Rating: BUY
Target Price: $3.50

Loi Paves the Way to Completion

▶ Another 25,000 tonnes of TiO₂ Likely Spoken for: Argex announced the signing of an LOI for the distribution of up to 25,000 tpa of TiO₂ to a large, unnamed chemical distribution company. While this LOI is not yet a binding off-take agreement, it does lay the groundwork for negotiations, with the intent being to reach such a definitive off-take stage with a second customer.

Our June 28, 2013 note, Off-Take Agreement with PPG, surmised that 15,000–17,000 of the 50,000 tpa capacity was now destined for PPG. Assuming the newly announced LOI moves forward, at least 80% of the material produced from Argex’s first operating line (40,000–42,000 tpa) would now be spoken for.

If projections from the Argex third-party engineering study are correct, it is clear that the initial PPG off-take essentially makes the first module built by Argex breakeven. This off-take, when concluded, should provide substantial profitability. We maintain our BUY recommendation.

▶ Next Steps: Argex continues to progress in a positive and systematic fashion. It is building a solid and diversified customer base through off-take agreements while continuing to clarify the economics of its process modules, as in the recently announced third-party feasibility study (announced on October 9, 2013). Moving forward, Argex will use today’s LOI as a guideline for the negotiation of a definitive marketing and off-take agreement with a second major customer. We would also expect the company will soon lock down a third customer for the remaining uncommitted 8,000–10,000 tpa from its first operating module. This would be consistent with our June 28, 2013 note in which we explained the rationale behind Argex management’s desire to split initial output between three major customers.

▶ Conclusions: All along we have built our model with sales of 50,000 tpa commencing in 2015 and ramping to 100,000 tpa in 2017. While today’s LOI opens the potential to de-risk the sales process, we are confident that our 14% discount rate remains appropriate at this time. Hence there is no change to our DCF model — using a flat, $3,500/tonne price for TiO₂ pigment with production and discount rate as stated, we are maintaining our $3.50 target price and BUY recommendation.
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<thead>
<tr>
<th>Rating</th>
<th>Description</th>
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<tbody>
<tr>
<td>STRONG BUY</td>
<td>The security represents extremely compelling value and is expected to appreciate significantly from the current price over the next 12-18 month time horizon.</td>
</tr>
<tr>
<td>BUY</td>
<td>The security represents attractive value and is expected to appreciate significantly from the current price over the next 12-18 month time horizon.</td>
</tr>
<tr>
<td>SPECULATIVE BUY</td>
<td>The security is considered a BUY but in the analyst’s opinion possesses certain operational and/or financial risks that may be higher than average.</td>
</tr>
<tr>
<td>HOLD</td>
<td>The security represents fair value and no material appreciation is expected over the next 12-18 month time horizon.</td>
</tr>
<tr>
<td>SELL</td>
<td>The security represents poor value and is expected to depreciate over the next 12-18 month time horizon.</td>
</tr>
</tbody>
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