



Performance Materials

MANAGEMENT'S DISCUSSION AND ANALYSIS

NEO PERFORMANCE MATERIALS INC.

FOR THE THREE-MONTH AND SIX-MONTH PERIODS ENDED JUNE 30, 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. should be read in conjunction with the MD&A and the audited consolidated financial statements for the year ended December 31, 2017 dated March 9, 2018 filed on 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 Accounting Standard ("**IAS**") 34, Interim Financial Reporting as adopted by the International Accounting Standards Board ("**IASB**") and in accordance with International Financial Reporting Standards ("**IFRS**") as adopted by the IASB. "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" 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 in the MD&A dated March 9, 2018 under "*Risk Factors*". See "*Forward-Looking Information*".

The discussion and analysis in this MD&A are based upon information available to management as of August 10, 2018. 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, which 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, August 10, 2018, 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, 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 thirty 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 head office 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)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Volume (in mt)				
Magnequench	1,554	1,426	3,081	3,085
C&O	1,776	2,178	3,783	4,468
Rare Metals	139	129	274	222
Corporate / Eliminations	(73)	(75)	(143)	(135)
Consolidated Volumes	3,396	3,658	6,995	7,640
Revenue				
Magnequench	\$ 56,229	\$ 42,277	\$ 111,963	\$ 89,721
C&O	36,698	41,366	81,854	84,432
Rare Metals	21,321	21,059	44,092	39,480
Corporate / Eliminations	(3,815)	(3,068)	(7,291)	(5,337)
Consolidated Revenue	\$ 110,433	\$ 101,634	\$ 230,618	\$ 208,296
Operating Income (Loss)				
Magnequench	\$ 11,432	\$ 8,498	\$ 24,773	\$ 19,770
C&O	3,808	4,538	5,925	9,198
Rare Metals	1,160	1,485	3,639	2,688
Corporate / Eliminations	(4,131)	(6,715)	(8,563)	(12,970)
Consolidated Operating Income	\$ 12,269	\$ 7,806	\$ 25,774	\$ 18,686
Adjusted EBITDA ⁽¹⁾				
Magnequench	\$ 13,408	\$ 11,150	\$ 28,883	\$ 24,595
C&O	5,180	6,413	8,700	14,679
Rare Metals	2,472	2,555	6,268	5,176
Corporate / Eliminations	(3,202)	(5,320)	(6,705)	(9,012)
Consolidated Adjusted EBITDA	\$ 17,858	\$ 14,798	\$ 37,146	\$ 35,438
Net Income				
	\$ 19,138	\$ 9,550	\$ 27,990	\$ 17,775
Attributable to:				
Equity holders of Neo	19,174	9,294	27,841	17,472
Non-controlling interest	(36)	256	149	303
Earnings per share attributable to equity holders of Neo				
Basic	\$ 0.48	\$ 0.23	\$ 0.70	\$ 0.44
Diluted	\$ 0.47	\$ 0.23	\$ 0.69	\$ 0.44
Adjusted Net Income				
	\$ 12,489	\$ 12,121	\$ 22,757	\$ 26,150
Attributable to:				
Equity holders of Neo	12,525	11,865	22,608	25,847
Non-controlling interest	(36)	256	149	303
Adjusted earnings per share attributable to equity holders of Neo:				
Basic	\$ 0.31	\$ 0.30	\$ 0.57	\$ 0.65
Diluted	\$ 0.31	\$ 0.30	\$ 0.56	\$ 0.64
Capital expenditures	\$ 3,929	\$ 2,939	\$ 6,234	\$ 4,303
Cash taxes paid	\$ 3,089	\$ 3,929	\$ 5,985	\$ 6,993
Dividends paid to shareholders	\$ 2,945	\$ —	\$ 5,958	\$ —
Repurchase of common shares under Normal Course Issuer Bid	\$ 484	\$ —	\$ 708	\$ —
			June 30, 2018	December 31, 2017
Cash and cash equivalents			\$ 74,659	\$ 96,805
Debt			\$ 7	\$ 181

Notes:

(1) 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.

Highlights of the three months ended June 30, 2018 compared to the three months ended June 30, 2017

Magnequench

- For the three months ended June 30, 2018, sales volume increased by 9% compared to the three months ended June 30, 2017. Magnequench continued 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 three months ended June 30, 2018 was up by 33% compared to the three months ended June 30, 2017. This is due to a combination of higher volumes and increased selling prices from higher rare earth input costs (which are subject to pass through mechanics).
- For the three months ended June 30, 2018, adjusted OIBDA was \$13.4 million, a 20% improvement from the same period in the prior year, and was driven by volumes, continued strong operating performance, strategic purchases of other non-rare earth raw materials, product mix and the impact of selling prices being adjusted on a lagged basis.

Chemicals & Oxides

- In the auto-catalyst segment, C&O continued to incur additional premium freight costs in the second quarter of 2018 of \$1.1 million (compared to \$3.0 million in the first quarter of 2018) as the supply chain was replenished following the implementation of the new wastewater system in one of its manufacturing plants.
- Timing of campaign production planning and customer purchasing patterns impacted the rare earth separation business in the second quarter of 2018. The segment operates its heavy rare earth plant in China on a campaign basis which is expected to occur later in 2018 than in the previous year, while still planning to fill the annual production quota for heavy rare earth separation.

Rare Metals

- Strong improvement in results continued to be realized at the Silmet facility, due to a combination of increased volumes, higher selling prices (particularly for tantalum products), higher flow-through margins, continued focus on higher margin programs and continued operational improvements. This was offset by lower customer demand for the segment's hafnium based products.
- The segment was also affected by its customers making adjustments to their quarterly purchasing patterns and inventory levels resulting in timing differences in realizing sales with its customers.

Highlights of the six months ended June 30, 2018 compared to the six months ended June 30, 2017

Magnequench

- For the six months ended June 30, 2018, sales volume was comparable to the six months ended June 30, 2017. Magnequench continued to see growth in many of its end market applications, including traction motors for hybrid/electric vehicles and micro motors for factory automation, home appliances and supporting the trend toward the electrification of vehicles, offset by a decline in the hard disk drive ("HDD") market. In addition, from time to time, customers make adjustments to their quarterly purchasing patterns and inventory levels which caused higher volumes in first quarter of 2017 and lower volumes in first quarter of 2018. Revenue for the six months ended June 30, 2018 was up by 25% from prior year largely due to the increased selling prices from higher rare earth input costs (which are subject to pass through mechanics).
- For the six months ended June 30, 2018, adjusted OIBDA was \$28.9 million, a 17% improvement from the same period in the prior year, driven by continued strong operating performance, strategic purchases of other non-rare earth raw materials and the impact of selling prices being adjusted on a lagged basis.

Chemicals & Oxides

- As noted above, in the auto-catalyst segment, C&O incurred premium freight costs of \$4.1 million in the six months ended June 30, 2018 as the supply chain was replenished following the implementation of the new wastewater system in one of its manufacturing plants.
- Continued high rare earth prices benefited the rare earth separation business in the first quarter of 2018. This has remained a positive factor since the latter half of 2017 as the segment was able to capitalize on higher selling prices for inventory which was on hand. This impact partially offset the impact of delaying the production campaign for heavy rare earths until later in 2018 and normal changes in customer buying patterns.

