CHEMTRADE LOGISTICS INCOME FUND

Q2 2021 Results Conference Call

Rohit Bhardwaj

Good morning, everyone and thank you for joining us today. We also have Scott Rook, our CEO with us on the call this morning and similar to the last few earnings calls we are in different locations.

To start, we have a change to the structure of the call that I would like to highlight. There will be a slide presentation to accompany our earnings results discussion today. You should be able to view the presentation on the webcast link provided and the slides are also available for download on our website.

To begin, I will review the Q2 2021 results after which I will provide an update to our 2021 full year earnings guidance and assumptions and key sensitivities after which Scott will follow with some remarks on the current state and outlook for the business. Following that we will have a Q&A session.

Before I start on the Q2 results, I would like to remind you that our presentation contains certain forward-looking statements that are based on current expectations and are subject to a number of uncertainties and risks, and actual results may differ materially. Further information identifying risks, uncertainties and assumptions, and additional information on certain non-IFRS measures referred to in this call can be found in the disclosure documents filed by Chemtrade with the securities regulatory authorities, available at sedar.com.

One of the non-IFRS measures that we will refer to in this call is Adjusted EBITDA, which is EBITDA modified to exclude only non-cash items such as unrealized foreign exchange gains and losses. For simplicity, we will just refer to it as EBITDA as opposed to Adjusted EBITDA. Both of these terms are fully defined in our MD&A.

Results

Starting with the aggregate results for the second quarter of 2021, revenue was $337.3 million, a decrease of $10.3 million from 2020. The stronger Canadian dollar relative to the US Dollar had a negative impact on reported revenues of $29.4 million. The Canadian dollar relative to the U.S. dollar was significantly stronger during the second quarter at US$1.00 equaling Canadian$1.23 compared with the same period of 2020 when US$1.00 equaled Canadian $1.39. This had a negative impact on the financial results in all of our operating segments during the second quarter. In addition, lower selling prices for sodium chlorate and caustic soda in the Electrochemicals ("EC") segment resulted in lower revenues for the period but this was partially offset by higher sales volumes of all chlor-alkali products in the EC segment and higher sales volumes of Regen Acid in the SPPC segment.

Consolidated EBITDA of $65.2 million was $10.4 million lower than Q2 2020, with the stronger Canadian dollar responsible for $7.5 million of the decrease. Distributable Cash of $21.2 million was $10.5 million lower than the same period in 2020, with the stronger Canadian dollar representing $4.3 million of the decrease.

As a reminder, every one cent of increase in the Canadian dollar per U.S. dollar is expected to reduce annual EBITDA by roughly $1.8 million and Distributable Cash by $1.0 million and vice-versa.

Shifting now to the individual segment results for the quarter, Sulphur Products and Performance Chemicals, or "SPPC" generated revenue of $105.2 million during the second quarter of 2021, which was higher than the $104.0 million generated during the same quarter of 2020, despite $10.2 million of headwinds attributable to the stronger Canadian dollar. The increase in revenue is attributed to higher sales volume of Regen due to refineries running at higher rates and higher selling prices for Regen and Merchant acid. We were pleased to see a rebound in Regen acid demand as COVID restrictions were lifted in North America and the miles driven have started to get back to pre-pandemic levels. In addition, we have been able to capture higher pricing in Regen and Merchant acid driven by the higher sulphur index numbers and strong demand. That was partially offset by lower sales volumes of ultrapure acid resulting from the previously disclosed, large end-use customer that decided to obtain acid from an alternate source.

EBITDA for the period was $30.3 million, which was $1.1 million lower than 2020. The stronger Canadian dollar negatively affected EBITDA by $3.3 million. Better results in Regen acid more than offset the foreign exchange impact and lower ultrapure sulphuric acid results.

Also of note, during the quarter SPPC's largest by-product sulphuric acid supplier, Vale, experienced a work stoppage that started on June 1, 2021. They recently announced their plans to restart their operations in the first week of August 2021. This event did not have a significant impact on results for the second quarter, but it will have a more significant impact on third quarter results.

