



Performance Materials

MANAGEMENT'S DISCUSSION AND ANALYSIS

NEO PERFORMANCE MATERIALS INC.

FOR THE YEAR ENDED DECEMBER 31, 2018

Management's Discussion and Analysis

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Unless otherwise noted, all amounts in this discussion are expressed in United States dollars

The following Management's Discussion and Analysis ("**MD&A**") for Neo Performance Materials Inc. ("**Neo**") should be read in conjunction with the accompanying audited consolidated financial statements and related notes thereto as at and for the year ended December 31, 2018 available on Neo's website at www.neomaterials.com and on SEDAR at www.sedar.com. Unless otherwise stated, references in this section to "Neo", "our", "we" or "Group", refer to Neo Performance Materials Inc. and its consolidated subsidiaries.

The financial results presented in this MD&A are prepared in accordance with International Financial Reporting Standards ("**IFRS**") as issued by the International Accounting Standards Board ("**IASB**"). "Adjusted EBITDA", "Adjusted EBITDA Margin", "Adjusted Net Income or Loss", "Adjusted OIBDA", "Adjusted OIBDA Margin", "Adjusted Earnings per Share", "EBITDA", "Free Cash Flow", "Free Cash Flow Conversion" and "OIBDA" are not measures recognized under IFRS and do not have any standardized meaning prescribed by IFRS. These measures may differ from those used by, and are not necessarily comparable to similar measures presented by, other companies. There are no directly comparable IFRS measures to any of these measures. These measures are intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS. See "*Management's Discussion and Analysis - Non-IFRS Financial Measures*" below.

This discussion contains forward-looking statements and information. The actual results, performance and achievements could differ materially from those implied by these forward-looking statements as a result of various factors, including those discussed below, particularly under "*Risk Factors*". See "*Forward-Looking Information*".

The discussion and analysis in this MD&A are based upon information available to management as of March 10, 2019. This MD&A should not be considered all-inclusive, as it excludes changes that may occur in general economic, political and environmental conditions. Additionally, other events may or may not occur that could affect Neo in the future.

1. Forward-Looking Information

The following discussion and analysis contains "forward-looking information" within the meaning of applicable securities laws in Canada. Forward-looking information may relate to future events or future performance of Neo. All statements in this disclosure, other than statements of historical facts, with respect to Neo's objectives and goals, as well as statements with respect to its beliefs, plans, objectives, expectations, anticipations, estimates, and intentions, are forward-looking information. Specific forward-looking statements in this discussion include, but are not limited to: expectations regarding certain of Neo's future results and information, including, among other things, revenue, expenses, revenue growth, capital expenditures, and operations; statements with respect to expected use of cash balances; continuation of prudent management of working capital; source of funds for ongoing business requirements and capital investments; expectations regarding sufficiency of the allowance for uncollectible accounts and inventory provisions; analysis regarding sensitivity of the business to changes in exchange rates; impact of recently adopted accounting pronouncements; risk factors relating to intellectual property protection and intellectual property litigation, and; expectations concerning any remediation efforts to Neo's design of its internal controls over financial reporting and disclosure controls and procedures. Often, but not always, forward-looking information can be identified by the use of words such as "plans", "expects", "is expected", "budget", "scheduled", "estimates", "continues", "forecasts", "projects", "predicts", "intends", "anticipates" or "believes", or variations of, or the negatives of, such words and phrases, or state that certain actions, events or results "may", "could", "would", "should", "might" or "will" be taken, occur or be achieved. This information involves known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking information. Neo believes the expectations reflected in such forward-looking information are reasonable, but no assurance can be given that these expectations will prove to be correct and such forward-looking information included in this discussion and analysis should not be unduly relied upon. For more information on Neo, investors should review Neo's continuous disclosure filings that are available under its profile at www.sedar.com.

The forward-looking information is only provided as of the date of this MD&A, March 10, 2019, and is subject to change as a result of new information, future events or other circumstances, as discussed above, in which case the forward-looking information will be updated by Neo as required by law.

2. Overview

Neo has established itself as a global leader in the innovation and manufacturing of rare earth- and rare metal-based functional materials, which are essential inputs to high technology, high-growth, future-facing industries. Neo has a global platform that includes 10 manufacturing facilities located in China, the United States ("U.S."), Germany, Canada, Estonia, Thailand and South Korea as well as two dedicated research and development ("R&D") centres in Singapore and the United Kingdom ("UK"). Neo is the only non-Chinese company with a license to separate rare earth elements ("REEs") in China, which provides unique competitive advantages and a degree of vertical integration. Since 1994, Neo has leveraged its rare earth separation expertise to innovate and grow into a leading manufacturer of functional engineered materials for specialty end markets. This includes establishing the #1 global market position in bonded magnets, a top-three global market position in auto emission control catalysts, the #1 gallium trichloride ("GaCl₃") producer for light-emitting diodes ("LEDs") and growth opportunities into new end markets such as waste-water treatment. Neo is organized along three business segments: Magnequench, Chemicals & Oxides ("C&O") and Rare Metals, as well as the Corporate segment.

Magnequench

The Magnequench segment, with over 30 years of manufacturing experience, is the world leader in the production of magnetic powders used in bonded and hot-deformed, fully dense neodymium-iron-boron ("NdFeB") magnets. These powders are formed through Magnequench's market-leading technology related to the development, processing and manufacturing of magnetic powders. Magnequench uses a proprietary process to manufacture Magnequench powder using a blend of rare earth oxides ("REOs") as the primary input. These powders are used in the production of bonded permanent magnets that are components in automotive motors, micro motors, traction motors, sensors and other applications requiring high levels of magnetic strength, improved performance, and reduced size and weight.

C&O

The C&O segment manufactures and distributes a broad range of light and heavy rare earth functional materials that have become an indispensable part of modern life. Neo's world-class rare earth processing and materials manufacturing capabilities enable Neo to meet increasingly demanding specifications from manufacturers that need custom engineered materials. Applications from these products include auto catalysts, consumer electronics, petroleum refining, hybrid and electric vehicles and wastewater treatment.

Rare Metals

The Rare Metals segment sources, reclaims, produces, refines and markets high value metals and their compounds. These products include both high-temperature metals (tantalum, niobium, hafnium and rhenium) and electronic metals (gallium and indium). Applications from products made in this segment primarily include superalloys for jet engines, medical imaging, wireless technologies and LED lighting. Other applications include their use in flat panel displays, solar, steel additives, batteries and electronics applications.

Corporate

Neo's global headquarter is in Toronto, Ontario, Canada, with additional corporate offices in Greenwood Village, Colorado, United States and Beijing, China. The functions of this group include finance, administration, information technology, accounting and legal.

3. Selected Financial Highlights

(\$000s, except volume)	Year Ended December 31,		Combined Year Ended December 31, 2016 ⁽¹⁾	Three Months Ended December 31,		
	2018	2017		2018	2017	2016
Revenue						
Magnequench	\$ 213,712	\$ 202,905	\$ 159,238	\$ 47,210	\$ 59,131	\$ 40,834
C&O	161,422	170,890	164,150	38,207	36,212	45,198
Rare Metals	93,789	76,009	70,219	27,309	19,722	17,465
Corporate / Eliminations	(14,728)	(15,635)	(11,477)	(3,365)	(5,613)	(2,489)
Consolidated Revenue	\$ 454,195	\$ 434,169	\$ 382,130	\$ 109,361	\$ 109,452	\$ 101,008
Operating Income (Loss)						
Magnequench	\$ 41,957	\$ 40,986	\$ 29,002	\$ 6,670	\$ 12,831	\$ 3,298
C&O	12,934	16,892	19,930	3,101	1,005	2,543
Rare Metals	4,578	3,935	(3,960)	438	720	(4,186)
Corporate / Eliminations	(16,581)	(26,988)	(16,128)	(3,985)	(9,840)	(6,260)
Consolidated Operating Income	\$ 42,888	\$ 34,825	\$ 28,844	\$ 6,224	\$ 4,716	\$ (4,605)
Adjusted EBITDA⁽²⁾						
Magnequench	\$ 50,483	\$ 49,407	\$ 38,131	\$ 9,051	\$ 14,686	\$ 9,537
C&O	18,483	25,294	24,516	4,569	2,359	10,203
Rare Metals	9,754	9,123	954	1,702	1,951	(40)
Corporate / Eliminations	(11,607)	(15,928)	(15,963)	(2,087)	(3,403)	(5,920)
Consolidated Adjusted EBITDA	\$ 67,113	\$ 67,896	\$ 47,638	\$ 13,235	\$ 15,593	\$ 13,780
Volume (in mt)						
Magnequench	6,128	6,305	5,369	1,446	1,539	1,439
C&O	7,611	8,656	8,968	1,843	1,923	2,593
Rare Metals	650	448	373	227	124	86
Corporate / Eliminations	(306)	(324)	(318)	(77)	(97)	(70)
Consolidated Volumes	14,083	15,085	14,392	3,439	3,489	4,048
Net Income	\$ 41,139	\$ 25,393	\$ 1,710	\$ 4,381	\$ (1,666)	\$ (7,330)
Attributable to:						
Equity holders of Neo	40,795	24,620	1,873	4,285	(1,903)	(7,110)
Non-controlling interest	344	773	(163)	96	237	(220)
Earnings per share attributable to equity holders of Neo						
Basic	\$ 1.02	\$ 0.62	n.m.	\$ 0.11	\$ (0.05)	\$ (0.18)
Diluted	\$ 1.01	\$ 0.61	n.m.	\$ 0.11	\$ (0.05)	\$ (0.18)
Adjusted Net Income⁽³⁾	\$ 38,923	\$ 36,936	\$ 7,090	\$ 7,497	\$ 4,887	\$ 3,261
Attributable to:						
Equity holders of Neo	38,579	36,163	7,253	7,401	4,650	3,376
Non-controlling interest	344	773	(163)	96	237	(115)
Adjusted Earnings per Share attributable to equity holders of Neo ⁽³⁾ :						
Basic	\$ 0.97	\$ 0.91	n.m.	\$ 0.19	\$ 0.12	n.m.
Diluted	\$ 0.96	\$ 0.90	n.m.	\$ 0.18	\$ 0.11	n.m.
Capital expenditures	\$ 13,511	\$ 12,279	\$ 7,314	\$ 4,760	\$ 4,807	\$ 2,399
Cash taxes paid (tax refunds received)	\$ 13,169	\$ 9,264	\$ 14,679	\$ 3,219	\$ (1,444)	\$ 3,886
Dividends paid to shareholders	\$ 11,714	\$ 24,924	\$ —	\$ 2,855	\$ —	\$ —
Repurchase of Common Shares under Normal Course Issuer Bid	\$ 3,771	\$ —	\$ —	\$ 1,886	\$ —	\$ —
	December 31,					
	2018	2017	2016			
Cash and cash equivalents	\$ 71,015	\$ 96,805	\$ 79,408			
Debt	\$ 3,970	\$ 181	\$ 7,925			

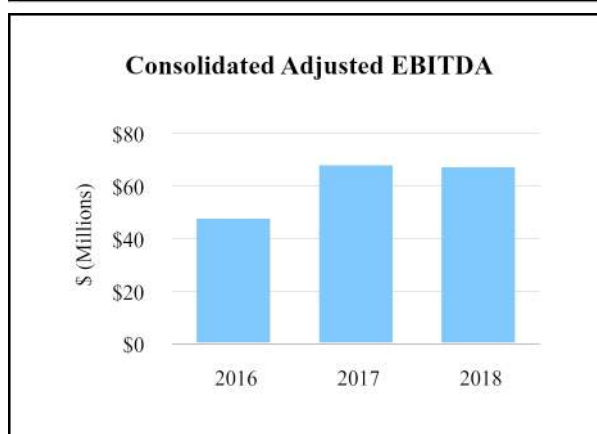
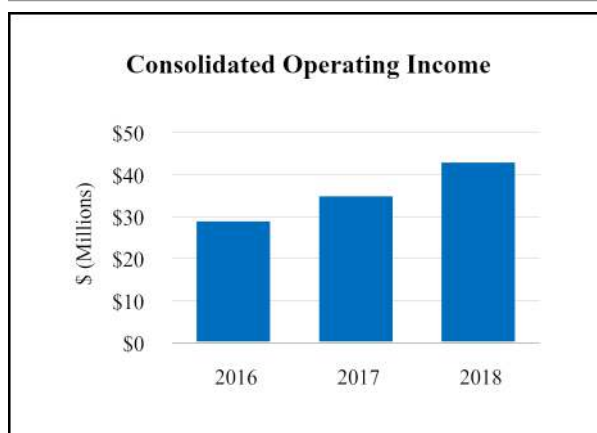
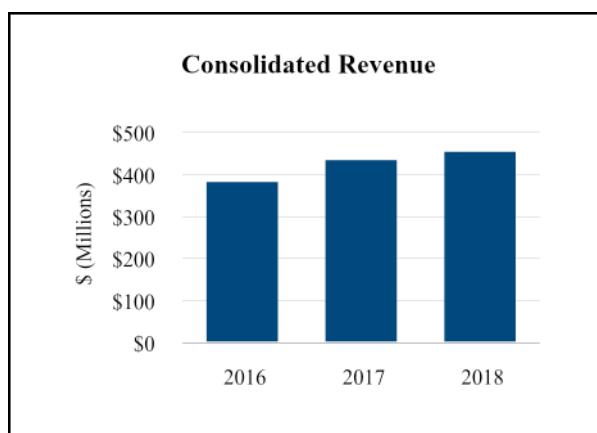
Notes:

- (1) For the purpose of providing a comparison, management has prepared unaudited combined supplemental financial information for the year ended December 31, 2016 (please refer to the MD&A dated March 9, 2018).
- (2) Neo uses references to Adjusted OIBDA and Adjusted EBITDA interchangeably as the use of adjustments in each measure provides the same calculated outcome of operating performance. See "Non-IFRS Financial Measures" and details of computation of Adjusted OIBDA.
- (3) See "Non-IFRS Financial Measures" for computations of Adjusted Net Income and Adjusted Earnings per Share.