Rare Metals

- Similar to the results for the three months ended June 30, 2018, the Silmet facility continues to benefit from a combination of increased volumes, increased selling prices (primarily for the tantalum and gallium products), higher flow-through margins, continued focus on higher margin programs and continued operational improvements.
- Rare Metals benefited from improved performance in the GaCl₃ end market as its customer recovered from a fire that happened in mid-2017. The segment was also affected by its customers making adjustments to their quarterly purchasing patterns and inventory levels resulting in timing differences in realizing sales with its customers.

Cash and Liquidity Highlights for the six months ended June 30, 2018

- Neo continues to have a strong financial position. As at June 30, 2018, Neo had \$74.7 million in cash and nominal debt. This compares to \$96.8 million in cash and \$0.2 million in debt at December 31, 2017.
- Cash used in operating activities was \$8.7 million which was positively impacted by strong operating results but negatively impacted by an increase in working capital associated with higher raw material inventory purchases, higher inventory in the auto-catalyst supply chain, increased inventory costs, and by certain cash costs related to the completion of the Initial Public Offering in December 2017. Neo invested \$6.2 million in capital expenditures in property, plant and equipment and intangibles and paid \$6.0 million in cash taxes in the six months ended June 30, 2018.
- For the six months ended June 30, 2018, Neo paid dividends to its shareholders of \$6.0 million and nominal dividends paid to its non-controlling interest partners. As part of the Normal Course Issuer Bid (the "**Bid**") program, Neo purchased and canceled 54,646 shares with an aggregate disbursement of \$0.7 million.

Other Highlights for the six months ended June 30, 2018

- Neo recorded other income of \$7.9 million related to the partial settlement of the insurance claims from the fire affecting Silmet in 2015. Neo received installments of \$2.3 million in 2015, \$1.2 million in 2016, \$2.2 million in 2017 and \$7.9 million in the third quarter of 2018.

4. Consolidated Results of Operations

Comparison of the three and six months ended June 30, 2018 to the three and six months ended June 30, 2017:

(\$000s)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenue	110,433	101,634	230,618	208,296
Costs of sales				
Costs excluding depreciation and amortization	76,368	67,237	160,054	141,993
Depreciation and amortization	2,475	3,150	4,985	4,932
Gross profit	31,590	31,247	65,579	61,371
Expenses				
Selling, general and administrative	11,913	16,237	25,059	27,126
Stock-based compensation	1,090	1,623	2,180	4,981
Depreciation and amortization	1,722	1,711	3,604	3,396
Research and development	4,596	3,870	8,962	7,182
	19,321	23,441	39,805	42,685
Operating income	12,269	7,806	25,774	18,686
Other income	8,112	1,276	8,078	3,049
Finance income, net	1,703	90	1,466	25
Foreign exchange gain (loss)	237	(537)	66	(523)
Income from operations before income taxes and equity income of associates	22,321	8,635	35,384	21,237
Income tax (expense) recovery	(3,351)	640	(6,542)	(4,067)
Income from operations before equity income of associates ...	18,970	9,275	28,842	17,170
Equity income (loss) of associates (net of income tax)	168	275	(852)	605
Net income	\$ 19,138	\$ 9,550	\$ 27,990	\$ 17,775
Attributable to:				
Equity holders of Neo	19,174	\$ 9,294	27,841	\$ 17,472
Non-controlling interest	(36)	256	149	303
	\$ 19,138	\$ 9,550	\$ 27,990	\$ 17,775
Earnings per share data attributable to equity holders of Neo:				
Basic	\$ 0.48	\$ 0.23	\$ 0.70	\$ 0.44
Diluted	\$ 0.47	\$ 0.23	\$ 0.69	\$ 0.44

Revenue

Neo's consolidated revenue for the three months ended June 30, 2018 was \$110.4 million compared to \$101.6 million in the prior year; an increase of \$8.8 million or 8.7%. For the six months ended June 30, 2018, consolidated revenue was \$230.6 million compared to \$208.3 million for the same period in the prior year; an increase of \$22.3 million or 10.7%. The revenue increase was predominantly at the Magnequench segment.

The Magnequench segment revenue increased to \$56.2 million in the three months ended June 30, 2018 compared to \$42.3 million in the same period of the prior year; an increase of \$14.0 million or 33.0%. For the six months ended

June 30, 2018, the Magnequench segment revenue was \$112.0 million compared to \$89.7 million for the same period in the prior year; an increase of \$22.2 million or 24.8%. The Magnequench segment represented 48.5% of consolidated revenue in the six months ended June 30, 2018.

The C&O segment revenue decreased to \$36.7 million in the three months ended June 30, 2018 compared to \$41.4 million in the same period of the prior year; a decline of \$4.7 million or 11.3%. For the six months ended June 30, 2018, the C&O segment revenue was \$81.9 million compared to \$84.4 million for the same period in the prior year; a decrease of \$2.6 million or 3.1%. The C&O segment represented 35.5% of consolidated revenue in the six months ended June 30, 2018.

The Rare Metals segment revenue increased to \$21.3 million in the three months ended June 30, 2018 compared to \$21.1 million in the same period of the prior year; an increase of \$0.3 million or 1.2%. For the six months ended June 30, 2018, the Rare Metals segment revenue was \$44.1 million compared to \$39.5 million for the same period in the prior year; a decrease of \$4.6 million or 11.7%. The Rare Metals segment represented 19.1% of consolidated revenue in the six months ended June 30, 2018.

Inter-segment revenue in the three and six months ended June 30, 2018 was \$3.8 million and \$7.3 million, respectively, compared to \$3.1 million and \$5.3 million in the three and six months ended June 30, 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 \$76.4 million and \$160.1 million in the three and six months ended June 30, 2018, respectively, compared to \$67.2 million and \$142.0 million in the three and six months ended June 30, 2017, respectively; an increase of \$9.1 million or 13.6% quarter-over-quarter, and an increase of \$18.1 million or 12.7% year-over-year. Costs of sales, excluding depreciation and amortization increased as a result of higher revenue in the three and six months ended June 30, 2018, in addition to the impacts of sales price, product mix, and operational changes in the business segments. Additionally, in the auto-catalyst segment, Neo incurred additional premium freight costs in the first six months of 2018 as the supply chain replenished following the implementation of the new wastewater treatment system in one of the manufacturing locations. As of June 30, 2018, the supply chain has been adequately replenished and accordingly, notwithstanding any new developments, premium freight costs are not expected to continue into the third quarter of 2018.

Consolidated depreciation and amortization in costs of sales were \$2.5 million and \$5.0 million for the three and six months ended June 30, 2018, respectively, compared to \$3.2 million and \$4.9 million in the three and six months ended June 30, 2017, respectively. 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 three and six months ended June 30, 2018, SG&A expense was \$11.9 million and \$25.1 million, respectively, compared to \$16.2 million and \$27.1 million in the corresponding periods last year. The lower SG&A costs in the current three-month period compared to the corresponding period in 2017 relates to lower legal costs associated with the outstanding intellectual property disputes and certain SG&A costs being project based and may be higher or lower in any given period.

Stock-based compensation

For the three and six months ended June 30, 2018, stock-based compensation expense was \$1.1 million and \$2.2 million, a decrease of \$0.5 million and \$2.8 million compared to three and six months ended June 30, 2017, respectively.

Depreciation and amortization

Depreciation and amortization unrelated to production for the three and six months ended June 30, 2018 of \$1.7 million and \$3.6 million, respectively, were fairly consistent with the corresponding three and six-month periods in 2017, respectively.

