garrett Nelson *BB&T Capital Markets - Analyst*

Sam Dubinsky *Wells Fargo Securities, LLC - Analyst*

Leon Esterhuizen *CIBC World Markets - Analyst*

PRESENTATION

Operator

Greetings and welcome to the Stillwater Mining Company second-quarter results. (Operator Instructions). As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Mick McMullen, President and CEO. Thank you, Mr. McMullen. You may begin.

Mick McMullen - *Stillwater Mining Company - President, CEO*

Thank you very much and this is our second-quarter earnings call. You've got myself, Mick McMullen, the CEO; Greg Wing, our CFO; and Mike Beckstead, our IR manager here.

For everybody who's got the presentation, I would like to refer you to page 2, which is our forward-looking statements, if you could all read that at your leisure. And moving into slide 3, I would just like to go through the summary of our second-quarter highlights.

Our net income attributable to common stockholders was \$17.9 million, or \$0.14 per diluted share. This does include a reorganization charge of \$5.6 million, so if you add that back in, we actually had a very solid quarter.

I have spoken at length in the past to say that we are focused very much on cash generation, and the cash plus investments increased quarter on quarter by \$28 million to just over \$500 million, and that was a very good effort because we also increased our working capital in the recycling business by \$9.8 million.

Our all-in sustaining costs were at \$792 per PGM ounce, which is below our previous guidance and at the low end of our newly-revised guidance, which I will discuss shortly.

Our corporate overheads were reduced to \$9.3 million for the quarter, which was a 50% decrease from the same period in the previous year. We entered into a sales and refining agreement with Johnson Matthey, which I will also discuss shortly.

Our mine production was 126,400 ounces of PGM. We are very focused on safety, maintaining our social license, and profitability. The management team here is not driven by any specific ounce target. The Company is very focused on generating the maximum free cash flow that we can by keeping our workforce safe and maintaining our social license.



We're going to change our practices going forward, so in future, we will announce our quarterly production and our earnings at the same time. This will allow us to put the production results in the context of the earnings and the cost savings that we are making.

And lastly, in terms of the summary, and certainly not least, our safety performance has been very good for this first half of this year. Compared to the previous year, we saw a 21% reduction in our overall incidence rate. This is very important to us. We are very focused on safety. We see it as a leading indicator of the health of the business and the Company and we are very happy to report that we have had such a significant improvement.

Turning to slide 4, breaking down the second-quarter results, as we discussed, production was down approximately 3.9% year on year and our cash costs per mined ounce was up by about 3.4%. However, we are much more focused on our all-in sustaining cost, which was down 6.5% from the same period last year, really driven by significant reduction in corporate overheads, halving, and also capital expenditure came down by just under 2% as well.

As we previously announced, recycling PGM ounces was down 23% year on year; however, we did see a reasonably significant increase in those ounces quarter on quarter. This builds on the trend that we discussed on the last call where we saw a slow start to the year, mainly weather related. We have seen that pick up quite a bit.

Slide 5 is some new information that we started giving last quarter, which breaks down our costs per ton by area and by mine. If we look at the very bottom line, you can see that at the Stillwater Mine quarter on quarter, we dropped about \$25 per ton off our costs. At the East Boulder Mine, we dropped approximately \$15 a ton off our costs, and then if you go back up through the slide, you can see that really it is our mining costs where we have driven quite significant change in our costs.

Again, I stress very heavily here that we are very focused on cost control as a business going forward. I would also like to point out our milling costs at the East Boulder operation were down to \$16 a ton. This is an excellent result. It takes us back to where the costs were several years ago.

Administration costs have gone up slightly at the Stillwater Mine. Now that does include royalties, and obviously as metal prices go up and it's a percentage royalty, that does drive a bit of an increase in our admin costs.

Byproduct credits went up slightly. Again, we are starting to see some higher realized prices for those, and recycling credits declined slightly.

Overall, it was an excellent result for us in terms of cost control. There is much work to be done in this area. We still think that we have potential here, but this is an important first step for us.

Turning to slide 6, in the last quarter we rolled out a program called Securing the Future, and this is very much about turning the business into a profitable, long-term PGM supplier here in Montana. We are very focused on cash flow and profitability. We demonstrated some very good progress during the second quarter. Excluding our recycling working capital increase, the operations generated approximately \$37 million cash during the quarter.