Our Water Solutions and Specialty Chemicals or “WSSC” segment reported second quarter revenue of $108.6 million compared with $113.5 million in 2020. The decrease in revenue is attributed to the stronger Canadian dollar which had a negative impact of $10.7 million. That was partially offset by higher selling prices and volumes for water solutions products.

EBITDA for the period was $23.3 million, which was $3.7 million lower than the same period in 2020. Higher raw material costs for water solutions products, in addition to the stronger Canadian dollar, offset the higher pricing and volumes that we were able to achieve during the quarter. As a reminder the water solutions business is generally a contract business that typically requires 1-year commitments on pricing. As a result, our ability to recoup raw material cost increases typically lags as we renew our contracts when they come due. This represents a headwind when raw materials are rising, and a tailwind when raw materials are declining.

The EC segment reported second quarter revenue of $123.5 million compared to $130.1 million in 2020. The lower revenue was primarily due to the impact of the stronger Canadian dollar which had a negative impact on revenue of $8.5 million. Lower sales volume and selling prices for sodium chlorate and lower caustic soda pricing was more than offset by a 38% increase in hydrochloric acid or HCl sales volumes and a 26% increase in sales volumes of Chlorine.

EBITDA for the period was $23.8 million compared to $34.7 million in 2020, a decrease of $10.9 million, with $4.2 million of the decrease attributable to the strong Canadian dollar. Lower sales volumes and prices for sodium chlorate and lower selling prices for caustic soda were the other reasons for the reduced EBITDA.

Corporate costs for the period were $12.6 million compared to $18.0 million in the same period in 2020. Excluding unrealized foreign exchange gains, corporate costs were $5.4 million lower than the same period of 2020. The decrease in corporate costs was primarily due to a realized foreign exchange gain of $4.1 million during the second quarter of 2021 compared with a loss of $2.1 million during the same period of 2020. In addition, the company benefited from a $1.0 million government grant recognized in relation to pandemic relief programs during the second quarter of 2021. This was partially offset by $2.9 million in higher long term incentive plan (LTIP) costs during the period compared with 2020.

Turning to our balance sheet, we maintain Senior Credit Facilities that consist of a US$325 million term loan and a US$525 million revolving credit line which in total represents an aggregate credit facility of US$850 million. We continue to maintain ample liquidity with US $246 million undrawn on our Credit Facility.

As of June 30, 2021, Chemtrade was compliant with all debt covenants contained in its credit agreement with a Senior Debt-to-EBITDA Ratio of approximately 3.8. Chemtrade has no debt maturities until August 2023. As a reminder, our decision to borrow mainly in U.S. dollars provides a long-term hedge against currency fluctuation.

Guidance

I will now shift to our financial outlook. We have decided to reinstate our guidance for 2021 as we now have more certainty in the key drivers for our business.

For the full year 2021 we expect:

- EBITDA to be in a range of $245-$260 million.
- Maintenance CAPEX to be in a range of $72 - $77 million.
- Lease expense is expected to be $50-$55 million
- Cash interest is expected to be between $65 - $70 million
- Cash Taxes are forecasted to be $4-$8 million

There are a few significant factors to be considered when comparing 2021’s EBITDA range and actual EBITDA achieved in 2020

a) Stronger Canadian dollar relative to the US dollar. During 2020, the average exchange rate was US$ 1= C$1.34, whereas, we are assuming an average exchange rate of US$1= C$ 1.23 during 2021. This has a negative impact on 2021’s EBITDA of approximately $20.0 million.

b) The first quarter of 2020 was unaffected by the COVID-19 pandemic and EBITDA for the first quarter of 2021 was $25.5 million below the first quarter of 2020.

c) As partial offsets to the above two points, 2020 had the biennial turnaround at our North Vancouver facility as well as a major customer turnaround which affected one of Chemtrade’s large regen plants.

The Key assumptions driving that outlook are in our M,D&A and shown on the slide:
I will not read these out for you but will remind you that our caustic soda price generally lags the North East Asia spot index by a quarter.

The Key Sensitivities that will have an annual impact our EBITDA and shown on the slide: again, I will not read these out.