R&D

For the three months ended June 30, 2018, R&D expense was \$4.6 million compared to \$3.9 million in the same period of the prior year; an increase of \$0.7 million. For the six months ended June 30, 2018, R&D expense was \$9.0 million compared to \$7.2 million in the corresponding period in 2017; an increase of \$1.8 million. Neo continues to prioritize making strategic and appropriate investments in R&D to develop new applications for its products and to strategically position Neo in meeting 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 three and six months ended June 30, 2018, Neo reported consolidated other income of \$8.1 million and \$8.1 million, respectively, compared to an other income of \$1.3 million and \$3.0 million for the corresponding three and six months ended June 30, 2017, respectively. In the three months ended June 30, 2018, Neo recorded \$7.9 million of insurance proceeds on claims associated with the 2015 fire at the Silmet facility.

For the six months ended June 30, 2017, Neo received a \$1.4 million settlement for a patent infringement case filed, net of legal expenses incurred, in its Magnequench segment, and \$2.2 million insurance proceeds on claims associated with the 2015 fire at the Silmet facility.

Finance income, net

Finance income, net, for the three and six months ended June 30, 2018 was \$1.7 million and \$1.5 million, respectively, compared to nominal finance income for the corresponding periods in 2017. Neo's finance income for the three and six months ended June 30, 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 three and six months ended June 30, 2018, Neo has nominal amounts of debt outstanding.

Income tax (expense) recovery

For the three and six months ended June 30, 2018, Neo had an income tax expense of \$3.4 million and \$6.5 million, respectively, on income from operations before taxes of \$22.3 million and \$35.4 million. For the three and six months ended June 30, 2017, Neo had an income tax benefit of \$0.6 million and income tax expense of \$4.1 million, respectively, on income from operations before taxes of \$8.6 million and \$21.2 million.

Neo's effective tax rate was 15.0% and 18.5% for the three and six months ended June 30, 2018, respectively. Neo's effective tax rate was (7.4%) and 19.2% for the three and six months ended June 30, 2017, respectively.

During the three months ended June 30, 2018, Neo recorded other income of \$7.9 million related to the partial settlement of insurance claims from the fire affecting its subsidiary in Estonia in 2015. As these proceeds are not currently taxable and will not be distributed in the foreseeable future, a tax liability has not been recognized. In the three months ended

June 30, 2017, Chinese tax authorities approved Neo's request to claim certain income tax incentives for its Chinese subsidiaries that required meeting various conditions. The benefits of these tax incentives were not previously recognized. As a result of this approval, Neo recognized a related income tax benefit in the three months ended June 30, 2017 relating to earnings from 2016 and the first quarter of 2017.

Other Expenditures and Legal Contingencies

Capital Expenditures

Neo capitalized expenditures of \$3.9 million and \$6.2 million for the three and six months ended June 30, 2018, respectively, and \$2.9 million and \$4.3 million for the three and six months ended June 30, 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).

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, 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 being 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's products infringed two expired patents of Rhodia Chimie ("**Rhodia**") (European patent #0735984 B1 ("**984**") and European patent #0863846 B1 ("**846**")) and management was ordered to provide information related to the calculation of damages. The Court also determined that certain of Neo's products infringe a third patent (European patent #0605274 ("**274**")). Neo 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 Neo's favor, 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 Neo's two other invalidity actions, significantly restricting the claims in one patent and slightly modifying the other. These two Court judgments are subject to ongoing appeals.

In December 2017, the Regional Court of Mannheim (Germany) determined that certain of Neo'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 has appealed the decision and continues to pursue a lawsuit to invalidate the patent upon which this infringement ruling is based. In April 2018, the UK Court determined that certain of Neo's products infringed the equivalent UK patent 338. Neo's request for permission to appeal this judgment is pending before the Court of Appeal.

In January 2018, Neo 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 ruled in favor 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. On May 23, 2018, the Court in Zibo, China, dismissed the cases initiated by Rhodia that were affected by the ruling of the Patent Reexamination Board which invalidated the claims of Chinese patent ZL 03817110.4. Rhodia has the right to appeal to 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 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

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.

5. 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), reorganization items, stock 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), stock and value-based compensation, transaction costs associated with the Arrangement and the Initial Public Offering ("**IPO**"), impairment of goodwill and other long-lived assets, and acquired inventory fair value release, net of the related tax effects and adjustment to deferred tax asset;

"**Adjusted OIBDA**" is defined as OIBDA before stock 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 six months ended June 30, 2018 and 2017:

(\$000s, except volume)	Three Months Ended June 30,				Six Months Ended June 30,			
	2018	2017	Change	%	2018	2017	Change	%
Operating income	\$ 12,269	\$ 7,806	\$ 4,463	57.2 %	\$ 25,774	\$ 18,686	\$ 7,088	37.9 %
Add back:								
Depreciation and amortization included in Costs of Sales	2,475	3,150	(675)		4,985	4,932	53	
Depreciation and amortization	1,722	1,711	11		3,604	3,396	208	
OIBDA	16,466	12,667	3,799	30.0 %	34,363	27,014	7,349	27.2 %
Acquired inventory fair value release ⁽¹⁾	—	508	(508)		—	3,443	(3,443)	
Stock-based compensation ⁽²⁾	1,392	1,623	(231)		2,783	4,981	(2,198)	
Adjusted OIBDA	\$ 17,858	\$ 14,798	\$ 3,060	20.7 %	\$ 37,146	\$ 35,438	\$ 1,708	4.8 %
Adjusted OIBDA margin	16.2%	14.6%			16.1%	17.0%		
Revenue	\$110,433	\$101,634	\$ 8,799	8.7 %	\$230,618	\$208,296	\$ 22,322	10.7 %
Sales volume (tonnes).	3,396	3,658	(262)	(7.2)%	6,995	7,640	(645)	(8.4)%

Notes:

- (1) In accordance with IFRS 3 Business Combinations and on completion of the reorganization, Neo recorded the acquisition of its inventory at fair value, which included a mark-up for profit of \$27,062 (please refer to the MD&A dated March 9, 2018). A portion of this inventory was sold in the three and six months ended June 30, 2017 and had a \$508 and \$3,443 impact, respectively, 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 stock and value based compensation expense in respect of the Legacy Plan adopted upon the completion of the reorganization (please refer to the MD&A dated March 9, 2018) and the long-term value bonus plan, which has similar vesting criteria to the stock 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. The value based compensation expense of \$302 and \$603 are included in selling, general, and administration expenses for the three and six months ended June 30, 2018, respectively, and \$nil are included in selling, general, and administration expenses for both three and six months ended June 30, 2017, respectively. Neo has removed both the stock and value based compensation expense from OIBDA to provide comparability with historic periods and to treat it consistently with the Share-based plan awards that they are intended to replace.

Adjusted OIBDA was \$17.9 million or 16.2% of revenue for the three months ended June 30, 2018 compared to \$14.8 million or 14.6% of revenue for the corresponding period in 2017; an increase of \$3.1 million or 20.7%. For the six months ended June 30, 2018, Adjusted OIBDA was \$37.1 million or 16.1% of revenue, compared to \$35.4 million or 17.0% of revenue for the six months ended June 30, 2017; an increase of \$1.7 million or 4.8%.