Again, we reduced our corporate overheads by 50% year on year. We had \$17.9 million of net income, including our reorganization costs, and our cash balance increased quite significantly.

The reorganization program that we had underway led us to reducing our salaried personnel by 48 people. We had 35 voluntary separations within our hourly employees and we recognized \$5.6 million worth of reorganization costs in the second quarter. This relates to both the salaried rates and the hourly rates, and we believe that, for the most part, that should be the end of those charges.

The graph on the bottom right-hand side of that page shows our headcount over the last few years. You can see that it really did grow quite rapidly from 2011 through to 2013. We have now taken that down through the salaried rate reduction, the voluntary separations within the hourly rates, and also through some natural attrition of the workforce. We are sitting around about 1,663 people at the end of the quarter.



You could also see our cash cost per ounce. The trend had been significant increases. We have now flattened that out and we look to drive that down even further.

Slide 7 just illustrates our quarterly net income or loss over the last five quarters. You can see really Q3/Q4 of last year, we had significant impairments on our foreign assets, which drove a large loss. Q1, we had net earnings of \$19.6 million. Q2 this year, \$17.9 million, but as I said, that does include \$5.6 million of reorganization costs, so after stripping that out, a very strong result.

Greg, I think we had some very minor reorganization costs in Q1, in the order of \$100,000 or \$200,000.

Greg Wing - *Stillwater Mining Company - VP, CFO*

They were not big.

Mick McMullen - *Stillwater Mining Company - President, CEO*

Yes. So overall Q2, I think the trend has been very positive, and we are starting to demonstrate some real progress in terms of the changes in the organization.

Coming to slide 8, on our all-in sustaining costs, again, down 6.5% from the same period last year. You can see that on the graph at the top here that despite production ounces coming down slightly, we have actually managed to maintain that lower all-in sustaining cost. We are being very disciplined how we deploy our capital. We are very focused on operational efficiencies.

We have in this presentation and the earnings announcement this morning decreased our guidance range again for this year to be \$780 to \$830 an ounce range.

We still have a goal -- this is not formal guidance, but we have a goal of reducing our all-in sustaining costs by approximately \$100 an ounce from our 2013 numbers, into the low \$700s.

Again, on the graph there, you can see -- the title on the bottom right-hand side there, you can see the drivers of that change in the all-in sustaining costs to a large extent have been corporate. And we have done that despite having a smaller recycling credit as well.

Slide 9 is a slide that I would like to spend some time on because for me, this is one of the most important slides in the presentation. This talks about our cash over the quarter-on-quarter period. You can see that at the start of the period, we had \$474 million in cash and investments. The operations added a significant amount of cash.

We then had some G&A. We did increase our recycling inventories by almost \$10 million. I'd also like to point out that we paid our insurance renewals, our annual insurance renewals, in May of approximately -- Greg, \$5.6 million, from memory? Which is a one-off annual payment.

We had some additional cash coming from the slag inventories. Again, if people recall, in Q1 we talked about processing the slag. We did receive some revenue from that, and then we've got our capital costs and our taxes.

Net net over the quarter-on-quarter period, we increased our cash by a significant amount of money, despite all the one-offs that we had.

Subsequent to the end of the quarter, we redeemed our \$30 million 8% bonds. This saves us approximately \$2.5 million per annum. We felt that this was a good return, guaranteed return, no risk. We had the cash on hand. We increased our cash balance and I am very much in favor of reducing any debt that we can within the business.

Slide 10, operational improvements and mine planning. So during the course of the quarter, we completed a very detailed analysis of profitability by mining area at the Stillwater operation. What that told us is what we suspected is that some of the ounces we were previously mining, we were mining at a loss. And some other ounces we were mining ahead of when infrastructure was in place, and if we wait until we get infrastructure in place, we could actually make significantly better margin.

The initiative underway now is to focus on profitable ounces and redeploy our resources accordingly. We will only grow production that is profitable and this is a significant change in the culture of the organization. To help us with that, we are implementing some new mine planning software, which will allow us to run various options faster and it will improve our planning of long-term infrastructure.