Highlights for the year ended December 31, 2018

Consolidated Results

- Revenue in 2018 rose by 4.6% over 2017 and 18.9% over 2016 levels. Improvements were led by the Magnequench segment, which is Neo's largest, most profitable and highest-growing segment. The C&O segment continued to see demand growth in its three-way vehicle emissions catalyst business, which helped to offset a market slowdown in diesel vehicle catalyst products and helped mitigate inherent pricing volatility in the rare earth separation business. The Rare Metals segment has shown sustained increased revenue with the Silmet facility back to full production in 2017 and with demand growth for several core products. Consolidated revenue in the fourth quarter of 2018 was in-line with prior years, despite a general market slowdown in auto sales, particularly in China, which can impact Magnequench and C&O catalyst revenues.
- 2018 operating income of \$42.9 million improved by \$8.1 million or 23.2% from the prior year, and improved by \$14.0 million or 48.7% from 2016 levels. Net income grew to \$41.1 million in 2018, from \$25.4 million in 2017 and \$1.7 million in 2016. Adjusted Net Income was \$38.9 million in 2018, compared to \$36.9 million in 2017 and \$7.1 million in 2016.
- Adjusted EBITDA for the year ended 2018 was \$67.1 million, a 1.2% decrease from the \$67.9 million reported in 2017 but an improvement of \$19.5 million, or 40.9% from 2016 levels. Adjusted EBITDA in 2018 includes a charge of \$4.2 million in premium freight costs incurred in early 2018 related to the installation of a new wastewater treatment system in a C&O facility in late 2017. Adjusted EBITDA in the fourth quarter of 2018 was \$2.4 million lower than the fourth quarter of 2017, primarily related to the impact of timing on Magnequench pass-through pricing agreements and the general slowdown in auto sales.



- Neo continues to see growth in demand for its products driven by several global macro trends. Magnequench continues to successfully capitalize on key trends in vehicle electrification and the need for more efficient motors, combined with demand growth for hybrid and electric vehicles and greater per-vehicle utilization of Magnequench materials in these vehicles. Demand growth for C&O products is driven by, among other things, increased regulations with respect to air and water emissions. The Rare Metals segment products continue to benefit from the ongoing trends toward greater utilization of lighter-weight materials in industries such as aerospace and consumer electronics. Neo's functional materials are integral to technologies in all of these markets.

Magnequench Segment

- Volumes in 2018 decreased by 2.8% compared to volumes in 2017 after having increased by 17.4% from 2016 to 2017. The 2018 volume decline occurred primarily in the fourth quarter and was driven largely by the general slowdown in auto markets. Notwithstanding the fourth quarter, Magnequench continues to see growth in many of its end-market applications, including traction motors for hybrid and electric vehicles and micro motors for vehicles, factory automation and other motor applications. Revenue for the year 2018 increased by 5.3% from prior year and 34.2% from 2016 levels. Revenues in the fourth quarter of 2018 decreased by 20.2% from the same period in the prior year.
- For the year ended 2018, Adjusted EBITDA was \$50.5 million, a 2.2% increase from 2017 and a 32.4% increase from 2016 levels. This improved performance was driven by strong operating performance, strategic purchases of other non-pass-through materials, product mix, and the impact of selling prices being adjusted on a lagged basis.
- For the three months ended December 31, 2018, Adjusted EBITDA was \$9.1 million, a 38.4% decrease from the same period in the prior year. The Magnequench business, to some degree, is impacted by rare earth price (and cost) changes. A key feature of the strategic focus of Neo on value-add margins is to pass-through rare earth prices to its customers, albeit on a lagged basis (generally monthly, quarterly or semi-annually). This quarterly (generally) delay in implemented selling price changes can cause larger fluctuations in quarter-to-quarter results but is effective at maintaining EBITDA in the longer term.

Chemicals & Oxides (C&O) Segment

- Auto-catalyst production showed strong improvements throughout 2018. C&O saw strong continuing growth in its three-way catalyst business, which helped offset a decline in its diesel catalyst business. Neo incurred \$4.2 million of premium freight costs in 2018, with the majority of these charges occurring in the first half of 2018. These premium freight charges were a result of production process upgrades made at the Zibo, China facility in late 2017, which also impacted the fourth quarter of 2017 operating performance. C&O had slower sales and performance in the fourth quarter of 2018 related to a general slowdown in automotive markets.
- Rare earth separation sales, particularly to international customers, can vary in volume and mix on a quarter-to-quarter basis. In addition, volatility in rare earth pricing can have an impact on immediate margins in the separation business as there is a lead-lag affect with inventory on hand. There was significant volatility in rare earth pricing in the third quarter of 2017 and Neo was able to capture excess margins. There was less volatility in 2018 with price pressure generally in the second half of 2018.
- Adjusted EBITDA in C&O was \$18.5 million for the year ended 2018 compared to \$25.3 million in 2017 and \$24.5 million in 2016. Adjusted EBITDA was \$4.6 million in the fourth quarter of 2018 compared to \$2.4 million in the same period of prior year.

Rare Metals Segment

- Rare Metals continues to see higher performance and growth trends in tantalum, niobium and gallium-based products. These gains were offset by lower customer demand for the segment's hafnium-based products. The segment also was affected by customers making adjustments to quarterly purchasing patterns and inventory levels, which resulted in timing differences in realizing sales with the segment's customers.

- The Rare Metals segment's Adjusted EBITDA grew to \$9.8 million in 2018 from \$9.1 million in 2017 and \$1.0 million in 2016. This improvement can be primarily attributed to strong results continuing at the Silmet facility, due to a combination of increased volumes, higher selling prices, higher flow-through margins, continued focus on higher margin programs and continued operational improvements, particularly since the capacity was re-introduced into the operation during 2017. In the fourth quarter of 2018, Adjusted EBITDA was \$1.7 million in 2018, compared to \$2.0 million in 2017, due to changes in selling prices and volumes within the quarter.

Cash and Other Highlights for the year ended December 31, 2018

- Neo continues to have a strong financial position. As at December 31, 2018, Neo had \$71.0 million in cash and \$4.0 million in debt.
- Cash used in operating activities was \$8.7 million. This was positively impacted by operating results but negatively impacted by an increase in working capital primarily associated with higher raw material inventory purchases, higher finished goods inventory in the auto-catalyst supply chain, and by certain cash costs related to the completion of the Initial Public Offering in December 2017 where cash outlays took place in 2018. Neo invested \$13.5 million in capital expenditures in property, plant and equipment and intangible assets and paid \$13.2 million in cash taxes in the year ended December 31, 2018.
- For the year ended December 31, 2018, Neo paid dividends to its shareholders of \$11.7 million and paid \$1.2 million dividends to its non-controlling interest partners. As part of the Normal Course Issuer Bid (the "**Bid**") program, Neo purchased and canceled 321,222 shares with an aggregate disbursement of \$3.8 million.
- Neo recorded other income in 2018 of \$11.8 million related to the partial settlement of the insurance claims from the fire affecting Silmet in 2015. This amount together with amounts received in 2015, 2016 and 2017 aggregate \$17.5 million and reflect the full settlement of the claim.
- On December 18, 2018, Neo entered into an arrangement agreement (the "**Arrangement Agreement**") with Luxfer Holdings plc ("**Luxfer**") and 2671219 Ontario Inc. (the "**Purchaser**"), a wholly-owned subsidiary of Luxfer, pursuant to which, the Purchaser would acquire the issued and outstanding common shares of Neo ("**Common Shares**") for a combination of cash and stock (the "**Luxfer Transaction**"). On March 10, 2019, Luxfer and Neo mutually agreed to terminate the Luxfer Transaction.

4. Factors Affecting Neo's Performance

Revenue

Neo produces highly engineered functional materials, custom and standard products based on rare earth and rare metals. Neo's products are essential inputs to high technology, high growth, and future-facing industries. REEs and rare metals are indispensable inputs for many applications because of their unique physical and chemical properties. These include magnetic, catalytic, luminescent, electrochemical, thermal stability and superconductive properties. Revenue is related to the demand of these end markets as well as the suitability and competitiveness of Neo's products.

Greater than 80% of the world's rare earth sources are mined in China. Neo's Chinese manufacturing facilities in the C&O segment are subject to rare earth separation quotas in China and the source rare earths used in the Magnequench business largely come from China. Restrictions in supply of these source rare earths may impact revenues from magnetic powders. Neo's customers are global and a substantial amount of sales are generated in the same regions as Neo's manufacturing facilities.

Rare earth prices are affected by supply and demand, and policies and circumstances affecting supply from China, including the continued existence of unlicensed mining operations in China. Most of Neo's custom and standardized element sales are subject to current market pricing. Most of Neo's magnetic powder sales and auto catalyst functional material sales have various forms of raw material pass-through agreements. These agreements generally have

mechanisms tied to the pricing of the rare earth elements but are implemented over established time frames (monthly, quarterly, semi-annually and annually). Accordingly, changes in rare earth pricing may have an impact on total revenue.

Costs of sales

Neo's costs of sales is comprised of raw materials, labour, processing costs, production overheads and depreciation and amortization of productive assets.

The largest element of Neo's costs of sales is related to the rare earth or rare metal material used in production that it purchases from outside vendors. Changes in rare earth concentrate input costs are either translated into selling prices of spot sales or incorporated into future selling prices via pass-through mechanisms. There are timing delays between the incorporation of changing material costs and selling prices.

Outside of material cost, Neo's largest costs include labour and benefits, chemical reagents, natural gas, electricity, maintenance, operating supplies, other plant overheads and depreciation and amortization. Some of these costs are fixed and some are variable. For a portion of variable costs, adjustments to production levels are made over periods of time. Accordingly, as production volume increases or decreases, average cost per volume produced decreases or increases, respectively. Some of these costs are subject to volume fluctuations and are influenced by general economic conditions beyond Neo's control.

Selling, general and administrative ("SG&A") expense

SG&A expense consists primarily of personnel and related costs, including legal, accounting and other professional service fees and information technology costs.

Neo has a global sales force that is highly technically trained and fluent in the major languages of its customers. Neo has made significant investments in creating and maintaining this global sales force in geographic proximity to its major customers, which positions the Company to better leverage global demand, work closely with customers in product development efforts, and maximize pricing.

Share-based compensation

Neo Cayman Holdings Ltd.'s ("**Neo Cayman**") management incentive plan was assigned to Neo upon the completion of the Arrangement. See "*Basis of Presentation*". This plan, (the "**Legacy Plan**"), was comprised of Share Options ("**Options**"), Restricted Share Units ("**RSUs**"), Performance Stock Units ("**PSUs**") and Special Performance Stock Units ("**Special PSUs**") (collectively referred to as "**Stock Units**"). These Stock Units were granted under the Legacy Plan to directors, officers, and employees, and provide the right for these individuals to receive Common Shares or, in the case of the options, to purchase Common Shares. Options and RSUs vest at a rate of 25% per year but also vest immediately if a liquidity event occurs, which is defined as consummation of a transaction or series of related transactions that results in Oaktree Capital Management L.P. ("**Oaktree**"), and its affiliates, ceasing to own at least 51% of the shares of Neo. PSUs and Special PSUs vest in segments upon a liquidity event occurring and achieving Oaktree's internal milestones.

In connection with the Arrangement, Neo has undertaken to issue Common Shares of Neo underlying the Stock Units, applying the exchange ratio applied in connection with the Arrangement. See "*Basis of Presentation*". On October 13, 2017, Neo adopted a Stock Option Plan, in conjunction with the Initial Public Offering. On May 9, 2018, Neo adopted a long-term incentive plan (the "**LTIP**").

R&D

One critical success factor for Neo is to continually develop and evolve new products that meet customer's exacting specifications. This includes maintaining close relationships with key customers, understanding changing market factors and responding with innovative products both as improvements to existing applications and developing new applications and solutions.

Neo invests in R&D activities in response to customer needs as well as perceived market development. These expenses consist primarily of salaries, outside labour, materials and equipment. R&D activities occur in both plant manufacturing locations and in dedicated R&D centres and are coordinated through global efforts within each business segment. Neo continues to dedicate resources to research and develop new applications for its products, provide technical solutions to its customers and drive new process development. These factors allow for a more efficient and profitable use of Neo's products.

Finance income (costs), net

From time to time, Neo may draw upon the various revolving lines of credit available to each subsidiary as part of the cash management strategy for that subsidiary. Financing costs may be incurred as a result of these cash management strategies. In addition, finance costs may be incurred as a result of the re-measurement in each period of Neo's derivative liability, which is comprised of a put option issued to the non-controlling interest of a consolidated subsidiary, Buss & Buss.

Income tax (expense) benefit

Neo's income tax expense or benefit is based on the income earned or loss incurred in each tax jurisdiction at the enacted or substantively enacted tax rate applicable to that income or loss.

In the ordinary course of business, there are many transactions for which the ultimate tax outcome is uncertain, and estimates are required for exposures related to examinations by tax authorities. Management reviews these transactions and exposures and records tax liabilities based on its assessment of many factors, including past experience and interpretations of tax law applied to the facts of each matter. The determination of tax liabilities is subjective and generally involves a significant amount of judgment. The final outcome may differ from estimates, and a change to these estimates could impact the income tax provision.

Neo recognizes deferred tax assets to the extent management believes it is probable that the related tax benefit amount will be realized. Management considers factors such as the reversal of taxable temporary differences, projected future taxable income, the character of the income tax asset, tax planning strategies, changes in tax laws and other factors. A change to these factors could impact the amount of deferred tax assets Neo recognizes.

Neo's effective income tax rate can vary significantly from quarter-to-quarter for various reasons, including the mix and volume of business in different tax jurisdictions, jurisdictions with tax holidays and tax incentives, and jurisdictions for which no deferred tax assets have been recognized because management believed it was not probable that future taxable profit would be available against which tax losses and deductible temporary differences could be utilized. Neo's effective income tax rate can also vary due to the impact of foreign exchange fluctuations, operating losses, changes in its provisions related to tax uncertainties and changes in management's assessment as to whether temporary differences arising from investments in subsidiaries will reverse in the foreseeable future.

5. Basis of Presentation

On September 12, 2017 OCM Neo Holdings (Cayman), L.P. ("**OCM**") formed Neo, a company incorporated in the province of Ontario, for the purpose of completing a Cayman Islands scheme of arrangement (the "**Arrangement**") with Neo Cayman and a subsequent public offering of Common Shares of Neo.

On November 30, 2017, Neo finalized the court approved Arrangement with Neo Cayman whereby Neo acquired all of the issued and outstanding shares of Neo Cayman in exchange for the issuance of an aggregate of 39,878,383 Common Shares. The acquisition by Neo of Neo Cayman was a transaction amongst entities under common control. Accordingly, Neo accounted for this transaction using book value accounting, based on the book values recognized in the consolidated financial statements of Neo Cayman. Financial information for the pre-acquisition period, including comparative period, is presented based on the historical information of Neo Cayman.