I'll now hand the call over to Scott for some comments on the longer-term outlook for Chemtrade's business.

Scott?

Scott Rook

Thank you, Rohit.

Good morning everyone and thank you for joining us on today's call. I hope you are all doing well.

As you would have noticed, effective this quarter we have decided to include a power point presentation to accompany this call. This has also been posted to our website. We believe that you will fill find this additional disclosure helpful. Even though the effects of the pandemic linger on and there is volatility, we decided to reintroduce earnings guidance.

Turning now to our Outlook,

As Rohit just reviewed our 2021 forecast, I will now spend some time reviewing our Longer-Term outlook and strategy. But before I do that, I would like to mention one item that will have an impact on third quarter results. As most of you probably know, Vale's Sudbury operation experienced a work stoppage from June 1st to last week. Thankfully, the strike is over and although it only lasted roughly two months, there will be additional costs incurred during the third quarter, as given the uncertainty regarding the duration of the strike, we had to make alternate sourcing decisions. Since, even before the strike, the sulphuric acid was market was in tight supply, the alternate supply was difficult to obtain and was very expensive. The situation is still quite fluid, but we estimate that this could have a negative impact of between $5 million and $10 million in 2021.

Now moving to our long-term outlook, as I've highlighted before, our strategy is to deliver sustained earnings growth which will result in an improved balance sheet and reward investors. Additionally, Chemtrade will focus on being a leading example for Corporate Environmental, Social and Governance Responsibility. This is ingrained in our culture and we will continue to strive towards making a positive impact for our employees, customers, shareholders, and the society we operate in.

There are three key components to our strategy. The first component is being positioned to benefit from a market recovery as the COVID-19 vaccine gets rolled out and the economy returns to more normal levels. The second, we are diligently pursing organic growth opportunities that will deliver increased size, scale, and diversity of earnings. In the near term we are focused on organic growth opportunities that we find attractive and in several years as our balance sheet strengthens, we may consider acquisitions again. And finally, a key area of focus is on our operational excellence. We are passionate about improving our productivity, assets, and people to drive sustainable earnings. We see our business and our balance sheet improving with time.

As mentioned, our EBITDA is sensitive to the US-Canadian exchange rate, although the impact is reduced at the Distributable Cash level.

Shifting now to our focus on Market Recovery from a post COVID-19 economy,

Starting with the EC business which includes our chlor-alkali product line, as a reminder, this business has been dramatically impacted over the past two years from the near record low caustic soda prices combined with low fracking activity in North America. In the second quarter, we continued to see signs of improvement particularly in the caustic soda market and we believe the "trough" is behind us. Demand for caustic soda in end use applications for aluminum and lithium-ion battery production continue to look strong with increased spending on infrastructure, housing and growing consumer demand for electric vehicles and other battery powered devices. Taiwan Caustic contract pricing, which historically has been a leading indicator for North East Asian spot pricing, has continued to move higher and market analysts are bullish on the mid to long-term. As a reminder for every US$50/Ton increase in caustic pricing the business generates about US$10.5 million in margin. For perspective, even if the current NE Asia spot price for caustic, US$ 350/Ton, stayed flat through 2022, it would mean a roughly $20 million improvement over 2021.

HCL demand and pricing should continue to improve as well with oil prices recovering and fracking activity picking up. This is particularly true for Western Canada were our chlor-alkali production is based. Chlorine demand and pricing has also benefited from strong demand for PVC and bleach products combined with the capacity in the US that was rationalized. We expect pricing to continue to remain strong driven by demand.

We also expect some modest improvement in demand for sodium chlorate as offices and schools reopen and demand for printing paper recovers.

In the SPPC Business,

Regen sulphuric acid will continue to depend on higher North American refinery utilization and industrial activity. In the second quarter, we had a strong rebound in demand from Refineries as the COVID restrictions in North America were lifted. Also in the second quarter, U.S. highway traffic data climbed above pre-pandemic levels for the first time since the start of the pandemic. We expect this to continue as COVID-19 vaccinations are increasingly administered across the world and borders fully reopen. We expect that driving miles in 2022 should be back to 2019 levels.