Broadly, there is somewhere between 12 -- 10,000 to 15,000 ounces that we have previously been producing that was either being produced at a loss or if we wait for the infrastructure to be in place, we could make a significantly better margin on.

This has led to a change in our guidance. We feel that this is the best way forward for the business. I can see no point in mining ounces if we don't make money on them.

On slide 11, with the metal inventory, so we reduced it by approximately 17,600 ounces during the quarter. I've talked before about how we have changed our sales program, how we sell our metals. Before we used to sell on long-term contracts, typically at a discount to the spot price. We started changing that early in 2014.

During the course of this quarter for palladium, we sold at a premium to spot between \$2 and \$8 an ounce. Platinum we sold at between flat to spot, or a \$5 premium per ounce.

We entered into a sales and refining agreement with Johnson Matthey. For those of you who don't know who Johnson Matthey are, a very large player in the PGM space, arguably the leading player. They will purchase all of our mined palladium and a significant portion of our platinum at our market-based formula, which allows us collect any premium that's in the market. They will also have the right to bid on any available recycled ounces as well.

Starting on July 1, Johnson Matthey are refining all of our ounces, both mined and recycled ounces, at slightly improved terms. Importantly for us, Johnson Matthey will assist us in securing additional fee for our recycling business. Again, this agreement only came into effect on July 1, but already we are starting to see some benefit out of this agreement with Johnson Matthey.

Also importantly for us, there is a nominal break fee for Stillwater on the sales contract and on the refining contract some years out. This allows us to have our relationship with Johnson Matthey, but I think importantly, corporately, it does allow us some flexibility in the future.

Realized sales price during the quarter for our mined ounces was \$962 an ounce. For our recycled material, it was slightly higher. We have a slightly different mix of metals. It was just over \$1,000 an ounce, and our mined basket price today, as we sit here, is \$1,023 an ounce. So we have seen some increase in the metal price over the quarter and, again, we continue to realize the premium.

You can see from that graph there that we have drawn down our inventory quite significantly. The processing of the slag was a large part of that, and again, the slag was material that we paid the majority of costs on and we had the ability to recover some cash out of that, which we have done.

Moving on to slide 12, in Montana we have some projects underway. Graham Creek is a project out at the East Boulder operation. It is essentially complete. We are just in the process of installing the vent fan now. It's an 8,800-foot development west of the existing infrastructure at the mine, with twin ventilation raises to the surface.

Mine production began out of that during the second quarter, ahead of schedule. It is currently providing around about 10% of East Boulder's ore feed.



The East Boulder Mine has seen very strong performance and it has enabled us to advance plans there for a third shift at the mill. So just to refresh people's memory, we have a mill there that currently operates four days on and three days off. We have lots of excess capacity. It is all about getting the ore tons out of the mine in order to fill that mill.

When that third shift comes on during the current quarter, it will add around about 2,000 ounces of production per month, and we are looking to advance that as rapidly as we can, based on the very strong performance out of the East Boulder Mine and the fact that Graham Creek has come online a little bit ahead of schedule.

Over at the Stillwater Mine, our main project is called Blitz. This is a very large project. It will be completed around about early 2018. This consists of a 23,000-foot development to the east of the existing Stillwater Mine on two levels and a portal called the Benbow portal.

The main haulage access tunnel is being driven by a tunnel boring machine, a TBM, as we call it. It is approximately 7,000 feet in. And there is a parallel drive of 600 feet above that, which is a conventional drive, and that's approximately 6,000 feet in.

We are looking at ways to expedite the advance of this project. We see this project as a core project for us going forward. It opens up a very large strike length of mineralized reef, and because of its location being on the same level as the concentrator and relatively short haul to get in to the orebody, we see this as being -- having the ability to add significant low-cost production in the future.

On slide 14, our portfolio. We have two foreign assets. One is called Marathon. This is a PGM and copper asset up in Ontario. The core business of the Company is profitable PGM assets in low-risk jurisdictions, and so Marathon is a PGM asset. It is in a low-risk jurisdictions

At current metal prices, the project does not provide us a sufficient shareholder return in order to justify us advancing this. We have a fantastic joint venture partner there in the form of Mitsubishi, who own 25% of the asset and we own 75%. We are currently working together to assess alternatives to determine the possibility of how we can get to a project that gives us the return that we need.