On November 30, 2017, Neo completed an IPO by way of a Secondary Offering on the Toronto Stock Exchange ("TSX") that began trading on December 8, 2017. Neo offered 11,115,000 Common Shares for total proceeds of Canadian dollar ("Cdn") \$200,070,000 with an over-allotment option. On January 8, 2018, the underwriters exercised a portion of the over-allotment option for the purchase of an additional 1,100,000 Common Shares for additional gross proceeds of Cdn \$19,800,000. All proceeds, net of underwriter commissions, were paid to the selling shareholder, Oaktree and its affiliates. Oaktree continues to be the largest and majority shareholder of Neo.

All intercompany transactions have been eliminated.

6. Consolidated Results of Operations

Comparison of the three and twelve months ended December 31, 2018 to the three and twelve months ended December 31, 2017:

(\$000s)	Three Months Ended December 31,		Year Ended December 31,	
	2018	2017	2018	2017
Revenue	109,361	109,452	454,195	434,169
Costs of sales				
Costs excluding depreciation and amortization	81,700	75,144	324,361	296,648
Depreciation and amortization	2,352	2,491	9,741	10,101
Gross profit	25,309	31,817	120,093	127,420
Expenses				
Selling, general and administrative	13,898	20,825	49,948	63,222
Share-based compensation	(222)	400	3,436	6,241
Depreciation and amortization	1,716	1,587	6,978	7,418
Research and development	3,693	4,289	16,843	15,714
	19,085	27,101	77,205	92,595
Operating income	6,224	4,716	42,888	34,825
Other income (loss)	723	(962)	10,660	1,803
Finance (cost) income, net	(945)	(28)	649	152
Foreign exchange (loss) gain	(382)	99	(565)	(466)
Income from operations before income taxes and equity income of associates	5,620	3,825	53,632	36,314
Income tax expense	(1,948)	(5,239)	(12,465)	(11,893)
Income (loss) from operations before equity income (loss) of associates	3,672	(1,414)	41,167	24,421
Equity income (loss) of associates (net of income tax)	709	(252)	(28)	972
Net income (loss)	\$ 4,381	\$ (1,666)	\$ 41,139	\$ 25,393
Attributable to:				
Equity holders of Neo	4,285	\$ (1,903)	40,795	\$ 24,620
Non-controlling interest	96	237	344	773
	\$ 4,381	\$ (1,666)	\$ 41,139	\$ 25,393
Earnings (loss) per share data attributable to equity holders of Neo:				
Basic	\$ 0.11	\$ (0.05)	\$ 1.02	\$ 0.62
Diluted	\$ 0.11	\$ (0.05)	\$ 1.01	\$ 0.61

Revenue

Neo's consolidated revenue for the year ended December 31, 2018 was \$454.2 million compared to \$434.2 million for the same period in the prior year; an increase of \$20.0 million or 4.6%. For the three months ended December 31, 2018, consolidated revenue was \$109.4 million compared to \$109.5 million in the corresponding period in the prior year; a decrease of \$0.1 million or 0.1%.

For the year ended December 31, 2018, Magnequench segment revenue was \$213.7 million, compared to \$202.9 million in the prior year; an increase of \$10.8 million or 5.3%. The Magnequench segment revenue decreased to \$47.2 million in the three months ended December 31, 2018 from \$59.1 million in the same period of the prior year; a decrease of \$11.9 million or 20.2%. The Magnequench segment represented 47.1% of consolidated revenue in the year ended December 31, 2018.

For the year ended December 31, 2018, C&O segment revenue was \$161.4 million, compared to \$170.9 million for the prior year; a decrease of \$9.5 million or 5.5%. The C&O segment revenue increased to \$38.2 million in the three months ended December 31, 2018, compared to \$36.2 million in the same period of the prior year; an improvement of \$2.0 million or 5.5%. The C&O segment represented 35.5% of consolidated revenue in the year ended December 31, 2018.

For the year ended December 31, 2018, Rare Metals segment revenue was \$93.8 million, compared to \$76.0 million for the prior year; an increase of \$17.8 million or 23.4%. The Rare Metals segment revenue increased to \$27.3 million in the three months ended December 31, 2018 as compared to \$19.7 million in the same period of the prior year; an increase of \$7.6 million or 38.5%. The Rare Metals segment represented 20.6% of consolidated revenue in the year ended December 31, 2018.

Inter-segment revenue in the twelve and three months ended December 31, 2018 was \$14.7 million and \$3.4 million, respectively, compared to \$15.6 million and \$5.6 million in the twelve and three months ended December 31, 2017, respectively. These have been eliminated on consolidation from the C&O segment revenue as C&O sold product to Magnequench, in the respective periods. The products sold to Magnequench are potential marketable third-party sales and are generally sold at fair market value.

Further commentary on the revenue changes in each segment are included in the discussion under the heading "*Discussion and Analysis of Reportable Segments*" below.

Costs of sales

Consolidated costs of sales, excluding depreciation and amortization, was \$324.4 million and \$81.7 million in the twelve and three months ended December 31, 2018, respectively, compared to \$296.6 million and \$75.1 million in the corresponding periods in 2017; an increase of \$27.7 million or 9.3% year-over-year and an increase of \$6.6 million or 8.7% quarter-over-quarter. Costs of sales, excluding depreciation and amortization, increased as a result of higher revenue in the twelve and three months ended December 31, 2018, in addition to the impacts of product cost, product mix, and operational changes in the business segments. Additionally, in the auto-catalyst segment, Neo incurred \$4.2 million of premium freight costs during the year ended December 31, 2018, the majority of which happened in the first half of 2018, as the supply chain replenished following the implementation of the new wastewater treatment system in one manufacturing location. As of June 30, 2018, the supply chain had been adequately replenished and accordingly, premium freight costs incurred were not significant in the second half of 2018.

Consolidated depreciation and amortization in costs of sales were \$9.7 million and \$2.4 million for the twelve and three months ended December 31, 2018, respectively, compared to \$10.1 million and \$2.5 million in the corresponding periods in 2017. The reduction in depreciation and amortization was mostly attributable to a lower asset base as a result of some assets being further depreciated.

Further commentary on the costs of sales changes in each segment are included in the discussion under the heading "*Discussion and Analysis of Reportable Segments*" below.

Selling, general and administrative ("SG&A") expense

Neo's SG&A expense consists primarily of personnel and related costs, including legal, accounting and other professional fees and information technology costs. For the twelve and three months ended December 31, 2018, SG&A expense was \$49.9 million and \$13.9 million, respectively, compared to \$63.2 million and \$20.8 million in the corresponding periods last year. The lower SG&A costs in the current twelve and three month periods, compared to the corresponding periods in 2017, relates primarily to lower legal costs associated with outstanding intellectual property disputes. SG&A costs in the twelve and three months ended December 31, 2018 included costs associated with the Luxfer Transaction. SG&A costs in the twelve and three months ended December 31, 2017 included costs associated with the Initial Public Offering of Neo shares.

Share-based compensation

For the year ended December 31, 2018, share-based compensation expense was \$3.4 million compared to \$6.2 million in the corresponding period in 2017. For the three months ended December 31, 2018, there was a \$0.2 million recovery of share-based compensation compared to an expense of \$0.4 million in the three months ended December 31, 2017. Neo granted stock options under the Stock Option Plan, deferred share units ("**DSUs**") under the Directors Share Unit Plan, and RSUs, PSUs and Additional PSUs, under the LTIP, to certain of its directors and executives in 2018. The Additional PSUs granted under the Legacy Plan and the LTIP have all been terminated as at December 31, 2018 as the Liquidity Event condition was not met.

Depreciation and amortization

Depreciation and amortization unrelated to production for the twelve and three months ended December 31, 2018 was \$7.0 million and \$1.7 million, respectively, which is comparable to \$7.4 million and \$1.6 million in the corresponding periods in 2017.

R&D

For the year ended December 31, 2018, R&D expense was \$16.8 million, compared to \$15.7 million in the corresponding period in 2017; an increase of \$1.1 million. For the three months ended December 31, 2018, R&D expense was \$3.7 million, compared to \$4.3 million in the three months ended December 31, 2017. Neo continues to prioritize making strategic and appropriate investments in R&D to develop new applications for its products and to strategically position Neo to meet customers' needs for technical solutions. Certain R&D costs are project-based and may be higher or lower in any given period.

Other income

For the twelve and three months ended December 31, 2018, Neo reported consolidated other income of \$10.7 million and \$0.7 million, respectively, compared to other income of \$1.8 million and other expense of \$1.0 million for the corresponding periods in 2017. In the year ended December 31, 2018, Neo recorded additional insurance proceeds on claims associated with the 2015 fire at the Silmet facility, offset by a retroactive duty charge. For the year ended December 31, 2017, Neo received a settlement for a patent infringement case in its Magnequench segment, and a partial installment of the insurance proceeds on claims associated with the 2015 fire at the Silmet facility.

Finance income (cost), net

Finance income, net, for the year ended December 31, 2018 was \$0.6 million and net finance cost was \$0.9 million for the three months ended December 31, 2018, compared to \$0.2 million net finance income and nominal amounts for the corresponding periods in 2017, respectively. Neo's finance costs for the twelve and three months ended December 31, 2018 were related to the re-measurement of Neo's derivative liability, which is comprised of a put option issued to the non-controlling interest of a consolidated subsidiary, Buss & Buss. This liability is re-measured at each reporting period with the change in fair value recorded to finance costs. For the twelve and three months ended December 31, 2018, Neo has nominal amounts of finance cost from debts. As at December 31, 2018, \$4.0 million was drawn from the revolving line of credits.

Income tax expense

For the twelve and three months ended December 31, 2018, Neo had an income tax expense of \$12.5 million and \$1.9 million, respectively, on income from operations before taxes of \$53.6 million and \$5.6 million. For the twelve and three months ended December 31, 2017, Neo had an income tax expense of \$11.9 million and \$5.2 million, respectively, on income from operations before taxes of \$36.3 million and \$3.8 million.

Neo's effective tax rate was 23.2% and 34.7% for the twelve and three months ended December 31, 2018, respectively and 32.8% and 137.0% for the twelve and three months ended December 31, 2017, respectively.

The decrease in Neo's effective tax rate during the three months ended December 31, 2018, is primarily due to benefiting from tax incentives in Asia. During the three months ended December 31, 2017, Neo incurred transaction costs related to the IPO that would, generally, not be deductible for tax purposes.

Other Expenditures and Legal Contingencies

Capital Expenditures

Neo capitalized expenditures of \$13.5 million and \$4.8 million for the twelve and three months ended December 31, 2018, respectively, and \$12.3 million and \$4.8 million for the three months ended December 31, 2017, respectively. The majority of these capital expenditures related to capital projects performed at the Zibo, Tianjin and Silmet facilities. These capital projects included a combination of maintenance capital (to assist with the continuing development and operations of Neo), growth capital (to assist in adding new capacity or new products) and strategic capital (tied to longer-term strategic planning initiatives).

Environmental Expenditures

Neo's operations are subject to numerous and detailed environmental laws, regulations and permits, including those pertaining to employee health and safety, environmental permitting and licensing, air quality standards, waste water treatment and pollution control, and handling and disposal of hazardous and radioactive materials and wastes.

Neo's Zibo facility was designed to make use of waste water treatment and discharge facilities of an adjacent petrochemical complex. There is a variable monthly charge based on the Zibo facility's usage. The facility is also obliged to pay a monthly environmental administration fee to the municipal government of Linzi, China. In both the twelve months ended December 31, 2018 and 2017, it has paid \$0.2 million annually in administration fees.

As part of the recycling of gallium and indium scrap into saleable metal, waste material is generated during the leaching process. Neo has adequate procedures in place to ensure that these wastes are appropriately contained and disposed of.

Neo's Canadian operations in Ontario are subject to federal, provincial and local regulation and must periodically submit documentation to validate the waste disposal process throughout the year. For the twelve months ended December 31,

2018, waste disposal costs related to the Rare Metals production facilities totaled \$0.3 million, compared to \$0.2 million in costs in the year ended December 31, 2017.

In its operations, Neo's Silmet facility, may generate hazardous NORM material as a by-product from one of several feedstock sources that may be used in production. As at December 31, 2018, Neo had a provision of \$4.7 million for the disposal of NORM and other related costs, which includes the disposal of all the materials present prior to the acquisition of the facility in 2011. The provision increased by \$0.1 million from December 31, 2017. This amount represents management's best estimate of the costs to be incurred by Neo to dispose of NORM at the Silmet facility. As of January 31, 2019, the facility's Radiation Practice License has expired and Silmet no longer has a permit to process feedstock that contains NORM materials. Silmet continues to manage and store NORM residue accumulated from historic production activities under the supervision of the Estonia Ministry of Environment. The Silmet facility is in the process of applying for a new permit to allow on-site storage of NORM residue pending the final disposition of the NORM residue with a third party. The Silmet facility continues to produce tantalum and niobium using alternative (non-NORM-bearing) feedstock. The rare earth operations at Silmet, which are part of the Chemicals & Oxides segment, do not require NORM permits and are not affected by the expiration of the Radiation Practice License.

Legal contingencies

Neo operates in a high technology and advanced engineering product environment in which many patents have been issued over time. The subsidiaries of Neo are currently, and may in the future become, involved in legal proceedings alleging patent infringement. At present, Neo is defending against patent infringement legal proceedings filed in Germany, the United Kingdom and the People's Republic of China. Additionally, Neo has initiated proceedings to invalidate certain patents of Neo's competitors issued in these same jurisdictions.

There are many factors that make it difficult to estimate the impact of a particular lawsuit on Neo, including, among others, being in the early stage of a proceeding when the claimant is not required to specifically identify the manner in which the patent has allegedly been infringed; damages sought that are unspecified, unsupported, unexplained or uncertain; discovery not having been started or still incomplete; the complexity of the facts that are in dispute (e.g., the analysis of the patent and a comparison to the activities of Neo is a labor-intensive and highly technical process); the difficulty of assessing novel claims or legal arguments, and; the parties not having engaged in any meaningful settlement discussions. Management is required to apply judgment with respect to estimating the potential impact of the ongoing patent litigation on Neo. Potential impacts to Neo include, but are not limited to, the possibility of an injunction prohibiting Neo from manufacturing, distributing, marketing or selling products that are found to infringe on an unexpired patent; potential damages, attorney's fees and costs that Neo could be ordered to pay if it is found to have infringed on a patent, and; damage to Neo's reputation with key customers, or prospective customers, from a finding of patent infringement.