Next, I'll discuss a few areas where we have significant potential for growth,

We see a significant opportunity for our Ultrapure sulphuric acid that mainly supplies the semiconductor industry. The long-term fundamentals for the semiconductor industry are strong with leading global semiconductor manufacturers such as TSMC, Samsung and Intel recently announcing U.S. expansion plans. In addition, the U.S. administration recently committed $50B to support domestic chip manufacturing capacity. We think there are very strong fundamentals for this business with current U.S. demand for Ultrapure sulphuric acid exceeding domestic capacity. Although there are short-term headwinds with this business due to the loss of a key customer, we have already made good strides towards replacing that lost business and we expect to return to 2020 sales levels during 2022. Going forward, we intend to add capacity and meet the growing needs of our key customers.

The Water Solutions business continues to be an appealing segment for us with some long-term organic growth opportunities, driven by tighter government regulations that are creating a need for more specialized products. As Rohit mentioned, in the short-term margins have been squeezed with higher raw material costs and the timing on how quickly we can pass those costs through to the end customer. But margins are recovering as we renew and update contract customers. So, we continue to remain focused on organic growth opportunities for new specialized water treatment coagulants and will look to expand our existing PAC/ACH production in regions where that makes sense. And in the future as we improve our balance sheet, we could also consider smaller acquisitions in this space.

The third area of growth is tied to our co-production of hydrogen that is part of the sodium chlorate process and to a lesser extent chlor-alkali. We are pursuing several opportunities in the hydrogen market that will allow us to fully monetize those hydrogen streams. Our plants manufacturing sites use hydroelectric power, so we are generating green Hydrogen which is important from an ESG perspective and financial return. In Q1 we announced a deal for our small chlorate plants in Prince George that requires no capital investment from Chemtrade and will start to have significant returns starting in five years. The big opportunity for Hydrogen is at our Brandon, Manitoba facility and that is about five times the size of the Prince George facility.

I will now spend a few minutes talking about the Operational Excellence initiatives we have been working on.

In 2020, we launched a Productivity and Reliability initiative that is focused on achieving $10 million in savings each year. These initiatives are critical to generating sustainable earnings and will help offset inflationary cost increases going forward. To support these projects, we have been assigning Black Belt and Green Belt leaders and we have also been training our staff in these proven six sigma methodologies. Our goal is to create a culture of continuous improvement that leverages the best practices and technology to drive improved performance.

I would now like to discuss our ESG Approach and how we will be implementing systems company wide to help us track our performance.

Targets will be set and integrated into our long-term strategic planning which will include:

- Environmental – Green house gas, waste and energy management
- Social – workforce and operational safety, emergency preparedness and employee diversity and inclusion
- Governance – Focus on ethical and doing the right thing, management of our legal and regulatory environment and proactively governing our environmental and social issues

Some of the recent ESG highlights include:
Our focus on renewable energy, where 96% of the electricity used at our 17 largest facilities was generated from renewable hydroelectric sources in 2020. We talked about the financial benefit of the sale of hydrogen to Hydra Energy which will generate over $5 million in margin annually by 2028 but that will also reduce carbon dioxide equivalent (CO_2e) emissions by 10% of our total CO_2 emissions (equivalent to the emissions from North Vancouver, our largest Canadian site). From a waste generation, over 75% of our industrial waste is high clay alumina (HCA). In 2020, we repurposed 27% and reduced landfill costs. We are pursuing projects to repurpose an additional 30%. And most importantly, on Safety in 2020, employee injury frequency (excluding COVID-19) was at a seven-year low. This has created a culture where Employee retention rate in 2020 was 86.6%.

In summary,
Our earnings growth will be driven by being well positioned to benefit from the COVID-19 recovery. Commercially, we will continue to pursue organic growth opportunities in ultrapure acid, water, and hydrogen. Operationally we will continue to focus on improved productivity and reliability. Additionally, we will be a leading example for Corporate ESG Responsibility. We think these initiatives will be critical as we continue to strive to be a great chemical company.

Thank you.
Rohit and I will now be happy to take any questions.