We don't think we will have a decision point earlier than early next year. We are working very hard together to see if we can advance that decision point. In the interim, we have reduced staffing up there by 50% and scaled back our spend.

And Altar is a very large porphyry copper asset in Argentina. It is a non-core asset for us by virtue of the fact that it is copper. It is in Argentina, and that's actually -- it's a very large asset. In terms of contained copper globally, this is probably about number 12 on the undeveloped copper assets in the world.

We have scaled back activity there at the moment. We are looking at the best ways to realize value from that project. Again, we've reduced staffing there. We have reached agreement with IPEEM, one of the tenement holders there, to extend some mineral leases through to next year, and we have done quite a bit of test work on some alternative concentrate treatment methods, which look to have quite favorable results there.

You can see from the table on that page that we have reduced spend at both -- or at Marathon significantly over the quarter. We spent a little bit more in Altar quarter on quarter, but overall, our spend level at both those assets is relatively small at this point.

So coming on to slide 15, and I expect some questions on this later, you can see with our new guidance, we have taken down our guidance range for mine production by 10,000 ounces. So the range that we are giving now is 510,000 to 525,000 ounces. This is very much being driven by the review work that we've done at the Stillwater operation that indicates that some ounces we have been mining in the past have not been profitable, and we are taking those out of the mine plan for now.

For the large part of those, it is a deferral of mining those ounces. We have been mining them ahead of when infrastructure has been in place. And so, we're waiting until the infrastructure catches up and we can get those ounces mined and hauled on rail haulage, instead of being hauled in very small trucks over long hauls and being handled three or four times.

This has no impact on our reserves. What it does have an impact on is when we will mine those ounces.

Cash costs, again, we have left that the same. We have reduced our all-in sustaining cost guidance by \$20 an ounce, and again, you can see where we've landed on the last quarter. We think we are sitting in good shape for coming in to that guidance.

Corporate overhead we have left the same. We have reduced some of the capital expenditure guidance, partly in sustaining CapEx and partly in project capital. Again, for a large part, that is because we have been able to do the same things with less money in the capital area, and there are some other areas where we've been able to just take stuff out of the capital budget altogether. We are still continuing to spend at full pace on projects like Graham Creek and Blitz and we are not reining back expenditure in core areas.

Now coming on to the summary slide, we have quite good momentum in terms of our financial performance. We have taken some reorganization actions to secure the long-term sustainability of this Company.

The third bullet point, I think, is really the key one here. We have demonstrated that we have a continued focus on cash generation and profitability. That is absolutely the mantra for this Company going forward is to demonstrate that we can provide a return to shareholders.

We increased our cash by a significant amount of money, despite some one-offs and increasing our working capital in the recycling business as we started to rebuild volumes there. We have shown very good continued progress in capital allocation and cost control. And in a broader sense, we see there is obviously a very favorable PGM fundamental environment, particularly for palladium.

And that concludes the presentation that I have today. I will be happy to take questions from anyone and open up the floor.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). John Bridges, JPMorgan.

John Bridges - JPMorgan Chase & Co. - Analyst

Thanks for the results. I was just wondering. You mentioned some low-value loss-making stopes that you have come across, but my understanding of the big proven reserve that you're carrying is to avoid that sort of thing and allow you to pick and choose where you go a year or so ahead of where you get there. So I am just a bit surprised that you have come across stopes which are loss making and you have not been able to avoid them. Could you give a little bit of color on that? Thanks.

Mick McMullen - Stillwater Mining Company - President, CEO

Yes, good question. I think that this level of review has not been done in the past, and so, in a nutshell, average costs and average yields have been applied across some of the stoping areas, and when we have really drilled down into the detail and applied specific costs for each stoping area, that has highlighted that some of those stopes are loss making.

And then when we have drilled further down into it and said, well, why are they loss making? To a large extent, it is because we are mining them ahead of when the infrastructure is there.

So to give you an example, some of those stopes have haulage costs that are \$35 to \$40 a ton more than if we wait for the rail haulage to get in place. And that just pushes them over into being either loss making or, in some areas, we are actually making a conscious decision to wait until the rail gets there and pick up that extra margin of \$35 to \$40 a ton.