Of the various lawsuits initiated and underway, in March 2016, the German Court determined that certain of Neo Chemicals & Oxides (Europe) Ltd's ("**Neo C&O (Europe)**") products infringed two expired patents of Rhodia Chimie ("**Rhodia**") (European patent #0735984 B1 ("**984**") and European patent #0863846 B1 ("**846**")), and ordered Neo C&O (Europe) to provide information related to the calculation of damages. The Court also determined that Neo C&O (Europe) infringed a third patent (European patent #0605274 ("**274**")). Neo C&O (Europe) filed an appeal in each of the three infringement actions and those appeals are still pending.

In September 2016, the German Federal Patent Review Court ruled in favor of Neo C&O (Europe), invalidating 274 that it was previously found to infringe. Rhodia has appealed this judgment of invalidity, and its appeal is still pending. In October 2016, the German Federal Patent Court ruled on two other invalidity actions, significantly restricting the claims in 984 and slightly modifying the claims in 846. These two Court judgments are subject to ongoing appeals.

In December 2017, the Regional Court of Mannheim (Germany) determined that certain of Neo C&O (Europe)'s products infringed a German patent (European & UK patents #1435338 B1 ("**338**")), and an injunction prohibiting the sale of affected products into Germany was granted. Neo C&O (Europe) has appealed the decision. In April 2018, the UK Court determined that certain of Neo C&O (Europe)'s products infringed the equivalent UK patent 338. In January 2019, the Federal Patent Court in Munich revoked the German designation of patent 338. Rhodia has agreed to a

temporary stay of the Regional Court of Mannheim's judgment of infringement of patent 338, including a stay of the injunction against Neo C&O (Europe) selling its products in Germany, pending the issuance the Federal Patent Court's written opinion. Neo C&O (Europe) has also filed a request to stay enforcement of the judgment of infringement before the Higher Regional Court of Karlsruhe, but the matter has not yet been set for a hearing and no decision has been made on Neo C&O (Europe)'s request for a stay. The revocation decision by the German Federal Patent Court is subject to appeal.

In January 2018, Neo C&O (Europe) reached a settlement with Magnesium Elektron Limited with respect to UK patent #1444036 whereby Neo is able to continue to sell its products into the UK on a royalty-free basis and without restriction. The terms of the settlement are subject to a confidentiality agreement.

On April 18, 2018, the Patent Reexamination Board of the State Intellectual Property Office of China ("**PRB**") ruled in favor of Zibo Jiahua Advanced Materials Resources Co., Ltd ("**ZAMR**"), a Chinese subsidiary of Neo, by invalidating all claims associated with Chinese patent ZL 03817110.4, held by Rhodia Operations S.A.S., an affiliate of Brussels-based Solvay ("**Rhodia Operations**"). On May 23, 2018, the Intermediate People's Court of Zibo, China, dismissed the pending lawsuit by Rhodia Operations alleging infringement of Chinese patent ZL 03817110.4. Rhodia Operations has appealed the decisions of the PRB and the Intermediate People's Court of Zibo concerning Patent ZL 03817110.4.

On September 26, 2018, the PRB again ruled in favor of ZAMR by invalidating all product claims associated with patent ZL 200710146613.6, held by Daiichi Kigenso Kagaku Kogyo Co. ("**DKKK**"). On October 24, 2018, the Intermediate People's Court of Zibo, China, dismissed the pending lawsuit by DKKK and Rhodia Operations alleging infringement of patent ZL 200710146613.6. DKKK and Rhodia Operations have appealed these decisions.

In January, 2019, the PRB ruled in favor of ZAMR by invalidating all patent claims associated with patent ZL 97195463.1. On February 28, 2019, the Intermediate People's Court of Zibo, China, dismissed the pending lawsuit by Rhodia Operations and DKKK alleging infringement of patent ZL 97195463.1. Rhodia Operations and DKKK have the right to appeal these decisions.

The following infringement proceedings are ongoing. These proceedings are at various stages of court proceeding including being at pre-trial stage, within infringement proceedings, as well as invalidity proceedings.

Patent Reference	Jurisdiction of Claim	Specified Damages by Claimant
Chinese patent ZL 03817110.4	China	\$3.0 million
Chinese patent ZL 200710146613.6	China	\$2.3 million
European patent 0863846 B1	Germany	\$8.4 million
European patent 0735984 B1	Germany	\$6.1 million
Chinese patent ZL 94194552.9	China	\$0.8 million
Chinese patent ZL 96196505.3	China	\$6.8 million
Chinese patent ZL 97195463.1	China	\$0.8 million
European & UK patents 1435338 B1	UK	Not specified
European & UK patents 1435338 B1	Germany	Not specified
European patent 0605274 B1	Germany	Not specified
European patent 0955267	Germany	Not specified
European patent 1527018	Germany	Not specified
European patent 2007682	Germany	Not specified

Management has made an assessment, based on its interpretation of the claims as to the quantum of the appropriate provision for certain claims. Such a provision is based on management's best estimate, as damages are uncertain and are subject to judicial determination. Management's assessment, based on its interpretation of the claims, the limited facts available at this time and independent legal advice, is that for all other claims it is not probable that an outflow

of resources will be required in settling these claims and no provision has been made. Future developments in these cases could cause management to change its assessment.

Management does not have sufficient information to comment on the quantum or methodology of the damages sought by the claimants including with respect to potential duplicity of the parts affected. Management's view on specified damages could be materially different than those proposed by the claimant in each case.

Neo intends to defend itself vigorously in all cases. In light of the inherent uncertainties in litigation there can be no assurance that the ultimate resolution of these matters will not significantly exceed the reserves currently accrued for those cases for which an estimate can be made. Losses in connection with any litigation for which management is not presently able to reasonably estimate any potential loss, or range of loss, could be material to Neo's results of operations and financial condition.

7. Non-IFRS Financial Measures

This MD&A makes reference to certain non-IFRS financial measures. These measures are not recognized measures under IFRS, do not have a standardized meaning prescribed by IFRS and may not be comparable to similar measures presented by other companies. Rather, these measures are provided as additional information to complement IFRS financial measures by providing further understanding of Neo's results of operations from management's perspective. Neo's definitions of non-IFRS measures used in this MD&A may not be the same as the definitions for such measures used by other companies in their reporting. Non-IFRS measures have limitations as analytical tools and should not be considered in isolation nor as a substitute for analysis of Neo's financial information reported under IFRS. Neo uses non-IFRS financial measures, including "Adjusted EBITDA", "Adjusted EBITDA Margin", "Adjusted Net Income or Loss", "Adjusted OIBDA", "Adjusted OIBDA Margin", "EBITDA", "Adjusted Earnings per Share", "Free Cash Flow", "Free Cash Flow Conversion" and "OIBDA" to provide investors with supplemental measures of its base-line operating performance and to eliminate items that have less bearing on operating performance or operating conditions and thus highlight trends in its core business that may not otherwise be apparent when relying solely on IFRS financial measures. Neo believes that securities analysts, investors and other interested parties frequently use non-IFRS financial measures in the evaluation of issuers. Neo's management also uses non-IFRS financial measures in order to facilitate operating performance comparisons from period to period. Neo defines such financial measures as follows:

"Adjusted EBITDA" is defined as EBITDA before equity income (loss) in associates, other income (expense), foreign exchange loss (gain), share and value-based compensation, impairment of goodwill and other long-lived assets, and acquired inventory fair value release;

"Adjusted EBITDA Margin" is defined as Adjusted EBITDA divided by revenue;

"Adjusted Net Income or Loss" is defined as net income or loss before insurance recovery, foreign exchange loss (gain), share and value-based compensation, and acquired inventory fair value release, net of the related tax effects and adjustment to deferred tax assets;

"Adjusted OIBDA" is defined as OIBDA before share and value-based compensation, transaction costs associated with the Arrangement and the IPO, impairment of goodwill and other long-lived assets, and acquired inventory fair value release;

"Adjusted OIBDA Margin" is defined as Adjusted OIBDA divided by revenue;

"EBITDA" is defined as net income (loss) before finance costs, net, income tax expense, depreciation and amortization included in cost of sales, and depreciation and amortization included in operating expenses;

"Adjusted Earnings per Share" is defined as Adjusted Net Income or Loss attributable to equity holders of Neo divided by the weighted average number of common shares outstanding;

"Free Cash Flow" is defined as Adjusted EBITDA less capital expenditures;

"Free Cash Flow Conversion" is defined as Free Cash Flow divided by Adjusted EBITDA; and

"OIBDA" is defined as operating income before depreciation and amortization.

Neo uses references to Adjusted OIBDA and Adjusted EBITDA interchangeably as the adjustments in each measure provides the same calculated outcome of operating performance. Management believes that the use of these adjustments (as defined in Adjusted EBITDA and Adjusted OIBDA) provides a more consistent measure of underlying operating performance, with comparability among periods that investors may find useful. The exclusion of certain adjustments does not imply that they are non-recurring.

The following tables illustrate the comparison of the Adjusted OIBDA for the three and twelve months ended December 31, 2018 to the three and twelve months ended December 31, 2017:

(\$000s, except volume)	Three Months Ended December 31,				Year Ended December 31,			
	2018	2017	Change	%	2018	2017	Change	%
Operating income	\$ 6,224	\$ 4,716	\$ 1,508	32.0 %	\$ 42,888	\$ 34,825	\$ 8,063	23.2 %
Add back:								
Depreciation and amortization included in Costs of Sales.	2,352	2,491	(139)		9,741	10,101	(360)	
Depreciation and amortization ...	1,716	1,587	129		6,978	7,418	(440)	
OIBDA	10,292	8,794	1,498	17.0 %	59,607	52,344	7,263	13.9 %
Acquired inventory fair value release ⁽¹⁾	—	—	—		—	2,912	(2,912)	
Share and valued-based compensation ⁽²⁾	782	802	(20)		5,345	6,643	(1,298)	
Non-recurring transaction cost ⁽³⁾ ..	2,161	5,997	(3,836)		2,161	5,997	(3,836)	
Adjusted OIBDA	\$ 13,235	\$ 15,593	\$ (2,358)	(15.1)%	\$ 67,113	\$ 67,896	\$ (783)	(1.2)%
Adjusted OIBDA margin	12.1%	14.2%			14.8%	15.6%		
Revenue	\$109,361	\$109,452	\$ (91)	(0.1)%	\$454,195	\$434,169	\$ 20,026	4.6 %
Sales volume (tonnes)	3,439	3,489	(50)	(1.4)%	14,083	15,085	(1,002)	(6.6)%

Notes:

- (1) In accordance with IFRS 3 Business Combinations and on completion of the reorganization (please refer to the MD&A dated March 9, 2018), Neo recorded the acquisition of its inventory at fair value, which included a mark-up for profit of \$27,062. A portion of this inventory was sold in the year ended December 31, 2017 and had a \$2,912 impact on OIBDA. Neo has removed this from OIBDA to provide a measure of operating performance without the non-cash, non-operational accounting change to the inventory and to provide comparability with historic periods.
- (2) Represents share and value-based compensation expense in respect of the Legacy Plan, the LTIP and the long-term value bonus plan, which has similar vesting criteria to the share-based plan and is settled in cash for non-executives and non-North Americans where implementation of a share settlement plan would have been prohibitively expensive in terms of administration and compliance. Value-based compensation expense of \$1,004 and \$1,909 is included in selling, general, and administration expenses for the three and twelve months ended December 31, 2018, respectively, and \$402 is included in selling, general, and administration expenses for both three and twelve months ended December 31, 2017, respectively. Neo has removed both the share and value-based compensation expense from OIBDA to provide comparability with historic periods and to treat it consistently with the share-based awards that they are intended to replace.
- (3) These costs are related to legal, professional advisory fees and other transaction costs incurred primarily associated with the Luxfer Transaction in the three and twelve months ended December 31, 2018 and as a result of the IPO by way of Secondary Offering in the three and twelve months ended December 31, 2017. These charges were included in selling, general, and administration expense.

For the year ended December 31, 2018, Adjusted OIBDA was \$67.1 million or 14.8% of revenue, compared to \$67.9 million or 15.6% of revenue for the year ended December 31, 2017; a decrease of \$0.8 million or 1.2%. Adjusted OIBDA was \$13.2 million or 12.1% of revenue for the three months ended December 31, 2018 compared to \$15.6 million or 14.2% of revenue for the corresponding period in 2017.

Adjusted OIBDA for the year ended December 31, 2018 compared to the corresponding period in 2017 was higher in the Magnequench and Rare Metals segments but lower in the C&O segment. Adjusted OIBDA for the three months ended December 31, 2018, compared to the corresponding period in 2017 was higher in the C&O segment, but lower in the Magnequench and Rare Metals segments.

Further commentary on the operating performance changes in each segment are included in the discussion under the heading "Discussion and Analysis of Reportable Segments" below.

Reconciliation of Net Income to EBITDA, Adjusted EBITDA and Free Cash Flow:

(\$000s)	Three Months Ended December 31,		Year Ended December 31,	
	2018	2017	2018	2017
Net income (loss)	\$ 4,381	\$ (1,666)	\$ 41,139	\$ 25,393
Add back (deduct):				
Finance cost (income), net	945	28	(649)	(152)
Income tax expense	1,948	5,239	12,465	11,893
Depreciation and amortization included in Costs of Sales	2,352	2,491	9,741	10,101
Depreciation and amortization	1,716	1,587	6,978	7,418
EBITDA	11,342	7,679	69,674	54,653
Adjustments to EBITDA:				
Equity (income) loss in associates	(709)	252	28	(972)
Other (income) loss ⁽¹⁾	(723)	962	(10,660)	(1,803)
Foreign exchange loss (gain) ⁽²⁾	382	(99)	565	466
Share and value-based compensation expense ⁽³⁾	782	802	5,345	6,643
Acquired inventory fair value release ⁽⁴⁾	—	—	—	2,912
Non-recurring transaction cost ⁽⁵⁾	2,161	5,997	2,161	5,997
Adjusted EBITDA	\$ 13,235	\$ 15,593	\$ 67,113	\$ 67,896
<i>Adjusted EBITDA Margins</i>	<i>12.1%</i>	<i>14.2%</i>	<i>14.8%</i>	<i>15.6%</i>
Less:				
Capital expenditures	4,760	4,807	13,511	12,279
Free Cash Flow	\$ 8,475	\$ 10,786	\$ 53,602	\$ 55,617
<i>Free Cash Flow Conversion</i> ⁽⁶⁾	<i>64.0%</i>	<i>69.2%</i>	<i>79.9%</i>	<i>81.9%</i>

Notes:

- (1) Represents other income (expenses) resulting from non-operational related activities. Other income primarily relating to costs and insurance recoveries as a result of the fire at the Silmet facility and other costs that are non-recurring and have less bearing on Neo's operating performance. These costs and recoveries are not indicative of Neo's ongoing activities.
- (2) Represents unrealized and realized foreign exchange losses (gains) that include non-cash adjustments in translating foreign denominated monetary assets and liabilities.
- (3) Represents share and value-based compensation expense in respect of the Legacy Plan, the LTIP and the long-term value bonus plan, which has similar vesting criteria to the share-based plan and is settled in cash for non-executives and non-North Americans where implementation of a share settlement plan would have been prohibitively expensive in terms of administration and compliance. Value-based compensation

expense of \$1,004 and \$1,909 is included in selling, general, and administration expenses for the three and twelve months ended December 31, 2018, respectively, and \$402 is included in selling, general, and administration expenses for both three and twelve months ended December 31, 2017, respectively. Neo has removed both the share and value-based compensation expense from EBITDA to provide comparability with historic periods and to treat it consistently with the share-based awards that they are intended to replace.