Question and Answer Session

Operator: Your first question is from Jacob Bout of CIBC.

Jacob Bout, CIBC

I wanted to start with the sodium chlorate and the decline of volumes that you've seen so far this year. Maybe talk a bit about, you know, how you're thinking about that. How much is structural versus pandemic-related?

Scott Rook, President & Chief Executive Officer

Alright. Well, so, there are two parts to it. Let's start with the pandemic part. We have seen, in North America, there has been approximately a 50% reduction in office paper production since COVID-19 has started. So, that's the white paper. It's bleached paper, which uses chlorate. We do believe that as schools and offices reopen, we expect office paper to pick up. We do not expect it to pick up to the pre-pandemic levels, but we are forecasting that we will see a pick-up from that.

That being said, there are some structural changes happening in this market. We have a number of our customers that have closed, that they've shut down their production lines for bleached paper. Those lines that have been shut down can reopen, but it's hard to say right now. We do expect a pick-up in volume, but we don't expect it to pick back up to pre-pandemic levels.

Jacob Bout, CIBC

So, on a normalized basis, what would you think the decline in structure volumes, you know, is going to be on a go-froward basis?

Scott Rook, President & Chief Executive Officer

So, I think that where we were, we saw a 10% drop in our chlorate demand. And I'll hope for a pick-up of half of that is going to come back.

Jacob Bout, CIBC

Okay. And then, moving to the WSSC business, sounds like the biggest driver of lower margins was OPEX. With the new contracts being negotiated, are you able to tie the selling price to the Canadian dollar, or are you thinking about changes in how you're hedging your OPEX?

Rohit Bhardwaj, Chief Financial Officer

So, let me take a look at that. So, are you asking about the water business?

Jacob Bout, **CIBC**

Yeah, on the water

Rohit Bhardwaj, Chief Financial Officer

So, our water business, the Canadian dollar is not relevant to our water business because we don't really export water. It's produced close to customers, where US customers get, you know, products from our US plants, and Canadian customers get products from the Canadian plants.

So, the big headwind there had been raw material increases. And so, we cannot tie our contracts, most of our contracts are municipal, so you have to give a fixed price. But what happens is, when they come up for renewal, which is all the time, we are able to pass through the raw material costs generally without an issue.

And typically, if you look at historically, whenever raw materials have been rising and as these contracts roll over, we actually expand margins, because on the other side of it, when raw materials start to stabilize then start to decline, prices take a longer time coming down. So, in that business, the exchange is not as big of a factor.

Jacob Bout, **CIBC**

Okay. And then, what do the contact renewals look like for the next 12 to 18 months?

Rohit Bhardwaj, Chief Financial Officer

It's normal. So, we don't have any peak contacting seasons they're spread out. This business is very dispersed. So, there's basically hundreds of contracts that come up every week, basically. So, for all intents and purposes, it's evenly spread.

Jacob Bout, **CIBC**

So, renewals, what, kind of a three-year process, or would it be less than that?

Rohit Bhardwaj, Chief Financial Officer

Not less, typically, they're annual contracts, so it takes about six months on average. They're annual contracts.

Jacob Bout, **CIBC**

Okay, helpful. Thank you.

Operator: Your next question is from Joel Jackson of BMO Capital Markets.

Joel Jackson, BMO Capital Markets

I had a few questions. I'm going to ask them one by one. So, typically Q3 earnings are higher for you in the fourth quarter for both the company and I follow the segment for some of the reasons you've stated. It looks like the reverse would be true for both the company and for probably Electrochem and SPPC. Can you please elaborate on that?

Scott Rook, President & Chief Executive Officer

So, let me start out, Joel, with that and then I'll have Rohit. So, yes, we do see that is going to be the case with Electrochem. I think as you know, caustic soda for us is priced roughly on the average of the prior quarter's caustic soda price, and so as we are seeing caustic soda continue to move up. And, so what we shared, the comment that I made earlier a few minutes ago was that even if caustic soda stayed flat with where it is right now for us next year, that's a $20 million gain just on this--as you look at the--again, the prior caustic price in the quarter. So, I think that's the most significant change.