Adjusted OIBDA for the three and six months ended June 30, 2018 compared to the corresponding periods in 2017 was higher in the Magnequench and Rare Metals segments but lower in the C&O. Magnequench continued to benefit from operational improvements, changes in foreign exchange rates and strategic purchasing of non-rare earth based raw materials. Rare Metals benefited primarily from the increased production capacity available at the Silmet facility as well as operational improvements and increased selling prices. C&O was adversely impacted by continuing premium freight costs (\$1.1 million and \$4.1 million in the three and six months ended June 30, 2018, respectively) and from the timing impact of adjusting its production campaign timing for its heavy rare earth plant later into 2018 (than 2017).

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 June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	\$ 19,138	\$ 9,550	\$ 27,990	\$ 17,775
Add back (deduct):				
Finance income, net	(1,703)	(90)	(1,466)	(25)
Income tax expense (recovery)	3,351	(640)	6,542	4,067
Depreciation and amortization included in Costs of Sales	2,475	3,150	4,985	4,932
Depreciation and amortization	1,722	1,711	3,604	3,396
EBITDA	24,983	13,681	41,655	30,145
Adjustments to EBITDA:				
Equity (income) loss in associates	(168)	(275)	852	(605)
Other income ⁽¹⁾	(8,112)	(1,276)	(8,078)	(3,049)
Foreign exchange (gain) loss ⁽²⁾	(237)	537	(66)	523
Stock and value-based compensation expense ⁽³⁾	1,392	1,623	2,783	4,981
Acquired inventory fair value release ⁽⁴⁾	—	508	—	3,443
Adjusted EBITDA	\$ 17,858	\$ 14,798	\$ 37,146	\$ 35,438
<i>Adjusted EBITDA Margins</i>	<i>16.2%</i>	<i>14.6%</i>	<i>16.1%</i>	<i>17.0%</i>
Less:				
Capital expenditures	3,929	2,939	6,234	4,303
Free Cash Flow	\$ 13,929	\$ 11,859	\$ 30,912	\$ 31,135
<i>Free Cash Flow Conversion</i> ⁽⁵⁾	<i>78.0%</i>	<i>80.1%</i>	<i>83.2%</i>	<i>87.9%</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. 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 stock and value based compensation expense in respect of the Legacy Plan adopted upon the completion of the reorganization (please refer to the MD&A dated March 9, 2018) and the long-term value bonus plan, which has similar vesting criteria to the stock 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. The value based compensation expense of \$302 and \$603 are included in selling, general, and administration expenses for the three and six months ended June 30, 2018, respectively, and \$nil for both three and six months ended June 30, 2017, respectively. Neo has removed both the stock and value based compensation expense from EBITDA to provide comparability with historic periods and to treat it consistently with the Share-based plan awards that they are intended to replace.
- (4) In accordance with IFRS 3 Business Combinations and on completion of the reorganization, 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 three and six months ended June 30, 2017 and had a \$508 and \$3,443 impact, respectively, on net income. Neo has removed this from net income 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) Calculated as Free Cash Flow divided by Adjusted EBITDA.

Reconciliation of Net Income to Adjusted Net Income:

(\$000s)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income	\$ 19,138	\$ 9,550	\$ 27,990	\$ 17,775
Adjustments to net income:				
Foreign exchange (gain) loss ⁽¹⁾	(237)	537	(66)	523
Stock and value-based compensation expense ⁽²⁾	1,392	1,623	2,783	4,981
Acquired inventory fair value release ⁽³⁾	—	508	—	3,443
Insurance recovery included in other income ⁽⁴⁾	(7,865)	—	(7,865)	—
Tax impact of the above items.....	61	(97)	(85)	(572)
Adjusted net income	\$ 12,489	\$ 12,121	\$ 22,757	\$ 26,150
Attributable to:				
Equity holders of Neo.....	\$ 12,525	\$ 11,865	\$ 22,608	\$ 25,847
Non-controlling interest.....	\$ (36)	\$ 256	\$ 149	\$ 303
Weighted average number of common shares outstanding:				
Basic.....	39,903,277	39,770,488	39,911,662	39,717,800
Diluted.....	40,458,090	40,156,968	40,451,774	40,102,516
Adjusted earnings per share attributable to equity holders of Neo:				
Basic.....	\$ 0.31	\$ 0.30	\$ 0.57	\$ 0.65
Diluted.....	\$ 0.31	\$ 0.30	\$ 0.56	\$ 0.64

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 stock and value based compensation expense in respect of the Legacy Plan adopted upon the completion of the reorganization (please refer to the MD&A dated March 9, 2018) and the long-term value bonus plan, which has similar vesting criteria to the stock 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. The value based compensation expense of \$302 and \$603 are included in selling, general, and administration expenses for the three and six months ended June 30, 2018, respectively, and \$nil for both three and six months ended June 30, 2017, respectively. Neo has removed both the stock and value based compensation expense from net income to provide comparability with historic periods and to treat it consistently with the Share-based plan awards that they are intended to replace.
- (3) In accordance with IFRS 3 Business Combinations and on completion of the reorganization, 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 three and six months ended June 30, 2017 and had a \$508 and \$3,443 impact, respectively, on net income. Neo has removed this from net income 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) Represents partial settlement of the insurance claims from the fire affecting Silmet in 2015. Neo has removed this from net income to provide comparability with historic periods.

6. 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).

6.1 Magnequench

(\$000s, except volume)	Three Months Ended June 30,				Six Months Ended June 30,			
	2018	2017	Change	%	2018	2017	Change	%
Operating income	\$ 11,432	\$ 8,498	\$ 2,934	34.5%	\$ 24,773	\$ 19,770	\$ 5,003	25.3 %
Add back:								
Depreciation and amortization included in costs of sales	599	1,159	(560)		1,204	867	337	
Depreciation and amortization	1,230	1,372	(142)		2,612	2,794	(182)	
OIBDA	13,261	11,029	2,232	20.2%	28,589	23,431	5,158	22.0 %
Acquired inventory fair value release ⁽¹⁾	—	32	(32)		—	868	(868)	
Stock and value-based compensation expense ⁽²⁾	147	89	58		294	296	(2)	
Adjusted OIBDA	\$ 13,408	\$ 11,150	\$ 2,258	20.3%	\$ 28,883	\$ 24,595	\$ 4,288	17.4 %
Adjusted OIBDA margin	23.8%	26.4%			25.8%	27.4%		
Revenue	\$ 56,229	\$ 42,277	\$ 13,952	33.0%	\$111,963	\$ 89,721	\$ 22,242	24.8 %
Sales volume (tonnes)	1,554	1,426	128	9.0%	3,081	3,085	(4)	(0.1)%

Notes:

- (1) In accordance with IFRS 3 Business Combinations and on completion of the reorganization, 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 three and six months ended June 30, 2017 and had a \$32 and \$868 impact, respectively, 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 stock and value based compensation expense in respect of the Legacy Plan adopted upon the completion of the reorganization (please refer to the MD&A dated March 9, 2018) and the long-term value bonus plan, which has similar vesting criteria to the stock 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. The value based compensation expense of \$93 and \$186 are included in selling, general, and administration expenses for the three and six months ended June 30, 2018, respectively, and \$nil for both three and six months ended June 30, 2017, respectively. Neo has removed both the stock and value based compensation expense from OIBDA to provide comparability with historic periods and to treat it consistently with the Share-based plan awards that they are intended to replace.