- (4) In accordance with IFRS 3 Business Combinations and on completion of the reorganization (please refer to the MD&A dated March 9, 2018), Neo recorded the acquisition of its inventory at fair value, which included a mark-up for profit of \$27,062. A portion of this inventory was sold in the year ended December 31, 2017 and had a \$2,912 impact on EBITDA. Neo has removed this from EBITDA to provide a measure of operating performance without the non-cash, non-operational accounting change to the inventory and to provide comparability with historic periods.
- (5) These costs are related to legal, professional advisory fees and other transaction costs incurred primarily associated with the Luxfer Transaction in the three and twelve months ended December 31, 2018 and as a result of the IPO by way of Secondary Offering in the three and twelve months ended December 31, 2017. These charges were included in selling, general, and administration expense.
- (6) Calculated as Free Cash Flow divided by Adjusted EBITDA.

Reconciliation of Net Income to Adjusted Net Income:

(\$000s)	Three Months Ended December 31,		Year Ended December 31,	
	2018	2017	2018	2017
Net income (loss)	\$ 4,381	\$ (1,666)	\$ 41,139	\$ 25,393
Adjustments to net income (loss):				
Foreign exchange loss (gain) ⁽¹⁾	382	(99)	565	466
Share and value-based compensation expense ⁽²⁾	782	802	5,345	6,643
Acquired inventory fair value release ⁽³⁾	—	—	—	2,912
Non-recurring transaction cost ⁽⁴⁾	2,161	5,997	2,161	5,997
Non-recurring items included in other income ⁽⁵⁾	(172)	—	(9,763)	(3,607)
Tax impact of the above items	(37)	(147)	(524)	(868)
Adjusted net income	\$ 7,497	\$ 4,887	\$ 38,923	\$ 36,936
Attributable to:				
Equity holders of Neo	\$ 7,401	\$ 4,650	\$ 38,579	\$ 36,163
Non-controlling interest	\$ 96	\$ 237	\$ 344	\$ 773
Weighted average number of common shares outstanding:				
Basic	39,772,272	39,954,609	39,852,189	39,800,816
Diluted	40,172,359	40,513,959	40,368,007	40,286,402
Adjusted earnings per share attributable to equity holders of Neo:				
Basic	\$ 0.19	\$ 0.12	\$ 0.97	\$ 0.91
Diluted	\$ 0.18	\$ 0.11	\$ 0.96	\$ 0.90

Notes:

- (1) Represents unrealized and realized foreign exchange losses (gains) that include non-cash adjustments in translating foreign denominated monetary assets and liabilities.
- (2) Represents share and value-based compensation expense in respect of the Legacy Plan, the LTIP and the long-term value bonus plan, which has similar vesting criteria to the share-based plan and is settled in cash for non-executives and non-North Americans where implementation of a share settlement plan would have been prohibitively expensive in terms of administration and compliance. Value-based compensation expense of \$1,004 and \$1,909 is included in selling, general, and administration expenses for the three and twelve months ended December 31, 2018, respectively, and \$402 is included in selling, general, and administration expenses for both three and twelve months ended December 31, 2017, respectively.

31, 2017, respectively. Neo has removed both the share and value-based compensation expense from net income (loss) to provide comparability with historic periods and to treat it consistently with the share-based awards that they are intended to replace.

- (3) In accordance with IFRS 3 Business Combinations and on completion of the reorganization (please refer to the MD&A dated March 9, 2018), Neo recorded the acquisition of its inventory at fair value, which included a mark-up for profit of \$27,062. A portion of this inventory was sold in the year ended December 31, 2017 and had a \$2,912 impact on net income (loss). Neo has removed this from net income (loss) to provide a measure of operating performance without the non-cash, non-operational accounting change to the inventory and to provide comparability with historic periods.
- (4) These costs are related to legal, professional advisory fees and other transaction costs incurred primarily associated with the Luxfer Transaction in the three and twelve months ended December 31, 2018 and as a result of the IPO by way of Secondary Offering in the three and twelve months ended December 31, 2017. These charges were included in selling, general, and administration expense.
- (5) Represents insurance proceeds on claims associated with the 2015 fire at the Silmet facility and other non-recurring transactions. Neo has removed these from net income to provide comparability with historic periods.

8. Discussion and Analysis of Reportable Segments

The analysis of Neo's reportable segments, which follows the discussion of its consolidated results, presents operating results on a gross basis (i.e., before intercompany eliminations).

8.1 Magnequench

(\$000s, except volume)	Three Months Ended December 31,				Year Ended December 31,			
	2018	2017	Change	%	2018	2017	Change	%
Operating income	\$ 6,670	\$ 12,831	\$ (6,161)	(48.0)%	\$ 41,957	\$ 40,986	\$ 971	2.4 %
Add back:								
Depreciation and amortization included in costs of sales	545	654	(109)		2,320	2,187	133	
Depreciation and amortization . . .	1,232	1,070	162		5,024	4,887	137	
OIBDA	8,447	14,555	(6,108)	(42.0)%	49,301	48,060	1,241	2.6 %
Acquired inventory fair value release ⁽¹⁾	—	—	—		—	868	(868)	
Share and value-based compensation expense ⁽²⁾	392	131	261		970	479	491	
Non-recurring transaction cost ⁽³⁾ .	212	—	212		212	—	212	
Adjusted OIBDA	\$ 9,051	\$ 14,686	\$ (5,635)	(38.4)%	\$ 50,483	\$ 49,407	\$ 1,076	2.2 %
Adjusted OIBDA margin	19.2%	24.8%			23.6%	24.3%		
Revenue	\$ 47,210	\$ 59,131	\$ (11,921)	(20.2)%	\$ 213,712	\$ 202,905	\$ 10,807	5.3 %
Sales volume (tonnes)	1,446	1,539	(93)	(6.0)%	6,128	6,305	(177)	(2.8)%

Notes:

- (1) In accordance with IFRS 3 Business Combinations and on completion of the reorganization (please refer to the MD&A dated March 9, 2018), Neo recorded the acquisition of its inventory at fair value, which included a mark-up for profit of \$7,994 for the Magnequench segment. A portion of this inventory was sold in the year ended December 31, 2017 and had a \$868 impact on OIBDA. Neo has removed this from OIBDA to provide a measure of operating performance without the non-cash, non-operational accounting change to the inventory and to provide comparability with historic periods.

- (2) Represents share and value-based compensation expense in respect of the Legacy Plan, the LTIP and the long-term value bonus plan, which has similar vesting criteria to the share-based plan and is settled in cash for non-executives and non-North Americans where implementation of a share settlement plan would have been prohibitively expensive in terms of administration and compliance. Value-based compensation expense of \$322 and \$601 is included in selling, general, and administration expenses for the three and twelve months ended December 31, 2018, respectively, and \$124 is included in selling, general, and administration expenses for both three and twelve months ended December 31, 2017. Neo has removed both the share and value-based compensation expense from OIBDA to provide comparability with historic periods and to treat it consistently with the share-based awards that they are intended to replace.
- (3) These costs are related to legal, professional advisory fees and other transaction costs incurred associated with a potential acquisition opportunity for the Magnequench segment in the three and twelve months ended December 31, 2018. These charges were included in selling, general, and administration expense.

For the year ended December 31, 2018, revenue in the Magnequench segment was \$213.7 million, compared to \$202.9 million in the year ended December 31, 2017; an increase of \$10.8 million or 5.3%. For the three months ended December 31, 2018, revenue in the Magnequench segment was \$47.2 million, compared to \$59.1 million in the same period in 2017; a decrease of \$11.9 million or 20.2%. For the year ended December 31, 2018, volume decreased to 6,128 tonnes, compared to 6,305 tonnes in the same period in 2017; a decrease of 177 tonnes or 2.8%. In the three months ended December 31, 2018, volume decreased to 1,446 tonnes, compared to 1,539 tonnes in the comparable period of 2017; a decrease of 93 tonnes or 6.0%. Generally, the differing rates of increase for revenue and volumes are primarily attributed to changes in commodity rare earth prices. Magnequench has material pass-through agreements with the vast majority of its customers, which enables Magnequench to pass-through the increased rare earth costs into the selling price on a lagged basis.

For the year ended December 31, 2018, operating income was \$42.0 million, an increase of \$1.0 million or 2.4% when compared to operating income for the year ended December 31, 2017. Operating income for the three months ended December 31, 2018 was \$6.7 million, a decrease of \$6.2 million or 48.0% compared to the same period in 2017.

Volumes were lower in the twelve and three months ended December 31, 2018 due to the following factors. First, there was increased buying in 2017 as a result of the volatility of rare earth pricing in the second half of 2017 (as discussed below). Second, there was a slowdown in auto sales, primarily in China, in the second half of 2018. Magnequench continues to see growth in many of its end market applications, including traction motors for hybrid and electric vehicles and micro motors for vehicles, factory automation and other motor applications. In addition, Magnequench is benefiting from growth in the utilization of its magnetic materials on a per-vehicle basis.

For the year ended December 31, 2018, Adjusted OIBDA was \$50.5 million, an increase of \$1.1 million compared to the prior year. This year-on-year increase was realized in spite of a decrease of \$5.6 million in the three months ended December 31, 2018 as compared to the prior year period. The decrease in Adjusted OIBDA in the three months ended December 31, 2018 is primarily attributable to the impact of the pricing pass-through mechanics on rare earth inputs. In the third quarter of 2017, rare earth costs increased rapidly, and temporarily, before decreasing in the fourth quarter of 2017. The pass-through mechanic, a key feature of Neo's strategic focus on value-add margins, increases selling prices on a lagged basis, generally monthly and quarterly. As a result, Neo increased selling prices in the fourth quarter of 2017 while costs were decreasing. Neo recorded lower Adjusted OIBDA per kg in the third quarter of 2017, when costs were higher but prices level, and higher Adjusted OIBDA per kg in the fourth quarter of 2017, when costs were level but prices were higher. For the third and fourth quarters of 2018, rare earth costs, and pricing, were relatively stable.

8.2 C&O

	Three Months Ended December 31,				Year Ended December 31,			
	2018	2017	Change	%	2018	2017	Change	%
(\$000s, except volume)								
Operating income	\$ 3,101	\$ 1,005	\$ 2,096	208.6 %	\$ 12,934	\$ 16,892	\$ (3,958)	(23.4)%
Add back:								
Depreciation and amortization included in costs of sales	749	789	(40)		3,099	3,360	(261)	
Depreciation and amortization	329	367	(38)		1,355	1,687	(332)	
OIBDA	4,179	2,161	2,018	93.4 %	17,388	21,939	(4,551)	(20.7)%
Acquired inventory fair value release ⁽¹⁾	—	—	—		—	2,463	(2,463)	
Share and value-based compensation ⁽²⁾	390	198	192		1,095	892	203	
Adjusted OIBDA	\$ 4,569	\$ 2,359	\$ 2,210	93.7 %	\$ 18,483	\$ 25,294	\$ (6,811)	(26.9)%
Adjusted OIBDA margin	12.0%	6.5%			11.5%	14.8%		
Revenue	\$ 38,207	\$ 36,212	\$ 1,995	5.5 %	\$161,422	\$170,890	\$ (9,468)	(5.5)%
Sales volume (tonnes)	1,843	1,923	(80)	(4.2)%	7,611	8,656	(1,045)	(12.1)%

Notes:

- (1) In accordance with IFRS 3 Business Combinations and on completion of the reorganization (please refer to the MD&A dated March 9, 2018), Neo recorded the acquisition of its inventory at fair value, which included a mark-up for profit of \$14,164 for the C&O segment. A portion of this inventory was sold in the year ended December 31, 2017 and had a \$2,463 impact on OIBDA. Neo has removed this from OIBDA to provide a measure of operating performance without the non-cash, non-operational accounting change to the inventory and to provide comparability with historic periods.
- (2) Represents share and value-based compensation expense in respect of the Legacy Plan, the LTIP and the long-term value bonus plan, which has similar vesting criteria to the share-based plan and is settled in cash for non-executives and non-North Americans where implementation of a share settlement plan would have been prohibitively expensive in terms of administration and compliance. Value-based compensation expense of \$430 and \$837 is included in selling, general, and administration expenses for the three and twelve months ended December 31, 2018, respectively, and \$181 is included in selling, general, and administration expenses for both three and twelve months ended December 31, 2017. Neo has removed both the share and value-based compensation expense from OIBDA to provide comparability with historic periods and to treat it consistently with the share-based awards that they are intended to replace.

For the year ended December 31, 2018, revenue in the C&O segment was \$161.4 million, compared to \$170.9 million for the corresponding period in 2017; a decrease of \$9.5 million or 5.5%. For the three months ended December 31, 2018, revenue in the C&O segment was \$38.2 million, compared to \$36.2 million for the three months ended December 31, 2017; an increase of \$2.0 million or 5.5%.

Operating income for the year ended December 31, 2018 decreased to \$12.9 million from \$16.9 million in the year ended December 31, 2017; a decrease of \$4.0 million or 23.4%. Operating income for the three months ended December 31, 2018 was \$3.1 million, compared to \$1.0 million in the same period in 2017; an increase of \$2.1 million or 208.6%.

For the year ended December 31, 2018, C&O demonstrated strong revenue growth in its three-way catalyst products. This helped to offset a general slowdown of products going into the diesel market. Revenues in the auto catalyst markets were lower in the three months ended December 31, 2018 as a result of the general slowdown in auto sales in the last quarter of 2018. C&O incurred \$4.2 million of premium freight in the first half of 2018, with minimal premium freight in the second half of 2018 as the supply chain had been refilled following the production changes that occurred in 2017. Those production changes caused additional operating costs and premium freight costs in the three months ended December 31, 2017. In the separated rare earth market, for the year ended December 31, 2017, C&O benefited from

volatility in rare earth prices, while 2018 generally saw slow declines in pricing through the year causing compressed margins as C&O was selling the higher cost inventory on hand.