So this level of detail has not been done in the past in terms of evaluation. What that means is that in the short term, you will see different production as we take some of those stopes out of service, but then we will see production probably come back up as we redeploy those people into more productive areas.

John Bridges - *JPMorgan Chase & Co. - Analyst*

And you decided to take the nuclear option rather than just fading in this new policy?

Mick McMullen - *Stillwater Mining Company - President, CEO*

I wouldn't call dropping 10,000 ounces out of your production a nuclear option. I think that you are better off to focus on margin always, is my view.

John Bridges - *JPMorgan Chase & Co. - Analyst*

Okay. Graham Creek, better new story. You're going to bring in another shift, and do you have any sort of idea as to when that is going to be up and fully -- performing fully and what sort of increment we can expect from that site?

Mick McMullen - *Stillwater Mining Company - President, CEO*

We have said in here in the current quarter, Q3, it will be towards the end of Q3, and it is around about 2,000 ounces per month.

And look, to be honest with you, we actually have a large ore stockpile sitting on surface that is waiting for that extra crew to start up so that we can start moving our way through that.

The East Boulder Mine has performed very, very well. Some of the other smaller advantages of that third shift is that we can reduce the hourly throughput rate slightly in the mill, which allows us to pick up a little bit extra on recovery. And it also adds -- just adds ounces to us.

John Bridges - *JPMorgan Chase & Co. - Analyst*

Okay, that's great. Appreciate it. Best of luck for the rest of the year.

Operator

(Operator Instructions). Sam Crittenden, RBC Capital Markets.

Sam Crittenden - *RBC Capital Markets - Analyst*

Question on the slag inventory. I am just curious if that impacted the cash costs. Was that treated as a credit in the cash costs in this quarter?

Mick McMullen - *Stillwater Mining Company - President, CEO*

I might hand that over to Greg to answer that one.

Greg Wing - *Stillwater Mining Company - VP, CFO*

Again, we used for our mined production, and some of this is -- some of the slide probably is mined and some of it is recycled, but we use an average costing method. So, that does draw cost as we pull it out on an average basis.

Obviously, the mining costs have already been incurred. They are in inventory, so on a cash basis, those ounces in the period were less cash intensive than the average production, if you will. Is that helpful?

Sam Crittenden - *RBC Capital Markets - Analyst*

Yes, I guess what I'm getting at is if all else is equal going into Q3 and Q4, will there be a bit of an increase in cash costs, just without that benefit from the slag inventory?

Greg Wing - *Stillwater Mining Company - VP, CFO*

I think you might see a little bit, but on the whole, as I say, I think most of the cash cost has been incurred on those and taken care of. So, my sense is you might see -- we did benefit from those, certainly from the revenue, but on the cost side, I don't think you'll see a lot of change.

Sam Crittenden - *RBC Capital Markets - Analyst*

Okay. And then, just another question on costs, the overhead reductions and then employee number reductions, has that been fully felt in the Q2 numbers? Or are you going to see still more benefit from that going into Q3 and Q4?

Greg Wing - *Stillwater Mining Company - VP, CFO*

As accounting rules would require, we have accrued for everything that we can identify associated with those termination costs, so there may be some cash impact going forward. A lot of this is non-cash type compensation, but some of it is cash compensation. So, you may see some cash impacts, but the expense impact has been recognized already.

Mick McMullen - *Stillwater Mining Company - President, CEO*

And we are not currently planning any further additional reorganization or restructuring going forward. So, I think we are done with that. And so the one-off \$5.6 million reorganization costs we had in the last quarter, we don't expect to see that as an ongoing matter.

Greg Wing - *Stillwater Mining Company - VP, CFO*

I think we do make a comment that we will be evaluating our manpower needs as we go forward. To a large extent, we believe that if we need to reduce, that attrition will take care of that.

Sam Crittenden - *RBC Capital Markets - Analyst*

And then just to take a step back, so I guess you have got this goal of reducing your all-in sustaining costs by \$100 per ounce. It seems to me, have you made the immediate changes and you have obviously seen some reduction in costs, but then that next, call it, \$60 an ounce, is that something that is going to take more time and be gradual over the next two to three years?