For the three months ended June 30, 2018, revenue in the Magnequench segment was \$56.2 million compared to \$42.3 million in the same period in 2017; an increase of \$14.0 million or 33.0%. For the six months ended June 30, 2018, revenue in the Magnequench segment was \$112.0 million compared to \$89.7 million in the six months ended June 30, 2017; an increase of \$22.2 million or 24.8%. Volume increased to 1,554 tonnes compared to 1,426 tonnes in the three months ended June 30, 2017; an increase of 128 tonnes or 9.0%. For the six months ended June 30, 2018, volume remained consistent with the same period in 2017.

As noted above, in the three months ended June 30, 2018, revenue increased by 33.0% whereas volume increased by 9.0%. In the six months ended June 30, 2018, revenue increased by 24.8% whereas volume decreased by 0.1%. The differing rates of increase for revenue and volumes is primarily attributed to changes in commodity rare earth prices. Magnequench has material pass-through agreements with the vast majority of its customers, implemented on a lagged basis which enables Magnequench to pass-through the increased rare earth costs into the selling price.

Magnequench continues to see strong volumes and opportunities in the majority of its end product markets including traction motors (used in hybrid and electric vehicles), factory automation and across numerous automotive applications which exhibited strong volume growth for the three and six months ended June 30, 2018. This volume growth was

offset by a slowdown in the HDD end market and certain changes in customer inventory management systems that resulted in lower volumes earlier in the year.

Operating income for the three and six months ended June 30, 2018 was \$11.4 million and \$24.8 million, respectively, an increase of \$2.9 million or 34.5% and \$5.0 million or 25.3% when compared to the operating income for the three and six months ended June 30, 2017, respectively. Magnequench benefited from strategic purchases of raw materials, foreign exchange, product mix, operating performance improvements and the lagging impact of selling price changes (from pass-through agreements).

For the three months ended June 30, 2018, Adjusted OIBDA in the Magnequench segment was \$13.4 million compared to \$11.2 million in the three months ended June 30, 2017; an increase of \$2.3 million or 20.3%. For the six months ended June 30, 2018, Adjusted OIBDA in the Magnequench segment was \$28.9 million compared to \$24.6 million in the corresponding period in 2017; an increase of \$4.3 million or 17.4%.

6.2 C&O

(\$000s, except volume)	Three Months Ended June 30,				Six Months Ended June 30,			
	2018	2017	Change	%	2018	2017	Change	%
Operating income	\$ 3,808	\$ 4,538	\$ (730)	(16.1)%	\$ 5,925	\$ 9,198	\$ (3,273)	(35.6)%
Add back:								
Depreciation and amortization included in costs of sales	784	834	(50)		1,593	1,721	(128)	
Depreciation and amortization	345	140	205		696	287	409	
OIBDA	4,937	5,512	(575)	(10.4)%	8,214	11,206	(2,992)	(26.7)%
Acquired inventory fair value release ⁽¹⁾	—	723	(723)		—	2,881	(2,881)	
Stock and value-based compensation ⁽²⁾	243	178	65		486	592	(106)	
Adjusted OIBDA	\$ 5,180	\$ 6,413	\$ (1,233)	(19.2)%	\$ 8,700	\$ 14,679	\$ (5,979)	(40.7)%
Adjusted OIBDA margin	14.1%	15.5%			10.6%	17.4%		
Revenue	\$ 36,698	\$ 41,366	\$ (4,668)	(11.3)%	\$ 81,854	\$ 84,432	\$ (2,578)	(3.1)%
Sales volume (tonnes)	1,776	2,178	(402)	(18.5)%	3,783	4,468	(685)	(15.3)%

Notes:

- (1) In accordance with IFRS 3 Business Combinations and on completion of the reorganization, 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 three and six months ended June 30, 2017 and had a \$723 and \$2,881 impact, respectively, 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 stock and value based compensation expense in respect of the Legacy Plan adopted upon the completion of the reorganization (please refer to the MD&A dated March 9, 2018) and the long-term value bonus plan, which has similar vesting criteria to the stock 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. The value based compensation expense of \$135 and \$271 are included in selling, general, and administration expenses for the three and six months ended June 30, 2018, respectively, and \$nil for both three and six months ended June 30, 2017, respectively. Neo has removed both the stock and value based compensation expense from OIBDA to provide comparability with historic periods and to treat it consistently with the Share-based plan awards that they are intended to replace.

For the three months ended June 30, 2018, revenue in the C&O segment was \$36.7 million compared to \$41.4 million for the three months ended June 30, 2017; a decrease of \$4.7 million or 11.3%. Volume decreased to 1,776 tonnes in

the three months ended June 30, 2018 from 2,178 tonnes in the same period in 2017; a decrease of 402 tonnes or 18.5%. For the six months ended June 30, 2018, revenue in the C&O segment was \$81.9 million compared to \$84.4 million for the corresponding period in 2017; a decrease of \$2.6 million or 3.1%. Volume was 3,783 tonnes for the six months ended June 30, 2018 compared to 4,468 tonnes in the corresponding period in 2017; a decrease of 685 tonnes or 15.3%.

Volumes in the auto-catalyst market in the three months ended June 30, 2018 were similar to the volumes in the three months ended June 30, 2017 as C&O was able to replenish the supply chain throughout the quarter. The revenue in the three months ended June 30, 2018 was also affected by slower demand in the diesel segment of the automotive market. Volumes in the auto-catalyst segment in the six months ended June 30, 2018 were lower than the volumes in the prior year primarily attributable to lower demand for diesel related products and to a lesser degree, supply constraints. Volumes in the separated rare earth market were generally lower in both the three and six months ended June 30, 2018 compared to the prior year. The decrease in volumes and revenue in this market can generally be attributed to normal variations in production and customer purchasing patterns. In China, C&O operates within the production separation quotas established for each year. Given the capacity available at C&O, it generally operates through production campaigns. For 2018, the production campaign for one of the China facilities is occurring later in the year compared to 2017 and this impacted volumes and revenue from this facility (this facility produces heavy rare earths where selling prices are generally higher than light rare earths).

Operating income for the three months ended June 30, 2018 was \$3.8 million compared to \$4.5 million in the same period in 2017; a decrease of \$0.7 million or 16.1%. Operating income for the six months ended June 30, 2018 decreased to \$5.9 million from \$9.2 million in the six months ended June 30, 2017; a decrease of \$3.3 million or 35.6%. The C&O segment continued to incur premium freight costs in the three and six months ended June 30, 2018 of \$1.1 million and \$4.1 million, respectively. As of June 30, 2018, the C&O segment believes the supply chain is adequately replenished and under current operating parameters, it does not anticipate continuing premium freight costs from this production system change. Operating income was also impacted by lower volumes and mix differences in the separated rare earth markets.

For the three months ended June 30, 2018, Adjusted OIBDA in the C&O segment was \$5.2 million compared to \$6.4 million in the three months ended June 30, 2017; a decrease of \$1.2 million or 19.2%. For the six months ended June 30, 2018, Adjusted OIBDA in the C&O segment was \$8.7 million compared to \$14.7 million in the prior year period; a decrease of \$6.0 million or 40.7%. The decrease in each period can be primarily attributable to the premium freight costs incurred, as described above.