For the year ended December 31, 2018, Adjusted OIBDA in the C&O segment was \$18.5 million, compared to \$25.3 million in the prior year period; a decrease of \$6.8 million or 26.9%. For the three months ended December 31, 2018, Adjusted OIBDA in the C&O segment was \$4.6 million, compared to \$2.4 million in the three months ended December 31, 2017; an increase of \$2.2 million or 93.7%.

8.3 Rare Metals

(\$000s, except volume)	Three Months Ended December 31,				Year Ended December 31,			
	2018	2017	Change	%	2018	2017	Change	%
Operating income	\$ 438	\$ 720	\$ (282)	(39.2)%	\$ 4,578	\$ 3,935	\$ 643	16.3%
Add back:								
Depreciation and amortization included in costs of sales	1,058	1,049	9		4,322	4,554	(232)	
Depreciation and amortization	134	135	(1)		533	621	(88)	
OIBDA	1,630	1,904	(274)	(14.4)%	9,433	9,110	323	3.5%
Acquired inventory fair value release ⁽¹⁾	—	—	—		—	(419)	419	
Share and value-based compensation ⁽²⁾	72	47	25		321	432	(111)	
Adjusted OIBDA	\$ 1,702	\$ 1,951	\$ (249)	(12.8)%	\$ 9,754	\$ 9,123	\$ 631	6.9%
Adjusted OIBDA margin	6.2%	9.9%			10.4%	12.0%		
Revenue	\$ 27,309	\$ 19,722	\$ 7,587	38.5 %	\$ 93,789	\$ 76,009	\$ 17,780	23.4%
Sales volume (tonnes)	227	124	103	83.1 %	650	448	202	45.1%

Notes:

- (1) In accordance with IFRS 3 Business Combinations and on completion of the reorganization (please refer to the MD&A dated March 9, 2018), Neo recorded the acquisition of its inventory at fair value, which included a mark-up for profit of \$4,605 for the Rare Metals segment. A portion of this inventory was sold in the year ended December 31, 2017 and had a \$(419) impact on OIBDA. Neo has removed this from OIBDA to provide a measure of operating performance without the non-cash, non-operational accounting change to the inventory and to provide comparability with historic periods.
- (2) Represents share and value-based compensation expense in respect of the Legacy Plan, the LTIP and the long-term value bonus plan, which has similar vesting criteria to the share-based plan and is settled in cash for non-executives and non-North Americans where implementation of a share settlement plan would have been prohibitively expensive in terms of administration and compliance. Value-based compensation expense of \$95 and \$178 is included in selling, general, and administration expenses for the three and twelve months ended December 31, 2018, respectively, and \$37 is included in selling, general, and administration expenses for both three and twelve months ended December 31, 2017. Neo has removed both the share and value-based compensation expense from OIBDA to provide comparability with historic periods and to treat it consistently with the share-based awards that they are intended to replace.

For the year ended December 31, 2018, revenue in the Rare Metals segment was \$93.8 million, compared to \$76.0 million in the prior year period; an increase of \$17.8 million or 23.4%. For the three months ended December 31, 2018, revenue in the Rare Metals segment was \$27.3 million, compared to \$19.7 million in the three months ended December 31, 2017; an increase of \$7.6 million or 38.5%.

For the year ended December 31, 2018, operating income in the Rare Metals segment was \$4.6 million, compared to \$3.9 million in the corresponding period in 2017; an increase of \$0.6 million or 16.3%. Operating income for the three

months ended December 31, 2018 was \$0.4 million, a decrease of \$0.3 million or 39.2% compared to the same period in 2017.

Rare Metals continues to see higher performance and growth trends in tantalum, niobium and gallium-based products. This was offset by lower customer demand for the segment's hafnium-based products. Rare Metals has demonstrated sustained improved performance, with steady Adjusted OIBDA growth from \$9.1 million in the year ended December 31, 2017 to \$9.8 million in the current year ended December 31, 2018. Rare Metals has continued to execute its strategy of cost reduction, producing more high-value-added products, and bringing the Silmet facility back to full production following a fire in 2015.

For the year ended December 31, 2018, Adjusted OIBDA in the Rare Metals segment was \$9.8 million compared to \$9.1 million in the same period in 2017; an increase of \$0.6 million or 6.9%. For the three months ended December 31, 2018, Adjusted OIBDA in the Rare Metals segment was \$1.7 million compared to \$2.0 million in the three months ended December 31, 2017; a decrease of \$0.2 million or 12.8%.

9. Summary of Consolidated Quarterly Results

(\$000s, except for earnings per share information)	2018				2017			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Revenue	\$ 109,361	\$ 114,216	\$ 110,433	\$ 120,185	\$ 109,452	\$ 116,421	\$ 101,634	\$ 106,662
Net income (loss) attributable to equity holders of Neo	4,285	8,669	19,174	8,667	(1,903)	9,051	9,294	8,178
Basic EPS	0.11	0.22	0.48	0.22	(0.05)	0.23	0.23	0.21
Diluted EPS	0.11	0.21	0.47	0.21	(0.05)	0.22	0.23	0.20
Operating income	6,224	10,890	12,269	13,505	4,716	11,423	7,806	10,880
Add back:								
Depreciation and amortization included in costs of sales	2,352	2,404	2,475	2,510	2,491	2,678	3,150	1,782
Depreciation and amortization	1,716	1,658	1,722	1,882	1,587	2,435	1,711	1,685
OIBDA	10,292	14,952	16,466	17,897	8,794	16,536	12,667	14,347
Add back:								
Acquired inventory fair value release ⁽¹⁾	—	—	—	—	—	(531)	508	2,935
Share and value-based compensation ⁽²⁾	782	1,780	1,392	1,391	802	860	1,623	3,358
Non-recurring transaction costs ⁽³⁾	2,161	—	—	—	5,997	—	—	—
Adjusted OIBDA	\$ 13,235	\$ 16,732	\$ 17,858	\$ 19,288	\$ 15,593	\$ 16,865	\$ 14,798	\$ 20,640
Adjusted OIBDA margin	12.1%	14.6%	16.2%	16.0%	14.2%	14.5%	14.6%	19.4%

Notes:

- (1) In accordance with IFRS 3 Business Combinations and on completion of the reorganization (please refer to the MD&A dated March 9, 2018), Neo recorded the acquisition of its inventory at fair value, which included a mark-up for profit of \$27,062, a portion of this inventory was sold in 2017. Neo has removed this from OIBDA to provide a measure of operating performance without the non-cash, non-operational accounting change to the inventory and to provide comparability with various periods.
- (2) Represents share and value-based compensation expense in respect of the Legacy Plan, the LTIP and the long-term value bonus plan, which has similar vesting criteria to the share-based plan and is settled in cash for non-executives and non-North Americans where implementation of a share settlement plan would have been prohibitively expensive in terms of administration and compliance. Value-based compensation expense of \$1,004 and \$1,909 is included in selling, general, and administration expenses for the three and twelve months ended December

31, 2018, respectively, and \$402 is included in selling, general, and administration expenses for both three and twelve months ended December 31, 2017. Neo has removed both the share and value-based compensation expense from OIBDA to provide comparability with historic periods and to treat it consistently with the share-based awards that they are intended to replace.

- (3) These costs are related to legal and professional advisory fees and other transaction costs incurred primarily associated with the Luxfer Transaction in the three months ended December 31, 2018 and as a result of the IPO by way of Secondary Offering (please refer to the MD&A dated March 9, 2018) in the three months ended December 31, 2017. These charges were included in selling, general and administrative expenses. Neo has removed these charges from OIBDA to provide comparability with historic periods.

10. Liquidity and Capital Resources

Year ended December 31, 2018 compared to year ended December 31, 2017:

<i>(\$000s)</i>	Year Ended December 31,	
	2018	2017
<i>Cash flow:</i>		
Cash (used in) provided by operating activities	\$ (8,736)	\$ 60,431
Cash used in investing activities	(1,932)	(11,564)
Cash used in financing activities	(13,434)	(34,411)
<i>Financial position - as at</i>		
Cash and cash equivalents	December 31, 2018 \$ 71,015	December 31, 2017 \$ 96,805
Property, plant and equipment	86,963	88,392
Total assets	543,023	538,493
Bank advances and other short-term debt	3,970	181

As at December 31, 2018, Neo had cash and cash equivalents of \$71.0 million, compared to \$96.8 million as at December 31, 2017. Neo paid \$11.7 million in dividends to its shareholders and purchased \$3.8 million of its shares under the Bid program in the year ended December 31, 2018. In addition, Neo has approximately \$15.3 million available under its credit facilities with \$4.0 million drawn. Neo's financial position and ability to generate cash from its operations in the short and long-term remain sound.

The primary cash inflows and outflows contributing to the change from December 31, 2017 were the following:

Inflows

- \$61.9 million cash from operations before net change in working capital;
- \$11.8 million recovery from insurance claims;
- \$0.3 million of interest received, net; and
- \$3.8 million in advances from short-term debts.

Outflows

- \$13.0 million of dividends paid (including dividends paid to minority interest partners);
- \$57.8 million net change in working capital;
- \$13.5 million of capital spending;
- \$3.8 million on the repurchase of Neo's Common Shares; and
- \$13.2 million of income taxes paid.

Cash Provided by (Used in) Operating Activities

Net cash used in operating activities was \$8.7 million during the year ended December 31, 2018, compared to net cash provided by operating activities of \$60.4 million for the year ended December 31, 2017, primarily impacted by increased cash used to support working capital as well as insurance proceeds received from claims associated with the 2015 fire at the Silmet facility.

The \$57.8 million net cash used in non-cash working capital for the year ended December 31, 2018, was primarily attributable to increases in inventories related to more raw materials purchases primarily in the Rare Metals segment, increases in the general inventory levels associated with the auto-catalyst market (as the supply chain had been refilled in 2018) and increases in other current assets due to the prepayment for raw materials for strategic purposes. Net changes in accounts payable and accrued charges relate primarily to the disbursement of professional fees related to the initial public offering and IP related legal costs.

Cash Used in Investing Activities

For the year ended December 31, 2018, net cash used in investing activities was \$1.9 million, compared to \$11.6 million in the year ended December 31, 2017; a decrease of \$9.6 million. For the year ended December 31, 2018, Neo received \$11.8 million in insurance proceeds from claims associated with the 2015 fire at the Silmet facility and made capital purchases of \$13.5 million. Capital purchases were primarily used for operating capacity expansion and capital maintenance at the Chinese and Estonian operations.

Cash Used in Financing Activities

Net cash used in financing activities during the year ended December 31, 2018 was \$13.4 million, compared to \$34.4 million in the corresponding period in 2017. Neo distributed \$11.7 million in dividends to its shareholders and \$1.2 million in dividends to its non-controlling interest partners and spent \$3.8 million on its repurchase of Common Shares. In the year ended December 31, 2017, Neo distributed \$24.9 million in dividends to its shareholders and \$1.3 million in dividends to its non-controlling interest partners, and repaid \$7.8 million of bank advances in China and Germany.

(\$000s)

<i>Cash and cash equivalents by Country as at</i>	December 31, 2018	December 31, 2017
China (including Hong Kong)	\$ 36,871	\$ 54,062
Estonia	9,999	2,334
United States	1,743	3,765
Canada	5,886	2,947
Japan	1,645	3,070
United Kingdom	2,761	2,012
Germany	1,202	5,284
Singapore	3,007	8,449
Barbados	3,976	4,168
Thailand	2,527	2,178
Cayman Island	67	6,562
Other	1,331	1,974
Total cash and cash equivalents	\$ 71,015	\$ 96,805

Approximately \$11.2 million of cash on hand held by Neo's foreign operating subsidiaries relate to earnings that are considered indefinitely reinvested in these foreign subsidiaries. Although substantially all of Neo's cash and cash equivalents can be repatriated, a portion may be subject to withholding taxes under current tax laws. While some of Neo's subsidiaries are subject to local governmental restrictions on the flow of capital into and out of their jurisdictions (including in the form of cash dividends, loans or advances), these restrictions have not had a material impact on Neo's ability to meet its cash obligations. Therefore, Neo does not consider this to be a significant risk on its ability to meet ongoing commitments and fund operations.

In addition to cash on hand, the primary sources of liquidity for Neo's domestic and foreign subsidiaries are cash provided by operations and, in the case of the activities in China and Germany, borrowing under certain bank loans. From time to time, the sources of liquidity for Neo's operating subsidiaries may be supplemented by intercompany loans in the form of unsecured promissory notes. Neo's operating subsidiaries' liquidity generally is used to fund their working capital requirements, investments, capital expenditures and third-party debt service requirements.

11. Contractual Obligations

In the normal course of business, Neo is obligated to make future payments. These obligations represent contracts and other commitments that are known and non-cancellable.

(\$000s)	Payments Due by Period				
	1 year	2 - 3 years	4 - 5 years	Thereafter	Total
Operating lease obligations ⁽¹⁾ . . .	2,040	\$ 3,064	\$ 1,093	\$ 37	\$ 6,234
Accounts payable and other accrued charges	59,877	—	—	—	59,877
Derivative liability ⁽²⁾	—	—	—	9,525	9,525
Provisions ⁽³⁾	—	4,717	—	—	4,717
Other liabilities	777	559	—	—	1,336
Total	\$ 62,694	\$ 8,340	\$ 1,093	\$ 9,562	\$ 81,689

Notes:

- (1) Represents all operating lease payments for office space, land and office equipment.
- (2) Represents the fair value of the put option on shares of the remaining shareholder of Buss & Buss.
- (3) Represents management's best estimate of the costs to be incurred by Neo for the disposal of the hazardous NORM currently being stored at the Silmet facility.

As at December 31, 2018, Neo had \$71.0 million of cash and cash equivalents and approximately \$1.1 million of restricted cash in Canada, and \$0.6 million of restricted cash in the United States, both held as collaterals against Letters of Credit. Neo believes that the remainder of its cash, in addition to cash from operating activities, is available (or sufficient) to meet Neo's non-cancelable contractual obligations and other commercial commitments and the capital program for the next twelve months. Neo considers cash to be "available" to the extent it can be utilized in operating activities, for capital expenditures, for intercompany loans or for repatriation. Neo also maintains access to credit facilities and short-term borrowings for its working capital needs, capital expenditures, and general corporate purposes.

