Barron's: Dutch Materials Stock Looks Tempting

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It’s time to bet on Dutch materials firm Advanced Metallurgical Group.

Investors recently soured on lithium, casting a pall over the stock (ticker AMG. Netherlands), even though its exposure to the metal is small. Now the shares, including those traded over the counter in the U.S., under the symbol AMVMF, look cheap, especially given the company’s expanding profit margins.

Lithium’s dive began this year, after a report predicted a higher supply of lithium might depress prices. The accuracy of that assessment, however, is debatable. Unlike major commodity markets, such as those for oil or gold, “the challenge in the lithium space is that it is opaque,” says Jay Jacobs, a lithium-market expert who is the head of research and strategy at exchange-traded fund provider Global-X. “It is really hard to produce lithium and to produce it economically,” he adds. He’s skeptical that a supply surge will materialize soon.

That said, a key lithium index is 25% below its all-time high, hit in January, according to Trading Economics. The Global-X Lithium & Battery Technology (LIT) exchange-traded fund, which holds a basket of lithium and battery-related stocks, is down by 11% over the past six months, and AMG shares slid by 26% in the same span.

The plunge makes no sense for AMG, particularly in light of its recent stellar results, unless investors have zero belief in the sustainability of its nonlithium businesses. These include production of specialized materials that help reduce carbon dioxide emissions, such as titanium alloys (for coating jet-engine blades,) chromium (for other aerospace parts), and vanadium (for high strength low-alloy steel).

Third-quarter earnings, reported Nov. 1, showed operating margins jumping to 13.5% from 6.9% a year earlier, as after-tax profits, denominated in U.S. dollars, hit 93 cents a share, more than double the 44 cents of the corresponding 2017 stretch. Our “business portfolio continues to perform exceptionally well,” said CEO Heinz Schimmelbusch in the earnings statement, citing “strong end-market fundamentals and our relentless pursuit of improvements in productivity and efficiency.”

“The elephant in the room is ferrovanadium,” says Steve Hanke, professor of applied economics at Johns Hopkins University, and a member of the firm’s supervisory board. The price of ferrovandium, a combination of iron and vanadium for strengthening steel, jumped more than 160% this year after China mandated more vanadium in steel for construction. Next year, AMG’s results also should be boosted by its plan to start extracting lithium from tantalum mine tailings, rather than mines. “Needless to say, we have no mining costs for the lithium, so we will have nice margins,” says Hanke. Lithium should contribute around 10% of earnings before depreciation and amortization.

Given all this, AMG stock looks cheap, with a P/E of 10.3, based on next year's expected profits, down from 18 in 2017. While it’s hard to find exact rivals in specialty materials, the U.S.-based Materion (MTRN) is somewhat comparable. It trades at a forward P/E of 21.5, versus 23.5 in 2016. Both firms have an enterprise value (stock-market value plus net debt) of a little more than $1 billion. Analysts who cover AMG rate it Buy or Strong Buy, with an average 12-month target price of 66.72 euros ($76), an 80% premium to its recent €37 quote.