6.3 Rare Metals

(\$000s, except volume)	Three Months Ended June 30,				Six Months Ended June 30,			
	2018	2017	Change	%	2018	2017	Change	%
Operating income (loss)	\$ 1,160	\$ 1,485	\$ (325)	(21.9)%	\$ 3,639	\$ 2,688	\$ 951	35.4%
Add back:								
Depreciation and amortization included in costs of sales	1,092	1,158	(66)		2,188	2,345	(157)	
Depreciation and amortization	132	60	72		266	120	146	
OIBDA	2,384	2,703	(319)	(11.8)%	6,093	5,153	940	18.2%
Acquired inventory fair value release ⁽¹⁾	—	(247)	247		—	(306)	306	
Stock and value-based compensation ⁽²⁾	88	99	(11)		175	329	(154)	
Adjusted OIBDA	\$ 2,472	\$ 2,555	\$ (83)	(3.2)%	\$ 6,268	\$ 5,176	\$ 1,092	21.1%
Adjusted OIBDA margin	11.6%	12.1%			14.2%	13.1%		
Revenue	\$ 21,321	\$ 21,059	\$ 262	1.2 %	\$ 44,092	\$ 39,480	\$ 4,612	11.7%
Sales volume (tonnes)	139	129	10	7.8 %	274	222	52	23.4%

Notes:

- (1) In accordance with IFRS 3 Business Combinations and on completion of the reorganization, 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 three and six months ended June 30, 2017 and had a \$(247) and \$(306), respectively, 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 stock and value based compensation expense in respect of the Legacy Plan adopted upon the completion of the reorganization (please refer to the MD&A dated March 9, 2018) and the long-term value bonus plan, which has similar vesting criteria to the stock 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. The value based compensation expense of \$28 and \$55 are included in selling, general, and administration expenses for the three and six months ended June 30, 2018, respectively, and \$nil for both three and six months ended June 30, 2017, respectively. Neo has removed both the stock and value based compensation expense from OIBDA to provide comparability with historic periods and to treat it consistently with the Share-based plan awards that they are intended to replace.

For the three months ended June 30, 2018, revenue in the Rare Metals segment was \$21.3 million compared to \$21.1 million in the three months ended June 30, 2017; an increase of \$0.3 million or 1.2%. Volume increased to 139 tonnes compared to 129 tonnes in the same period in 2017, an increase of 10 tonnes or 7.8%. For the six months ended June 30, 2018, revenue in the Rare Metals segment was \$44.1 million compared to \$39.5 million in the prior year period; an increase of \$4.6 million or 11.7%. Volume was 274 tonnes compared to 222 tonnes in the same period in 2017; an increase of 52 tonnes or 23.4%.

Volume and revenue increases for the three and six months ended June 30, 2018 can be primarily attributable to more production volume from the Silmet facility (as full production capacity had been restored through 2017), higher sales in the GaCl₃ business (as a customer recovered from a fire that happened in mid-2017) and higher selling prices associated with some of the underlying products the segment sells (primarily tantalum and gallium). These factors are partially offset by lower hafnium sales volumes, where customer buying patterns have been lower than the prior year.

Operating income for the three months ended June 30, 2018 decreased to \$1.2 million from \$1.5 million in the three months ended June 30, 2017; a decline of \$0.3 million or 21.9%. For the six months ended June 30, 2018, operating income in the Rare Metals segment was \$3.6 million compared to \$2.7 million in the corresponding period in 2017; an increase of \$1.0 million or 35.4%. For the six months ended June 30, 2018, strong improvements in results continued to be realized at the Silmet facility, due to a combination of increased volumes, higher flow-through margins and operational improvements and having lower cost inventory on hand. Volume and operating income in the three months ended June 30, 2018 were partially impacted by quarterly fluctuations in customer buying patterns having been a strong first quarter of this year.

For the three months ended June 30, 2018, Adjusted OIBDA in the Rare Metals segment was \$2.5 million compared to \$2.6 million in the three months ended June 30, 2017; a decrease of \$0.1 million or 3.2%. For the six months ended June 30, 2018, Adjusted OIBDA in the Rare Metals segment was \$6.3 million compared to \$5.2 million in the same period in 2017; an increase of \$1.1 million or 21.1%.

7. Summary of Consolidated Quarterly Results

(\$000s, except for earnings per share information)	2018		2017				2016	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
							Successor ⁽¹⁾	Combined ⁽¹⁾
Revenue	\$ 110,433	\$ 120,185	\$ 109,452	\$ 116,421	\$101,634	\$ 106,662	\$ 101,008	\$ 94,695
Net income (loss) attributable to equity holders of Neo	19,174	8,667	(1,903)	9,051	9,294	8,178	(7,110)	(6,546)
Basic EPS	0.48	0.22	(0.05)	0.23	0.23	0.21	(0.18)	n.a. ⁽⁵⁾
Diluted EPS	0.47	0.21	(0.05)	0.22	0.23	0.20	(0.18)	n.a. ⁽⁵⁾
Operating income (loss)	12,269	13,505	4,716	11,423	7,806	10,880	(4,605)	(1,325)
Add back:								
Depreciation and amortization included in costs of sales	2,475	2,510	2,491	2,678	3,150	1,782	3,205	2,604
Depreciation and amortization	1,722	1,882	1,587	2,435	1,711	1,685	2,348	1,467
OIBDA	16,466	17,897	8,794	16,536	12,667	14,347	948	2,746
Add back:								
Acquired inventory fair value release ⁽²⁾	—	—	—	(531)	508	2,935	12,832	11,318
Stock and value-based compensation ⁽³⁾	1,392	1,391	802	860	1,623	3,358	—	—
IPO transaction costs ⁽⁴⁾	—	—	5,997	—	—	—	—	—
Adjusted OIBDA	\$ 17,858	\$ 19,288	\$ 15,593	\$ 16,865	\$ 14,798	\$ 20,640	\$ 13,780	\$ 14,064
Adjusted OIBDA margin	16.2%	16.0%	14.2%	14.5%	14.6%	19.4%	13.6%	14.9%

Notes:

- (1) The results for the three month period from July 1 to September 30, 2016 represent the operations of the Predecessor for July 1 to August 30, 2016 combined with the operations of the Successor from August 31 to September 30, 2016. Please refer to the MD&A dated March 9, 2018.
- (2) In accordance with IFRS 3 Business Combinations and on completion of the reorganization, 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 three and six months ended June 30, 2017 and had a \$508 and \$3,443 impact, respectively, 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 various periods.

- (3) Represents stock and value based compensation expense in respect of the Legacy Plan adopted upon the completion of the Reorganization (please refer to the MD&A dated March 9, 2018) and the long-term value bonus plan, which has similar vesting criteria to the stock 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. The value based compensation expense of \$302 and \$603 are included in selling, general, and administration expenses for the three and six months ended June 30, 2018, and \$nil are included in selling, general, and administration expenses for both three and six months ended June 30, 2017, respectively. Neo has removed both the stock and value based compensation expense from OIBDA to provide comparability with historic periods and to treat it consistently with the Share-based plan awards that they are intended to replace.
- (4) These costs are related to legal and professional advisory fees and other transaction costs incurred 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 for the three months ended December 31, 2017 to provide comparability with historic periods.
- (5) As the weighted average number of common shares at the end of the Combined three months ended September 30, 2016 reflect different basis of accounting, earnings per share is not considered meaningful, and the calculation of basic and diluted earnings per share for this period has not been provided.

Revenue over the prior eight quarters has shown a general positive growth trend with higher revenue in the first quarter of 2018.