Mick McMullen - *Stillwater Mining Company - President, CEO*

It will certainly take time and will be gradual. I would like to think we can do it quicker than the next two to three years, and a lot of it will come about through some of the changes we are making now, which we're only just making now in terms of pulling out some of the high cost ounces. That does have an impact on the all-in costs, and also, our productivity gains at the operations is where we expect to see the next lot come from.

Sam Crittenden - *RBC Capital Markets - Analyst*

Okay. And then, just one last one. I think you mentioned there is -- the Stillwater Mine production was impacted by mining conditions. From that, are you talking to those stopes that you didn't mine in or was there some other challenging ground conditions or something else going on?

Mick McMullen - *Stillwater Mining Company - President, CEO*

No, it was more related to not so much ground, but just the reorganization changes, moving people around from stoping area to a different stoping area. That was probably more what that comment was around.

Sam Crittenden - *RBC Capital Markets - Analyst*

Okay. Thanks, guys. Appreciate the update.

Operator

Garrett Nelson, BB&T Capital Markets.

Garrett Nelson - *BB&T Capital Markets - Analyst*

Nice work on the cost side and being able to lower your all-in cost per ounce guidance again.

Most of my questions have been answered about the Stillwater Mine, but I have a big-picture question. I wanted to get your perspective on how you think the new South African labor agreement will affect the industry's cash costs and whether any shift in the global cost curve might improve your competitive position?

Mick McMullen - *Stillwater Mining Company - President, CEO*

Look, good question, and we have in the past put a cost curve in there. From what we can see, and again, you would be better off asking the South Africans, possibly, but we think it has pushed the -- on a platinum-equivalent basis, we think it has pushed the cost curve up by about \$70 to \$80 an ounce. I think, Greg, that was where we arrived, wasn't it?

Greg Wing - *Stillwater Mining Company - VP, CFO*

That's right.

Mick McMullen - *Stillwater Mining Company - President, CEO*

So, again, just by virtue of us firstly holding our costs, then starting to drive them down, and their costs going up, and they appear to be across the board in South Africa, we think that has put us in a comparatively better position.

We said that last year on a platinum-equivalent basis, we were at about the 35 percentile in the cost curve, and our goal was to get us to about the 25 percentile, and I think that the agreements in South Africa have certainly helped us a bit in that front as well.

Greg Wing - *Stillwater Mining Company - VP, CFO*

The only other point I would make is that, obviously, all of the cost structure is very dependent on what the exchange rate is between the US dollar, which is what the metal is priced in, and the South African rand.

The rand has been weak. Again, we are not here to project where it is going, but if it were to weaken further, that would strengthen the South Africans relative to us, slightly.

Garrett Nelson - *BB&T Capital Markets - Analyst*

Sure. And then, your cash position increased by about \$22 million during the quarter, it looks like. Actually, maybe a bit more.

Mick McMullen - *Stillwater Mining Company - President, CEO*

\$28 million.

Garrett Nelson - *BB&T Capital Markets - Analyst*

Yes, \$28 million. Any thoughts on uses of that free cash? Paying a dividend or returning cash to shareholders in some form?

Mick McMullen - *Stillwater Mining Company - President, CEO*

Yes, well, you will have noted we paid off -- just after the quarter ended, we paid off \$30 million of a bond that was costing us 8%, so we felt that was a very good, no-risk return to us. It made a lot of sense.

So even after paying that off, we still do have a significant amount of cash. I still would like to be in a position to return something to shareholders, probably in the medium term. We haven't decided in what form that may or may not take. I would like to see how we go just with some of the operational changes that we are making at the moment to make sure that is all bedded in and just see how much cash generation we can drive out of these operations. Then at that point, we can look to do something for shareholders, I think.

Garrett Nelson - *BB&T Capital Markets - Analyst*

Okay, and then with the Johnson Matthey agreement, how will that impact gross margin for the recycling segment? Will that help improve the gross margin? It looks like gross margin in that business was about 2% during the quarter. Given that agreement went into effect at the beginning of July, should we expect any improvement in the results of that business?

Mick McMullen - *Stillwater Mining Company - President, CEO*

I don't know if the margin per se will improve, but the total volume should improve.

And you also need to remember on that business, we have every three to four years when we re-brick the furnace, we typically pick up a pile of ounces, so last year, we did have that. So we made \$35.5 million in that business last year.