Rohit Bhardwaj, Chief Financial Officer

Sorry Joel, I just wanted to make sure I understood your question. Were you saying that you're thinking that the back half of '21 is going to be weaker than the first half of '21?

Joel Jackson, BMO Capital Markets

No. No, no, I'm talking about the Q3/Q4 mix in the second half of '21. So, typically, Q3 you earn more money, more EBITDA in the Q3 than the Q4. But, this year, it looks like you're going to earn more in Q4 than Q3. Is that correct?

Rohit Bhardwaj, Chief Financial Officer

So, we didn't give you the quarterly split, so I just want to understand is that an assumption you're making or you're inferring that from something that we may have told you?

Joel Jackson, BMO Capital Markets

I'm asking you the question.

Rohit Bhardwaj, Chief Financial Officer

You're asking the question. Okay

Joel Jackson, BMO Capital Markets

I'm looking at lag caustic prices. I'm looking at the Vale issue in Q3 and some other factors.

Rohit Bhardwaj, Chief Financial Officer

Yeah, so I will just say that, you know, the Vale is definitely unique to Q3 and the caustic lag is correct. So, yeah, so on that basis, you can make that assumption. I just wanted to make sure you're getting the right facts and you're asking the question okay.

Joel Jackson, BMO Capital Markets

Okay, I appreciate the color on this caustic holds flat here you get $20 million more margin in 2022. Can we expand on that a little bit? If chlorine and hydrochloric acid prices hold flat, what will be the impact on 2022? And, then what would be the offset from the biannual turnaround at North Van?

Rohit Bhardwaj, Chief Financial Officer

So, the turnaround, you know, we've in the past said it's 5 to $7 million. It also depends on, in fact, you know, when caustic prices are higher, the margin impact is a little bit higher because we use production at a higher margin.

But, anyway, in that ballpark and I think with HCL and chlorine, you know, there is some impact but, we're already experiencing a bunch of that this year, so after you compare '22 to '21, there might be a slight lift, but not as much because you're already getting a good pricing there as opposed to caustic, which has a trajectory that is just starting to ramp up, and so that's going to impact in '22 more than on '21.

Joel Jackson, BMO Capital Markets

Okay, and finally, you know, you talked about normalized earnings for the business, the 300 or $350 million. How many years under that range, it's been now a couple? How many years under that range would it take you to start considering that you may have to reset and lower the distribution?

Scott Rook, President & Chief Executive Officer

So Joel, we don't have any plans to adjust the distribution as it is right now, and I will remind you that the exchange rate has a more pronounced impact on earnings than it does on cash.

And so even though our earnings are impacted by the strong Canadian dollar, at the cash level, it's half of that because our debt is based in U.S. dollars. So, the stronger the Canadian dollar in effect, our debt is going down.

We don't have any plans to change the distribution. We think we're going to be fine. Our organic growth projects are on track and so as the market recovers and we see that, the market recovery happening in regen, we see the market recovery happening in caustic soda, we're still looking for more recovery in chlorate. But, for the most part, I think the market recovery is on track for what we're looking for. And, organic growth is going to be kicking in, and so we think we'll be fine.

Rohit Bhardwaj, Chief Financial Officer

And I wanted to add just one thing to that, Joel, just to again set the stage there. So, when we released our guidance in 2020 of 300 to 350, actually our distribution was $1.20. When the COVID pandemic hit a couple months later is when we pulled our guidance and that's when we cut our distribution.

So, in the context of the 300/350, we actually were comfortable with the previous distribution rate. So, I don't--you know, so I don't think we have to--so, at the half rate I don't think there's a concern, you know, if we're below the $300 million.

Joel Jackson, BMO Capital Markets

Thank you very much.

Rohit Bhardwaj, Chief Financial Officer

You're welcome.

Operator

Your next question is from David Newman of Desjardins.

David Newman, Desjardins

So, just following on Joel's question on just looking at caustic and hydrochloric acid and chlorine, if you're going into the second half here and your guidance already looks like the caustic soda price is above your guidance for the full year. So, as you look into the second half versus the first half, any sense on what caustic could deliver in the second half and chlorine and hydrochloric acid in the second half versus the first half?