12. Normal Course Issuer Bid

On March 19, 2018, Neo announced that the Toronto Stock Exchange (the "TSX") has accepted a notice filed by Neo of its intention to make a Bid for up to 1,996,078 of its issued and outstanding Common Shares. In connection with the Bid, Neo has entered into an automatic share purchase plan with its designated broker to allow for purchases of its Shares (the "**Share Purchase Plan**"). The Share Purchase Plan is considered an "automatic plan" for purposes of applicable Canadian securities laws. Under the Share Purchase Plan, Neo's broker may purchase Shares on any trading day during the Bid, including during self-imposed trading blackout periods. The price that Neo will pay for any Shares purchased under the Bid will be the prevailing market price at the time of purchase. Any Shares purchased by Neo will be canceled.

For the year ended December 31, 2018, Neo repurchased and canceled 321,222 Shares for a total consideration of \$3.8 million.

Subsequent to the Luxfer Transaction, the Share Purchase Plan was automatically terminated.

13. Subsequent Event

2019 Q1 Dividends

On February 28, 2019, the Board of Directors declared a quarterly dividend of Cdn \$0.095 per Common Share payable in cash on March 29, 2019, to common shareholders of record at the close of business on March 20, 2019.

Business Combination

On December 18, 2018, Neo entered into an Arrangement Agreement with Luxfer and the Purchaser, a wholly-owned subsidiary of Luxfer, pursuant to which, the Purchaser would acquire the issued and outstanding Common Shares of Neo in consideration of US\$5.98 in cash and 0.395 Luxfer shares for each Common Share. On March 10, 2019, Luxfer and Neo mutually agreed to terminate the Luxfer Transaction.

14. Off-Balance Sheet Arrangements

As of December 31, 2018, Neo's only off-balance sheet arrangements are the operating leases and purchase obligations included in the contractual obligations table above.

15. Significant Management Judgment in Applying Accounting Policies

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenue and expenses. Actual results could differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Information about the significant judgments, estimates and assumptions that have the most significant effect on the recognition and measurement of assets, liabilities, income and expenses are discussed below.

Income taxes

In the ordinary course of business, there are many transactions for which the ultimate tax outcome is uncertain, and estimates are required for exposures related to examinations by tax authorities. Management reviews these transactions and exposures and records tax liabilities based on its assessment of many factors, including past experience and interpretations of tax law applied to the facts of each matter. The determination of tax liabilities is subjective and generally involves a significant amount of judgment. The final outcome may differ from estimates, and a change to these estimates could impact the income tax provision.

The assessment of the probability of future taxable income in which deferred tax assets can be utilized is based on Neo's expectation of future profitability by legal entity adjusted for significant non-taxable income and expenses as well as limits to the use of loss carryforwards or other tax credits. If a positive forecast of taxable income indicates the probable future use of a deferred tax asset, it is usually recognized in full. Recognition of deferred tax assets that are subject to certain legal or economic limits or uncertainties is assessed individually by management based on the specific facts and circumstances.

Impairment

An impairment loss is recognized for the amount by which an asset's or cash generating unit's ("CGU") carrying amount exceeds its recoverable amount, which is the higher of fair value less cost to sell and value-in-use. To determine the value-in use, management estimates expected future cash flows from each asset or CGU and determines a suitable interest rate in order to calculate the present value of those cash flows. In the process of measuring expected future

cash flows, management makes assumptions about future operating results. These assumptions relate to future events and circumstances. The actual results may vary, and may cause significant adjustments to Neo's assets in future periods. In most cases, determining the applicable discount rate involves estimating the appropriate adjustment to market risk and the appropriate adjustment to asset-specific risk factors.

Business combinations

On initial recognition, the identifiable assets and liabilities of the acquired business are included in the consolidated statements of financial position at their fair values. In measuring fair value, management uses estimates about future cash flows and discount rates. Any measurement changes from initial recognition would affect the measurement of goodwill.

Useful lives of depreciable assets

Management reviews the useful lives of depreciable assets at each reporting date. At December 31, 2018, management assessed that the useful lives represented the expected utility of the assets to Neo.

Inventories

Inventories are measured at the lower of cost and net realizable value. In estimating net realizable values, management takes into account the most reliable evidence available at the time the estimates are made. Neo's core business is subject to changes in foreign policies and internationally accepted metal prices which may cause selling prices to change rapidly.

Provisions

A provision is recognized if, as a result of a past event, Neo has a present legal or constructive obligation that can be reliably estimated and it is probable that an outflow of economic benefits will be required to settle the obligation. Timing or amount of the outflow may still be uncertain. Management estimates the expenditure required to settle the present obligation, based on the most reliable evidence available at the reporting date, including the risks and uncertainties associated with the present obligation. Provisions are discounted when the time value of money is significant.

Defined benefit pension liability

Management estimates the defined benefit pension liability annually with the assistance of independent actuaries; however, the actual outcome may vary due to estimation uncertainties. The estimate of the defined benefit pension liability is based on estimated retirement ages, medical cost trends and mortality. It also takes into account Neo's specific anticipation of future salary increases. Discount factors are determined based on matching the plan's projected cash flow with the independent actuaries' discount yield curve. Estimation uncertainties exist particularly with regard to medical cost trends, which may vary significantly in future estimates of Neo's defined benefit pension obligations.

Fair value of financial instruments

Management uses valuation techniques in measuring the fair value of financial instruments, where active market quotes are not available. Details of the assumptions used are given in the notes to the financial statements regarding financial assets and liabilities. In applying the valuation techniques management makes use of market inputs, and uses estimates and assumptions that are, as far as possible, consistent with observable data that market participants would use in pricing the instrument. Where applicable data is not observable, management uses its best estimate about the assumptions that market participants would make. These estimates may vary from the actual prices that would be achieved in an arm's length transaction at the reporting date.

Share-based compensation

Neo measures the cost of equity-settled transactions with employees and directors by reference to the fair value of the equity instruments at the date at which they are granted. Estimating fair value for share-based payment transactions requires determining the most appropriate valuation model, which is dependent on the terms and conditions of the grant. This estimate also requires determining and making assumptions about the most appropriate inputs to the valuation model including the expected life, volatility, dividend yield, forfeiture rate and expectations regarding achievement of market conditions and related timing of such achievement. Such assumptions are inherently uncertain and changes in these assumptions affect the fair value estimates.

16. Related Party Transactions and Balances

Neo's related parties are its joint ventures, associates, directors and executive officers.

Unless otherwise stated, none of the transactions incorporate special terms and conditions and no guarantees were given or received. Outstanding balances are usually settled in cash.

Transactions with associates

Neo holds a 33% investment in Toda Magnequench Magnetic Materials Co. Ltd. ("**TMT**"), which produces rare earth magnetic compounds with Magnequench Powders supplied by Magnequench's Tianjin facility in its normal course of business. Magnequench's Tianjin facility will then purchase these compounds back from TMT.

Neo holds a 25% ownership interest in Ganzhou Keli Rare Earth New Material Co., Ltd. ("**Keli**"), a company which converts rare earth oxides into metals for use in Magnequench Powders.

Neo also holds a 20% ownership interest in GQD Special Materials (Thailand) Co., Ltd. ("**GQD**"), a company which converts rare earth oxides into metals for use in Magnequench Powders.

For the year ended December 31, 2018, Neo purchased \$1.8 million worth of compounds from TMT, purchased metals and received services from Keli amounting to \$64.7 million, and received services from GQD amounting to \$0.9 million. For the year ended December 31, 2017, Neo sold Magnequench Powders and performed services, amounting to \$2.7 million to TMT, as well as sold rare earth oxides to Keli amounting to \$4.1 million.

For the year ended December 31, 2017, Neo purchased \$1.9 million worth of compounds from TMT, purchased metals and received services from Keli amounting to \$67.8 million, and received services from GQD amounting to \$1.0 million. For the year ended December 31, 2017, Neo sold Magnequench Powders and performed services amounting to \$2.8 million to TMT.

Transactions with joint venturers

Neo, through its sales company in Japan, Neo Japan Inc., has occasionally purchased Gallium from Beijing Jiya Semiconductor Material Co., Ltd. ("**Beijing Jiya**") for resale to third party customers. For the year ended December 31, 2018 and the year ended December 31, 2017, these purchases were \$0.7 million and \$0.5 million, respectively.

Neo also has occasionally purchased and sold products from and to Ganzhou Qian Dong Rare Earth Group Co. Ltd. ("**Qian Dong**") and Toda Kogyo Corp. ("**Toda**"). For the year ended December 31, 2018, purchases from Qian Dong were \$0.4 million. Sales to Toda for the year ended December 31, 2018, were \$1.0 million. There were no transactions with Qian Dong and Toda for the year ended December 31, 2017.

Transactions between Neo and its related parties are summarized in the table below:

(\$000s)	Year Ended December 31,	
	2018	2017
Sale of goods and services to related parties	\$ 7,804	\$ 2,815
Purchase of goods and services from related parties	68,585	71,097
(\$000s)	December 31, 2018	December 31, 2017
Trade balances:		
from related parties	\$ 327	160
due to related parties	(5,102)	(9,698)
Total	\$ (4,775)	\$ (9,538)

Directors and Key Management Compensation

Key management personnel consist of those persons having authority and responsibility for planning, directing and controlling the activities of Neo, directly or indirectly. Key management personnel include Neo's executive officers, vice-presidents and members of its board of directors. Neo's key management compensation expenses include short-term benefits and share-based compensation expenses. Total key management compensation expenses incurred are as follows:

Neo's short-term employee benefits are as follows:

	Year Ended December 31,	
	2018	2017
Directors	282	\$ 227
Key Executive Management	4,389	4,209
Total	\$ 4,671	\$ 4,436

Neo's share-based compensation expenses are as follows:

	Year Ended December 31,	
	2018	2017
Directors	\$ 405	\$ 647
Key Executive Management	3,093	4,877
Total	\$ 3,498	\$ 5,524

17. Financial Instruments and Risk Management

The following table presents financial assets and liabilities measured at fair value in the consolidated statements of financial position in accordance with the fair value hierarchy. It does not include financial assets and liabilities not measured at fair value if the carrying amount is a reasonable approximation of fair value. This hierarchy groups financial assets and liabilities into three levels based on the significance of inputs used in measuring the fair value of the financial assets and liabilities. The fair value hierarchy has the following levels:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The level in which the financial asset or liability is classified is determined based on the lowest level of significant input to the fair value measurement. The financial assets and liabilities measured at fair value in the consolidated statements of financial position as at December 31, 2018, are grouped into the fair value hierarchy as follows:

<i>(\$000s)</i>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Financial Liabilities:			
Put option issued to non-controlling interest of Buss & Buss	\$ —	\$ —	\$ 9,525

Neo's derivative liability classified in Level 3 uses the discounted cash flow method to determine the fair value based on significant inputs that are not based on observable market data.

Changing inputs to the Level 3 valuations to reasonably possible alternative assumptions would not significantly change amounts recognized in net income, total assets, total liabilities or total equity.

There have been no transfers between levels for the period ended December 31, 2018.

Neo is exposed to a number of risks in the normal course of business that have the potential to affect its performance. These risk factors include commodity price risk, foreign currency risk, credit risk and liquidity risk.

Commodity price risk

A portion of Neo's current business is conducted in the spot market; therefore, prices can vary with the transaction and individual bids received. Neo's products are primarily marketed to manufacturers as component materials. Prices will vary based on the demand for the end products being produced with the raw materials Neo processes.

Neo's sales and profitability are determined principally by the pricing of the rare earth and rare metals products it produces, and, to a lesser extent, by the price of natural gas and other supplies used in its production process. The prices of the rare earth products are influenced by the price and demand of the end products that Neo's products support, including automotive, electronics and clean energy technologies. A significant decrease in the global demand for these products may have a material adverse effect on Neo's business. Neo does not have hedging contracts for revenue and costs in place.

Neo's costs and capital investments are subject to market movements in other commodities such as natural gas and chemicals. Neo may enter into derivative contracts for a portion of the expected usage of these products, but it does not currently have any derivative contracts on these commodities and it does not currently anticipate entering into derivative agreements on commodities.

Foreign currency risk

Neo is exposed to fluctuations of the United States dollar against the functional currencies of its foreign subsidiaries, including the Euro, the Canadian dollar, the Renminbi, the Thai baht and the Japanese Yen, when Neo translates its foreign subsidiaries' financial statements into United States dollars for inclusion in its consolidated financial statements. Cumulative translation adjustments are recorded in accumulated other comprehensive income (loss) and a separate component of equity. Any increase (decrease) in the value of the United States dollar against those foreign currencies results in unrealized foreign currency translation losses (gains) with respect to assets acquired in, liabilities assumed from, intercompany balances with and results of operations from the foreign subsidiaries. Therefore, Neo may experience a negative impact on its comprehensive income (loss) and stockholders' equity with respect to its holdings in those subsidiaries as a result of foreign currency translation. Neo generally does not hedge against the risk that it may incur non-cash losses upon the translation of the financial statements of its foreign subsidiaries into United States dollars.

Credit risk

Credit risk refers to the possibility that a customer or counterparty will fail to fulfill its obligations under a contract and as a result, create a financial loss for Neo. Neo has a credit policy that defines standard credit practice. This policy dictates that all new customer accounts are reviewed prior to approval and establishes the maximum amount of credit exposure per customer. Credit worthiness and financial well-being of the customer is monitored on an ongoing basis.

Under IFRS 9 - Financial Instruments ("**IFRS 9**"), Neo establishes a loss allowance using the expected credit losses ("**ECL**") impairment model; therefore, the carrying amount of accounts receivable generally represents the maximum credit exposure. As at December 31, 2018, Neo recorded a loss allowance of \$0.1 million. The estimated credit losses, if any, is included in selling, general and administrative expenses in the consolidated statements of profit or loss and is net of any recoveries that were provided for in prior periods.

Counterparties to financial instruments may expose Neo to credit losses in the event of non-performance. Counterparties for derivative and cash transactions are limited to high credit quality financial institutions, which are monitored on an ongoing basis. Counterparty credit assessments are based on the financial health of the institutions and their credit ratings from external agencies. As at December 31, 2018, Neo does not anticipate non-performance that would materially impact Neo's financial statements.

Liquidity risk

Neo is exposed to the possibility that it may not be able to meet its financial obligations as they fall due. Neo manages liquidity risk by continuously monitoring actual and projected cash flows, taking into account its sales and receipts and matching the maturity profile of financial assets and liabilities. Neo continues to maintain sufficient cash and certain credit facilities which can be drawn upon to meet its operating and capital expenditure obligations as needed. The Board reviews and approves the annual operating and capital budgets, as well as any material transactions out of the ordinary course of business, including proposals on acquisition and other major investments.