Neo's continuing focus on the core downstream operations that form the Neo business has resulted in operational improvements and efficiencies, and a greater strategic focus on key growth segments such as the electrification of automobiles, requirements for precision and efficient motors, hybrid and electric vehicles, increased regulations with respect to air and water emissions and light-weight and material trends in other industries such as aerospace and consumer electronics.

Adjusted OIBDA over the prior eight quarters have also shown a positive growth trend over the period with a particularly higher quarter in the first quarter of 2017. Neo continues to show strong Adjusted OIBDA growth in Magnequench (capitalizing on key trends in electrification and the need of efficient motors) and in Rare Metals (supported by higher available production capacity in Silmet and higher market prices). These are offset by the current challenges in the C&O segment primarily attributable to the temporary premium freight cost to replenish the supply chain arising out of the change in the production and environmental control system at its auto-catalyst production plant.

8. Liquidity and Capital Resources

Six months ended June 30, 2018 compared to six months ended June 30, 2017:

(\$000s)	Six Months Ended June 30,	
	2018	2017
<i>Cash flow:</i>		
Cash (used in) provided by operating activities	\$ (8,662)	\$ 9,922
Cash used in investing activities	(6,234)	(4,294)
Cash used in financing activities	(6,860)	(8,169)
<i>Financial position - as at</i>		
	June 30, 2018	December 31, 2017
Cash and cash equivalents	\$ 74,659	\$ 96,805
Property, plant and equipment	87,027	88,392
Total assets	551,312	538,493
Bank advances and other short term debt	7	181

As at June 30, 2018, Neo had cash and cash equivalents of \$74.7 million, compared to \$96.8 million as at December 31, 2017. Neo paid \$6.0 million in dividends to its shareholders and purchased \$0.7 million of its shares under the Bid program in the six months ended June 30, 2018. In addition, Neo has approximately \$27.8 million available under its credit facilities with nominal amounts 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:

Inflows

- \$36.1 million cash from operations before net change in working capital;
- \$0.2 million of interest received, net;

Outflows

- \$6.0 million of dividends paid (including dividends paid to minority interest partners);
- \$39.0 million net change in working capital;
- \$6.2 million of capital spending; and
- \$0.7 million on the repurchase of Neo's common shares;
- \$6.0 million of income taxes paid.
- \$0.2 million, repayment of short-term debts

Cash Provided by (Used in) Operating Activities

Net cash used in operating activities was \$8.7 million during the six months ended June 30, 2018, compared to net cash provided by operating activities of \$9.9 million in the corresponding period ended June 30, 2017, primarily impacted by increased cash used to support working capital.

The \$39.0 million net cash used in non-cash working capital for the six months ended June 30, 2018, was primarily attributable to increases in inventories as more raw materials were purchased at the end of the quarter, (partially in preparation for the campaign production plan as described above), increases in the general inventory levels associated with the auto-catalyst market (as the supply chain has been refilled as described above), increases in rare earth and rare metal costs (most of which is passed on to customers in future selling prices), and increases in other current assets due to insurance proceeds receivable from claims associated with the 2015 fire at the Silmet facility. 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 six months ended June 30, 2018, net cash used in investing activities was \$6.2 million, compared to \$4.3 million in the six months ended June 30, 2017; an increase of \$1.9 million. These expenditures related primarily to 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 six months ended June 30, 2018 was \$6.9 million, compared to \$8.2 million in the corresponding period in 2017. Neo distributed \$6.0 million in dividends to its shareholders and nominal dividends paid to its non-controlling interest partners, repaid a net \$0.2 million to its German bank credit line, and spent \$0.7 million on its repurchase of common shares. In the six months ended June 30, 2017, Neo repaid \$7.9 million of bank advances in China and Germany and paid a \$0.2 million dividend to its non-controlling interest partners.

(\$000s)

<i>Cash and cash equivalents by Country as at</i>	June 30, 2018	December 31, 2017
China (including Hong Kong)	\$ 41,547	\$ 54,062
Estonia	1,149	2,334
United States	2,457	3,765
Canada	2,071	2,947
Japan	2,800	3,070
United Kingdom	2,122	2,012
Germany	4,909	5,284
Singapore	9,484	8,449
Barbados	4,619	4,168
Thailand	1,427	2,178
Cayman Island	2	6,562
Other	2,072	1,974
Total cash and cash equivalents	\$ 74,659	\$ 96,805

Approximately \$6.1 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, and 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.

9. 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⁾ . . .	\$ 2,229	\$ 3,408	\$ 2,056	\$ 12	\$ 7,705
Accounts payable and other accrued charges	65,496	—	—	—	65,496
Derivative liability ⁽²⁾	—	—	—	8,604	8,604
Provisions ⁽³⁾	—	4,706	—	—	4,706
Other liabilities	3,584	986	—	—	4,570
Total	\$ 71,309	\$ 9,100	\$ 2,056	\$ 8,616	\$ 91,081

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 June 30, 2018, Neo had \$74.7 million of cash and cash equivalents and approximately \$0.9 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.

10. 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 Normal Course Issuer Bid (the "Bid") for up to 1,996,078 of its issued and outstanding common shares (the "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.

As of March 16, 2018, being the date of the notice of the Bid, there were 39,921,577 Shares issued and outstanding. The 1,996,078 Shares that may be repurchased under the Bid represent approximately 5% of the issued and outstanding Shares on March 16, 2018.

For the three and six months ended June 30, 2018, Neo repurchased and canceled 38,046 and 54,646 Shares, respectively, for a total consideration of \$0.5 million and \$0.7 million, respectively.

11. Subsequent Event

On August 9, 2018, the Board of Directors declared a quarterly dividend of Canadian dollar ("Cdn") \$0.095 per Common Share payable in cash on September 28, 2018, to common shareholders of record at the close of business on September 21, 2018.

Between July 1 and August 10, 2018, Neo repurchased and canceled 92,223 Shares for a total consideration of \$1.2 million.

12. Off-Balance Sheet Arrangements

As of June 30, 2018, Neo's only off-balance sheet arrangements are the operating leases and purchase obligations included in the contractual obligations table above.

13. Critical Accounting Estimates

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that may affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period.

Estimates and underlying assumptions are reviewed on an ongoing basis. They are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. For a discussion about the significant estimates used in determining the carrying value of inventory, deferred tax assets, useful lives of depreciable assets, provisions, impairment of tangible and intangible assets, defined benefit pension liability, fair value of financial instruments, stock-based compensation and expected credit losses, please refer to the MD&A dated March 9, 2018. Neo cautions readers that the actual results could differ materially from those estimates and assumptions.

14. 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 three and six months ended June 30, 2018, Neo purchased \$0.4 million and \$0.8 million worth of compounds from TMT, purchased metals and received services from Keli amounting to \$15.0 million and \$34.2 million, and received services from GQD amounting to \$0.2 million and \$0.5 million, respectively.

For the three and six months ended June 30, 2018, Neo sold Magnequench Powders and performed services, respectively, amounting to \$0.5 million and \$1.2 million to TMT.

For the three and six months ended June 30, 2017, Neo purchased \$0.6 million and \$0.9 million worth of compounds from TMT, purchased metals and received services from Keli amounting to \$12.8 million and \$26.3 million, and received services from GQD amounting to \$0.2 million and \$0.4 million, respectively.

For the three and six months ended June 30, 2017, Neo sold Magnequench Powders and performed services, respectively, amounting to \$0.7 million and \$1.3 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 three and six months ended June 30, 2018, these purchases were nil and \$0.7 million, respectively. There were no transactions with Beijing Jiya for the three and six months ended June 30, 2017.