Rohit Bhardwaj, Chief Financial Officer

So, I think, David, the third quarter caustic was already established, you know, in our guidance. So, the Q3 is locked. You're right that Q4, if you do the math on our assumption, you will see that we are assuming that the index for Q2 and Q3, because that's the back half of '21, is $315 index level. So, today you know we are above that. If today's price hangs in there, you know, until the end of the third quarter, we get the lift in Q4. So, the Q4 lift, you know, could be about a $50 ton per ton higher, which we've quantified for you as a sensitivity being in that $10 million, 10 and a half million dollars annual.

So, that could be a couple million dollars in Q4. But, again, we have to see how it hangs in there and whatever puts and takes are there. But, in terms of chlorine and HCL, you know, we have been seeing those increases already and we've been factoring them into our guidance.

David Newman, Desjardins

Okay, and also, too, that's a U.S. dollar index and the Canadian dollar is starting to recover here a little bit, thank God. I mean, the other way around. So, what's the impact here in terms of, you said the sensitivity is 1 cent is equal to--again, sorry?

Rohit Bhardwaj, Chief Financial Officer

It's 1.7 on EBITDA and about .7 on distributable cash.

David Newman, Desjardins

Okay, but that's an EBITDA impact. How does it play into the actual realized pricing that you get in Vancouver and the Northwest part of the country?

Rohit Bhardwaj, Chief Financial Officer

Yeah, so you're right, it's a U.S. dollar index, so FX does play a role. So, you do have to apply, you know, what the current rates are. So, if you look at our assumption that we made, so our assumption is that the second half, we've assumed an exchange rate of $1.22. So, you can, you know, see how the dollars evolving and what impact that might have. So, I mean, I'd like to leave it at that because we've spelled out the assumption for you, what our second half assumption is on the exchange.

David Newman, Desjardins

Okay, and just again, the market itself, the whole molecule is doing well and, you know, there's a lot of a balancing act here that goes on between chlorine, hydrochloric acid, and--well, those two. And, so I mean, what are you burning right now and what are the dynamics of the market in chlorine versus hydrochloric acid?

Scott Rook, President & Chief Executive Officer

Yeah, so I'll take that. So, in the past, our strong preference would have been to sell hydrochloric acid into the fracking community as close to our North Vancouver site as we could have. Those dynamics are beginning to change, although that is still for us our best option to move chlorine. But the gap is beginning to close. The industry are seeing higher prices in chlorine and also higher prices in hydrochloric, and we've also seen a pickup in demand as well. So, the market--and as you say, the molecule--is doing well, both from a market demand standpoint and pricing.

David Newman, Desjardins

Okay, very good. And last question from me, guys, is, you know, you talked about Regen and obviously that during the whole pandemic, driving activity dropped like a stone and it is recovering. But I'm not sure we're full throttle just yet and certainly not full throttle in 2Q to begin 2Q and to end 2Q and into 3Q. And you look out into the fall and this hybrid model that we're all going to be living in, I'm not sure what your view is on that. But what do you think in your customers in terms of utilization levels and how did they begin the quarter and how did they end the quarter? And, how meaningful could that be in the second half visa vi the first half?

Scott Rook, President & Chief Executive Officer

So, I'll take that. In this year, our Q1 with regen was relatively light and that was primarily due to the stay-at-home orders in California and out on the West Coast, and then that was combined or coupled with the cold weather impact that we had in Texas and the Gulf Coast. So, Q1 started out pretty slow.

In Q2, our customers ran pretty hard for the most part across North America. They were coming out of it and they ran hard. And so, from the beginning of the quarter to the second part of the quarter, I would say that demand was ramping up.

And we see in Q3 that it's going to be pretty strong. There's always a seasonal drop-off in Q4. But, as we look into next year, we see a much stronger Q1 next year than what we've had versus last, versus this year.

David Newman, Desjardins

Very good.