So you sort of need to normalize earnings in more of those ounces because it is a bit lumpy as to when we re-brick that furnace. So I think the margin actually, once you do that, is a bit higher than 2%. Historically, it has been 3.5% to 4.5%, I think, when you run that out.

So I don't think the margin will grow because of Johnson Matthey, the Johnson Matthey agreement. I think what will happen is the total dollars that we make from that business should grow as we start to get the benefits of that agreement, from more volume.

I will say that even though the agreement did only start on July 1, we did sign it a few months earlier than that, and the relationship has been quite fruitful for us so far.

Garrett Nelson - *BB&T Capital Markets - Analyst*

Okay, one final question. I noticed the diluted share count was quite a bit higher than the basic share count. What was behind that?

Mick McMullen - *Stillwater Mining Company - President, CEO*

I will hand that over to Greg to talk to you about the intricacies of our convert.

Greg Wing - *Stillwater Mining Company - VP, CFO*

We do have a convertible debenture out there. The higher number, the 156 million shares, I think it is, assumes that each of the convertible debentures converts into the maximum number of shares that it possibly could.

I think in the real world, it is unlikely that would happen, that it would be that dilutive. But nevertheless, that's how the accounting process works at this point.

So, if anything, we're a bit overstated in how dilutive that we are there, perhaps, although we are certainly following the accounting guidance in doing it that way. You may recall those debentures come due in October -- I am sorry, become redeemable in October 2019, so there is some time out there until that -- we come to that juncture.

I can go into a lot more detail, but I'm not sure you want to hear it, so if you have questions, I am open to them.

Garrett Nelson - *BB&T Capital Markets - Analyst*

Okay, I will follow up later. Thanks very much.

Greg Wing - *Stillwater Mining Company - VP, CFO*

Sounds good.

Operator

Sam Dubinsky, Wells Fargo Advisors.

Sam Dubinsky - *Wells Fargo Securities, LLC - Analyst*

Congrats. I know your stock is down, but it seems like you are executing on your strategy pretty well, so I'm surprised by the movement.



But I just had a quick follow-up on recycling. I know comps are difficult because of the furnace brick from last year. What do you think a good target long-term run rate is for this business on volumes? And then, I have a follow-up.

Mick McMullen - *Stillwater Mining Company - President, CEO*

We don't give formal guidance on the business just because of the nature of it, but I think we would like to target something where we could grow that thing 10% year on year. And you have to remember that last year was a bit of an exceptional year. We grew it 38% year on year.

So what we're seeing now, there was a couple of -- there was some situations in the industry last year which led us to picking up a lot of volume from one other player, but I think if we work on it, growing 10% year on year is probably where I think is a reasonable target for us to be.

Greg Wing - *Stillwater Mining Company - VP, CFO*

(multiple speakers) guidance.

Mick McMullen - *Stillwater Mining Company - President, CEO*

Absolutely. We don't give formal guidance on that business, just because of the nature of the business.

Sam Dubinsky - *Wells Fargo Securities, LLC - Analyst*

Okay, I understand. And then, based on your experiences and conversations with Johnson Matthey, from a supplies perspective, how do you think this cycle compares to prior PGM cycles? And do you think there will be enough palladium to handle all the demand? It just seems like a lot of your competition is going by the wayside.

Mick McMullen - *Stillwater Mining Company - President, CEO*

That's a fair observation. I have been pretty clear before that I don't really subscribe to a doomsday scenario in the palladium market. I think that irrespective of what happens with Russia and potential sanctions, we will continue to see the Russian metal come out.

And similarly in South Africa, I think that the exchange rate will normalize to the level that just keeps the bulk of that South African production profitable on a cash basis, probably not sufficient to reinvest long term.

And I think the gap in -- or the apparent gap in demand, between supply and demand for palladium to a large extent is going to be filled in by recycling. So overall, we still think the fundamentals for palladium, especially, look really very strong. We are starting to see that in the metal price now, which incidentally has gone up significantly since the strikes in South Africa ended.

So overall, we think that the outlook for palladium looks very strong. I don't think you're going to get to what we could call a peak palladium where you actually run out of the stuff, and if you look at what people can substitute for palladium, really it's platinum or rhodium. Rhodium is a very thin market and the minute someone says they are going to substitute with rhodium, the price will go very high again, which takes out any benefit from it.