As at December 31, 2018, Neo is able to meet its financial obligations as they fall due.

18. Recent Accounting Pronouncements

18.1 New standards issued and adopted

Neo adopted the following accounting standards and amendments to accounting standards, effective January 1, 2018:

18.1.1 IFRS 15, Revenue from Contracts with Customers ("IFRS 15")

In May 2014, the IASB issued IFRS 15, which replaces the existing revenue recognition guidance with a new, comprehensive framework for determining how and when revenue is recognized.

Neo has adopted IFRS 15 using the cumulative effect method as of January 1, 2018 with no material impact on its consolidated financial statements.

18.1.2 IFRS 9, Financial Instruments ("IFRS 9")

In July 2014, the IASB issued the final version of IFRS 9 (2014), to replace IAS 39 - *Financial Instruments: Recognition and Measurement* ("IAS 39"). IFRS 9 eliminates previous IAS 39 financial asset categories of held to maturity, available-for-sale and loans and receivable. IFRS 9 provides a revised model for classification, measurement, impairment and derecognition of financial assets and liabilities, as well as general hedge accounting. IFRS 9 also requires a loss allowance for ECL on a financial asset that is measured at amortized cost.

The adoption of IFRS 9 has not had a significant effect on Neo's accounting policies relating to financial liabilities and derivative financial instruments. The adoption of the new classification requirements under IFRS 9 did not result in a change in the carrying value of any of Neo's financial instruments on the transition date. The application of the ECL model did not have a material impact on the consolidated financial statements as the credit risk related to the financial assets of Neo is low and historical customer defaults have been negligible.

The following table summarized the classification impacts upon adoption of IFRS 9.

Financial Assets and Liabilities	Classification under IAS 39	Classification under IFRS 9
Cash and cash equivalent	Fair value through profit or loss ("FVPL")	Amortized cost
Accounts receivable	Loans and receivables	Amortized cost
Bank advances and other short-term debt	Other liabilities	Amortized cost
Accounts payable and other accrued charges	Other liabilities	Amortized cost
Derivative liability	FVPL	FVPL

18.1.3 IFRIC 22 - Foreign Currency Transactions and Advance Consideration

In December 2016, the IASB issued IFRIC Interpretation 22 - *Foreign Currency Transactions and Advance Consideration*. The interpretation clarifies which date should be used for translation of a foreign currency transaction when an entity recognizes a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration before the entity recognizes the related asset, expense or income (or part of it).

The interpretation was applicable for annual periods beginning on or after January 1, 2018. Neo adopted the interpretation effective January 1, 2018, with no adjustment required to its consolidated financial statements.

18.2 New standards issued but not yet adopted

The following accounting pronouncements issued by the IASB were not effective for Neo as at December 31, 2018 and therefore have not been applied in preparing these consolidated financial statements. Neo intends to adopt these standards, if applicable, when they become effective.

18.2.1 IFRIC 23 - Uncertainty over income tax treatments

On June 7, 2017, the IASB issued IFRIC Interpretation 23 - *Uncertainty over income tax treatments* ("IFRIC 23"). IFRIC 23 clarifies how to apply the recognition and measurement requirements in IAS 12 - *Income taxes* ("IAS 12") when there is uncertainty over income tax treatments. The interpretation is effective for annual periods beginning on or after January 1, 2019, with earlier adoption permitted. As a result of Neo's analysis to date, Neo does not expect any significant impact on its consolidated financial statements resulting from the adoption of this interpretation.

18.2.2 IFRS 16 - Leases

On January 13, 2016, the IASB issued IFRS 16 - Leases ("**IFRS 16**"). IFRS 16 supersedes IAS 17 - Leases, IFRIC 4 - Determining whether an Arrangement contains a Lease, SIC-15 - Operating Leases – Incentives and SIC-27 - Evaluating the Substance of Transactions Involving the Legal Form of a Lease. IFRS 16 contains a single lessee accounting model, which eliminates the distinction between operating and finance leases from the perspective of the lessee. All contracts that meet the definition of a lease, other than short term leases and leases of low value items for which a lessee has the option not to apply the measurement and presentation requirements of IFRS 16, will be recorded in the statement of financial position with a "right of use" asset and a corresponding liability. The asset is subsequently accounted for as property, plant and equipment or investment property and the liability is unwound using the interest rate inherent in the lease. The accounting requirements from the perspective of the lessor remains largely in line with previous IAS 17 requirements. IFRS 16 has an effective date of January 1, 2019, with early application permitted only if IFRS 15 has also been adopted. Management plans to apply IFRS16 using a simplified transition approach and will not restate comparative amounts for the year prior to the effective date. On January 1, 2019, Neo will recognize right-of-use assets and lease liabilities for its operating leases in accordance with IFRS 16. The nature of expenses related to the operating leases will change because Neo will recognize a depreciation charge for right-of-use assets and interest expense on lease liabilities. No significant impact is expected for the recognition and measurement of finance leases under IFRS 16. Based on the information currently available, Neo estimated that it will recognize lease liabilities and right of use assets of approximately \$4.0 million to \$6.0 million as at January 1, 2019.

19. Internal Control Over Financial Reporting and Disclosure Controls and Procedures

Disclosure controls and procedures

Neo's Chief Executive Officer ("**CEO**") and Chief Financial Officer ("**CFO**") are responsible for establishing and maintaining disclosure controls and procedures for Neo. Neo maintains a set of disclosure controls and procedures designed to provide reasonable assurance that information required to be publicly disclosed is recorded, processed, summarized and reported on a timely basis. The CEO and CFO have evaluated the design and operating effectiveness of Neo's disclosure controls and procedures ("**DC&P**") as of December 31, 2018 and based on the evaluation, the CEO and CFO have concluded that the DC&P were effective.

Internal controls over financial reporting

Neo's internal controls over financial reporting ("**ICFR**") are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. Neo's management is responsible for establishing and maintaining adequate ICFR for Neo. National Instrument 52-109 of the Canadian Securities Administrators requires the CEO and CFO to certify that they are responsible for establishing and maintaining ICFR for Neo and that those internal controls have been designed and are effective in providing reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with IFRS. The CEO and CFO are also responsible for disclosing any changes to Neo's internal controls during the most recent period that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting. There have been no material changes during the year ended December 31, 2018. Neo's management under the supervision of the CEO and CFO has evaluated the design and operating effectiveness of Neo's ICFR based on the Internal Control - Integrated Framework issued in 2013 by the Committee of Sponsoring Organizations of the Treadway Commission. As at December 31, 2018, management assessed that Neo's ICFR were effective.

In designing such controls, management, including the CEO and CFO, recognized that due to inherent limitations, any controls, no matter how well designed and operating effectively, can provide only reasonable assurance of achieving the desired control objectives and may not prevent or detect all errors and fraud with respect to the financial statement preparation and presentation. Additionally, management is required to use judgment in evaluating controls and procedures.

20. Risk Factors

Overview

Neo's business activities exposes Neo to both risks and opportunities. Risk oversight and management processes are integral elements of Neo's approach to risk management and strategic planning initiatives to address both risks and opportunities.

Numerous risks and uncertainties could cause Neo's actual results or shareholder returns to differ materially from those expressed or implied, including those in the Forward-Looking Information, Financial Statements, other areas of this MD&A and Neo's 2018 Annual Information Form ("**AIF**") for the year ended December 31, 2018. Such risks and uncertainties include:

- Volatility in the price of Neo's Common Shares related to price or volume that may be unrelated to Neo's operating results;
- Payment of future dividends, which is at the discretion of the Board and may be subject to future restrictions or strategic initiatives;
- Difficulty in enforcing judgments in the jurisdictions in which Neo operates;
- The existence of a significant shareholder that may be able to direct a significant amount of voting power;
- The variability in quarterly results particularly as it relates to commodity price changes and the inability to pass-through cost changes;
- Failure to adapt to new products and technologies that may impact the sales of Neo's products;
- Disruptions to manufacturing processes and supply related to internal or external factors;
- Risks associated with the international nature of the business, including foreign legal requirements and differences in business practices;
- Changes to the general economic, industry and market conditions, both domestically and in foreign markets;
- Potentially adverse tax consequences in various jurisdictions, including the repatriation of cash to other jurisdictions;
- The inability to maintain permits and operating licenses in the jurisdictions and segments in which Neo operates;
- The inability to continue to procure cost effective material, including rare earths as well as material subject to conflict materials regulations;
- Trade barriers, exchange controls, export restrictions and other matters related to the export of materials from the manufacturing locations;
- The inability to maintain technical advantages through continuous development, protecting know-how and trade secrets as well as enforcing intellectual property rights in the various jurisdictions;
- The inability to defend against various intellectual property rights and applications currently asserted or potentially asserted in the future, including the inability to continue to supply parts to Neo's customers without significant economic penalty;
- The management and expiry of the Joint Ventures that form part of Neo's operations;
- Changes in other regulations related to operating in the various jurisdictions, including changes with respect to the regulated rare earth industry in China;
- The inability to manage risks associated with the potential unauthorized use of Company Chops in China or any other unauthorized use of authority;
- Customers and supplier dependence, including the inability to continually develop new products that meet changing standards and requirements;
- The inability to manage environmental liability exposure and continue to operate in environmentally sensitive areas with respect to legal requirements that may continue to change over time;
- The inability to maintain the services of key personnel including senior management, key technical people and other key employees;
- The inability to protect Neo's information technology systems and protect against cybersecurity attacks or any other situations that may cause disruption to Neo's inability to access its data and manage its business;
- The entrance of other competitors or substituted technologies into the markets in which Neo operates.

In addition to other information contained in this MD&A, readers should carefully consider the preceding factors before making an investment in Common Shares. All risk factors should be considered because they could cause Neo's actual results or financial condition to differ materially from those discussed in forward-looking statements contained elsewhere in this MD&A. The preceding risk factors are not an all-inclusive listing of risks. Risks and uncertainties that are either not known to Neo or that Neo considers at this time to be immaterial or insignificant could also be detrimental to the ongoing affairs of Neo. If any of these risks occur, Neo's business, financial position, results of operations or cash flows could be materially adversely affected. Further discussion of the risk factors set out above can be found in Neo's AIF.

21. Outstanding Shares Data

Class of Equity Security	<u>Numbers Outstanding</u>
Common Shares	39,650,340
Stock Options*	1,158,712
Restricted Share Units & Performance Stock Units	1,105,378

*Each stock option can be exercised to purchase one Common Share.

The number of Common Shares outstanding as at March 10, 2019 is 39,650,340.

22. Legal Proceedings and Regulatory Actions

Legal Proceedings

From time to time, Neo and its subsidiaries are subject to litigation claims arising in the ordinary course of business, most of which involve alleged violations of the intellectual property rights of others. Neo manufactures and sells many products that use scientific formulations and processes, and its competitors may from time to time allege that they hold a patent on such formulations or processes that Neo has infringed. Neo generally believes that it has meritorious defenses to the actions that have been brought against it and vigorously pursues the defense of each such action, including but not limited to initiating legal proceedings to revoke or invalidate the patents Neo is alleged to have infringed. However, litigation outcomes are inherently unpredictable and may be even harder to predict for patent litigation since patents are issued separately by each country or applicable jurisdiction with different standards for infringement or invalidation, as well as differing levels of damages, including as a result of the number of customers and level of activity of Neo in a given country or jurisdiction.

If many or most of the proceedings initiated against Neo in respect of the patents held by others, described under "*Other Expenditures and Legal Contingencies*", are finally determined in a manner adverse to Neo, there can be no assurance that such determinations would not have a material adverse effect upon Neo or upon its operations, cash flows, prospects or financial condition, and in some countries (or jurisdictions) listed in "*Other Expenditures and Legal Contingencies*", management expects that an injunction or other remedy imposed for infringement will be materially adverse to Neo. It is not possible at this time to predict with any degree of certainty the impact upon Neo's operations in the event of such final adverse determinations. If injunctions were granted against it, Neo would be prohibited from manufacturing and distributing certain products in those jurisdictions subject to those injunctive orders. Neo could, in such event, re-establish its manufacturing capability for such products in jurisdictions not prohibited by any such orders, and thus would expect to encounter interruptions in its manufacturing of such products and in its ability to distribute such products to customers in jurisdictions not subject to such orders. The litigation proceedings described in this section affect certain products manufactured by Neo's C&O segment for use in auto catalysts. Neo manufactures a wide variety of products that are used in the production of auto catalysts, which accounted for approximately 18% of total revenue in the year ended December 31, 2018. These products include multiple formulations in multiple jurisdictions to a number of different customers. We note; however, these claims do not affect all of the products manufactured by Neo's C&O segment, for use in auto catalysts nor do these claims pertain to all markets where such products are sold. Neo is not currently restricted with respect to the manufacture or distribution of any of its products as a result of ongoing litigation.

However, in the event of final adverse determinations, Neo expects to take all available actions to mitigate the impacts of such rulings, including but not limited to continuing to pursue invalidation of the applicable patent (if not already decided) appealing the adverse rulings, obtaining licensing rights and finding new customer outlets. The geographically diverse nature of Neo's operations and that of certain of its customers potentially provides Neo with a measure of flexibility to manufacture the same products in certain other jurisdictions and continue to supply certain of its customers with the same products in certain other jurisdictions. Neo also has the ability to work with customers to develop new products that may have a lower risk of potentially falling within the scope of existing patent claims.

Where appropriate, accruals are made in accordance with accounting standards for contingencies to provide for matters that are probable of resulting in an estimated loss. Based upon the status of the various cases, management's assessments of the likelihood of damages, and the advice of counsel, Neo has made accruals, as of December 31, 2018, for some of the proceedings outlined in "*Other Expenditures and Legal Contingencies*", where Neo believes it would be more likely than not be liable for damages and other outflows of resources. Neo considers some of the other outstanding litigation as currently being too uncertain to result in accruals. Several of these actions are at a preliminary stage and have not gone to trial.

As mentioned above the laws concerning patents differ from country to country. Damages for patent infringement in Europe and China may include lost profits or a reasonable royalty, but enhanced damages for wilful infringement are generally not available, unlike the case in the United States.

See section entitled "*Legal Proceedings and Regulatory Actions*" in Neo's AIF.

Regulatory Actions

There have been no penalties or sanctions imposed against Neo by a court relating to provincial and territorial securities legislation or by a securities regulatory authority since incorporation.

23. Additional Information

Additional information is included in Neo's AIF available on Neo's website at www.neomaterials.com and on SEDAR at www.sedar.com.