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 three and six months ended June 30, 2018, purchases from Qian Dong were \$0.2 million and \$0.3 million, respectively. Sales to Toda for the three and six months ended June 30, 2018, were \$0.4 million and \$0.5 million, respectively. There were no transactions with Qian Dong and Toda for the three and six months ended June 30, 2017.

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

(\$000s)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Sale of goods and services to related parties	\$ 1,101	\$ 683	\$ 2,065	\$ 1,253
Purchase of goods and services from related parties	15,882	13,643	36,443	27,643

(\$000s)	June 30, 2018	December 31, 2017
Trade balances:		
from related parties	\$ 365	160
due to related parties	(10,907)	(12,943)
Total	\$ (10,542)	\$ (12,783)

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, post-employment benefits and stock-based compensation expenses. Total key management compensation expenses incurred are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Directors	\$ 146	128	\$ 293	\$ 355
Key Executive Management.....	1,903	2,268	3,844	5,804
Total	\$ 2,049	\$ 2,396	\$ 4,137	\$ 6,159

15. Financial Instruments and Risk Management

The following table presents financial assets and liabilities measured at fair value in the condensed 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 June 30, 2018 are grouped into the fair value hierarchy as follows:

<i>(\$000s)</i>	Level 1	Level 2	Level 3
Financial Liabilities:			
Put option issued to non-controlling interest of Buss & Buss.....	\$ —	\$ —	\$ 8,604

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 June 30, 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 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 June 30, 2018, Neo has a loss allowance of \$0.1 million. The estimated credit losses, if any, is included in selling, general and administrative expenses in the condensed 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 June 30, 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 June 30, 2018, Neo is able to meet its financial obligations as they fall due.

16. Changes in Accounting Policies

IFRS 9 - Financial instruments

Effective January 1, 2018, Neo has adopted IFRS 9 and elected to not restate comparative information for prior periods. IFRS 9 supersedes IAS 39 - Financial Instruments: Recognition and Measurement ("**IAS 39**"). 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 eliminates previous IAS 39 financial asset categories of held to maturity, available-for-sale and loans and receivable. IFRS 9 also requires a loss allowance for ECL on a financial asset that is measured at amortized cost.

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

Financial Assets	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

As a result of the adoption of IFRS 9, Neo's accounting policy for financial instruments has been updated as follows:

Financial instruments - classification and measurement

Financial assets are classified and measured based on these categories: FVPL; fair value through other comprehensive income ("**FVOCI**") or amortized cost. Financial liabilities are classified and measured based on two categories: FVPL or amortized cost.

Financial assets and liabilities classified as FVPL are measured at fair value with changes in fair value recognized in the consolidated statements of profit or loss. Financial assets designated as FVOCI are measured at fair value with changes in fair value recognized in other comprehensive income with such changes never being reclassified to profit or loss. Financial assets and liabilities classified as amortized cost are initially measured at fair value, net of any transaction costs incurred and are measured subsequently using the effective interest method.

IFRS 15 - Revenue from contracts with customers

Effective January 1, 2018, Neo has adopted IFRS 15 - Revenue from Contracts with Customers ("**IFRS 15**"). IFRS 15 supersedes IAS 18 - Revenue and related interpretations. IFRS 15 provides a five-step model to be applied to all contracts with customers, except insurance contracts, financial instruments and lease contracts, which fall in the scope of other IFRSs. In addition to the five-step model, the standard also includes expanded disclosure requirements for annual financial statements to enable users of the financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

The majority of Neo's revenue stream comes from the sale of goods. Revenue from sales contracts with customers, if any, under the scope of IFRS 15 is recognized when a customer obtains control of the promised goods and Neo satisfies its performance obligation. Revenue is allocated to each performance obligation. Neo satisfies its performance obligations for its sales contracts based upon specified contract terms which are generally upon shipment or upon delivery.

Neo adopted IFRS 15 using the modified retrospective method, with recognition of transitional adjustments, if any, in retained earnings on the date of initial application on January 1, 2018, without restatement of comparative figures. The adoption of IFRS 15 did not result in significant changes in the accounting for revenue from contracts with customers and Neo has concluded that there was no significant impact on its unaudited interim condensed consolidated financial statements for the three and six months ended June 30, 2018 as a result of applying IFRS 15.

IFRIC 22 - Foreign currency transactions and advance consideration

Effective January 1, 2018, Neo has adopted IFRIC 22 - Foreign Currency Transactions and Advance Consideration ("**IFRIC 22**"). IFRIC 22 clarifies which date should be used for translation when foreign currency transactions involve an advance payment or receipt. IFRIC 22 clarifies that the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) is the date on which an entity initially recognizes the non-monetary asset or non-monetary liability arising from the payment or receipt of the advance consideration. Neo has elected to adopt IFRIC 22 prospectively. The adoption of IFRIC 22 has had no significant impact on Neo's unaudited interim condensed consolidated financial statements for the three and six months ended June 30, 2018.

17. Recent Accounting Pronouncements

The following accounting pronouncements issued by the IASB were not effective for Neo as at June 30, 2018 and therefore have not been applied in preparing the unaudited interim condensed consolidated financial statements. Neo intends to adopt these standards, if applicable, when they become effective.

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 statements 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 is currently assessing the impact of this standard on its consolidated financial statements and expects to complete the assessment in the second half of 2018.

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, and requires an entity to determine whether tax treatments should be considered collectively or independently. In addition, IFRIC 23 addresses the assumptions an entity should make about the examination of tax treatments by taxation authorities, as well as how an entity should consider changes in facts and circumstances. IFRIC 23 also provides guidance on how to determine taxable profit (tax loss), tax bases, unused tax losses, unused tax credits, and tax rates, based on whether it is probable that a tax authority will accept an uncertain tax treatment used, or proposed to be used, by an entity in its income tax filings. This interpretation is effective for annual periods beginning on or after January 1, 2019 and is to be applied retrospectively, or on a cumulative retrospective basis. Neo is in the process of determining the impact of this interpretation on its consolidated financial statements and expects to complete the assessment in the second half of 2018.

18. 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 of Neo's disclosure controls and procedures at the end of the quarter and based on the evaluation, the CEO and CFO have concluded that the disclosure controls and procedures are effectively designed.

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 current quarter. Neo's management under the supervision of the CEO and CFO has evaluated the design 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 June 30, 2018, management assessed that Neo's ICFR were appropriately designed.

In designing such controls, management, including the CEO and CFO, recognized that due to inherent limitations, any controls, no matter how well designed and operated, 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. Therefore, even when determined to be designed effectively, disclosure controls and internal control over financial reporting can provide only reasonable assurance with respect to disclosure, reporting and financial statement preparation.

19. Business Risks and Uncertainties

Neo's risk factors are substantially unchanged from and should be read in conjunction with Neo's MD&A dated March 9, 2018.

20. Outstanding Shares Data

Class of Equity Security	Numbers Outstanding
Common Shares	39,866,931
Stock Options*	1,098,708
Restricted Share Units, Performance Stock Units, & Special Performance Stock Units	1,375,285

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

The number of Common Shares outstanding as at August 10, 2018 is 39,774,708.

21. Additional Information

Additional information is included in Neo's Annual Information Form ("AIF") available on Neo's website at www.neomaterials.com and on SEDAR at www.sedar.com.