And you can get to a one-to-one substitution with palladium to platinum now, so that's telling you that, in theory, at least, the palladium price could run a long way yet before you get real substitution risk.



Sam Dubinsky - Wells Fargo Securities, LLC - Analyst

Okay, and my last question is on recycling capacity. Assuming there may not be a lot of palladium relative to supply relative to demand, in terms of recycling, is there enough smelter capacity? I know the industry in theory has enough, but is there any chance we can actually [see] pricing or margins get better in smelting or is that always going to be a low single-digit margin business?

Mick McMullen - Stillwater Mining Company - President, CEO

I think it will be a low single-digit margin business in the auto cat recycling sector. There are some other smelting options, i.e., for mined product, which I think have a significantly better margin, and they are certainly an area that we are investigating.

Sam Dubinsky - Wells Fargo Securities, LLC - Analyst

Great, thank you very much.

Operator

(Operator Instructions). Leon Esterhuizen, CIBC.

Leon Esterhuizen - CIBC World Markets - Analyst

Just -- I am trying to get the big kickers in your Company, Mick. If I look at your net income of, let's call it, \$18 million for the quarter, you are talking about about \$6 million worth of reorganization that could have been added to that, and if you look at the current price differential of about \$50 on what you had in the previous quarter, given your current run rate, that's about \$6 million again.

So just roughly, you could have added \$12 million to that \$18 million, so you could have been running \$30 million net income. But my problem is that you also have this inventory gain of almost \$20 million, or \$18 million. So if I look through into the next quarter, assuming everything stays where it is now, you gain \$12 million, but you lose \$18 million, so there is \$6 million down quarter on quarter.

What it comes down to for me is you really, I think, need to somehow start adding volume. You need to add more production ounces. Now I know you are not focused on ounces, you are focused on margin, but I'm just thinking -- I am trying to find the real kicker, the thing that gets you off to the races, so to speak.

Mick McMullen - Stillwater Mining Company - President, CEO

Yes, and look, we will add some volume, but you need to add volume that is making you money. If you are losing \$200 or \$300 an ounce, there is no point producing it. Simple as that.

And so, what we are looking to do is to redeploy some of that workforce out of areas that have been losing money and redeploy them into areas where they got higher productivity, which eventually will translate into more ounces. But you need to make that transition first and get them into those areas.

And that's what we are doing now. We started rolling that out towards the end of last quarter. We will do it this quarter. That may translate into higher ounces as we go forward, but for the rest of this year, the guidance that we are giving now, we feel that is the correct number.

We feel that what we are doing now will actually give us a better cash position at the end of the year than the plan we were previously on. In fact, we know it will.

Leon Esterhuizen - *CIBC World Markets - Analyst*

Okay, so if you roll this thing slightly forward, with your new areas coming on, I know you don't want to give guidance, but there must be a feeling that you're going to be producing more profitable ounces, say, over the next 24 months?

Mick McMullen - *Stillwater Mining Company - President, CEO*

That's correct. And we would probably see production -- again, this is not guidance, but we would probably see over that period the production would go up, but importantly for us, costs will continue to go down. That is the key for us.

As Greg mentioned, even though we're in a pretty good position on the cost curve now, if the rand was to depreciate suddenly, our position on the cost curve would worsen. So we must focus on our costs and we must focus on cash flow generation.

We did generate some cash out of the inventory, out of the slag, but that's been sitting there for a long time. I saw no point in letting it sit there. We might as well have it as cash on our balance sheet.

Similarly, the ounces that are sitting in the stockpile over at East Boulder, same story. It's cash sitting there that we can repay most of the costs on. We're going to pull that out into ounces and convert that into cash over the next quarter or four months.

Leon Esterhuizen - *CIBC World Markets - Analyst*

All right. Thanks.

Operator

Thank you. At this time, I would like to turn the floor back to Mr. McMullen for closing comments.

Mick McMullen - *Stillwater Mining Company - President, CEO*

I would like to thank everybody for dialing in and for all the questions. In summary, we think we had a pretty strong quarter and we look forward to building on this base and really just continuing to build on cash. Thank you.

Operator

This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.



DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2014, Thomson Reuters. All Rights Reserved.