Rohit Bhardwaj, Chief Financial Officer

And, David, they just published the refined utilization rates yesterday and it's right on the five-year average mark right now. So, you know, at least in the Q3, were right at that average.

David Newman, Desjardins

That makes sense. Excellent. Thanks, guys.

Operator

Your next question is from Steve Hansen of Raymond James.

Steve Hansen, Raymond James

Yeah, hey, guys. Just a couple for me. Just first on the water treatment margins, Rohit, you described sort of the six-month sort of average roll on the contracts or the time that it takes to roll the contracts. Where are we on that process relative to the raw material move? A lot of raw material started moving early this year, of course. I mean, should we start to expect that recovery into the back half here or should we expect another quarter or two of pressure?

Rohit Bhardwaj, Chief Financial Officer

I'd say probably a quarter or two. Especially when you're comparing against last year, again, you know, when we were actually hitting the high margins. So, yeah, on a comparative basis, it will take, you know, a couple of quarters more to start getting back.

Steve Hansen, Raymond James

And, also, if we wanted to think sequentially when we could start to feel its at the bottom, should we think about it that way

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Rohit Bhardwaj, Chief Financial Officer

Yes, but I always caution that there's some seasonality in the alum business, but, you know, sequentially you can look at that, yeah.

Steve Hansen, Raymond James

Okay. That's helpful. Thanks. And, then just again, not to harp on the FX issue, but just to make sure I understand it, the 1.8 that you cited as it grows per penny, that's on a corporate wide basis, right? It's not on an individual segment basis, correct?

Rohit Bhardwaj, Chief Financial Officer

Yeah, that's the corporate basis and as we said, half of that drops to the distributable cash level.

Steve Hansen, Raymond James

Understood. Okay, helpful. And, then just lastly, if I may, is just around, you know, this discussion over Vale, is there reason the range is still so wide at this point, the strike is over. So, I'm just trying to get a sense for is 5 more realistic or is 10 more realistic?

Scott Rook, President & Chief Executive Officer

I don't think I'll comment on is 5 more realistic or 10. I think we'll stick with the range. But what I will say is that as we were planning what to do with our operations to deal with the strike, we had to go ahead, as we said and lock up supply and to secure as much acid as we could to supply our contract customers. So, we have done that and we have signed agreements to secure acid and deliver that to our customers. And so, we are kind of locked in on that, so we are going to have an impact in Q3 because of that, even though the strike is over.

Rohit Bhardwaj, Chief Financial Officer

And I think the reason for the range, Steve, is because, you know, there's some details still being worked through and there could be some ups and downs there. So, that's why even though the strike is over, it's important that we keep that range because there are things that could get us below the midpoint and things that could get us above the midpoint.

Steve Hansen, Raymond James

Okay, no that's fair. I just wanted to ask. And, just lastly, maybe just to focus on the balance on that business, just do you want to maybe comment on the conditions up there in the merchant business today, excluding the Vale issue, of course? But it sounds like pricing is better and demand is better, but I mean, how should we think about the evolution versus the back half?

Scott Rook, President & Chief Executive Officer

Yeah, so, demand in that segment is pretty strong. So, sulphuric acid is going into fertilizer, it goes into metal production. It tends to follow general GDP and so demand is strong. And pricing has certainly moved up in that segment. Now, pricing in the merchant acid market changes very frequently. It certainly changes almost weekly. And so, Sulphur prices have gone up rapidly and this business has certainly covered those price increases, or the increases on raw materials.

Steve Hansen, Raymond James

Okay, fair enough. That's it for me, guys. Thanks.

Operator

Your next question is from Ben Isaacson of Scotia Bank.

Ben Isaacson, Scotia Bank

Thank you very much. Scott, when investors are looking at Chemtrade and they see you put up $265 million of EBITDA in 2020 and I think the midpoint is roughly 265 for this year and you've talked in the past about 3 to 350 as the kind of mid-cycle run rate EBITDA generation, can you describe what is in your control right now in terms of bridging your forecast of 265 roughly to that 3-350 versus how much is just waiting for prices to improve or kind of hoping for market recoveries? And, then within that context, can you break that up within each of the segments? How much are you expecting to control or what can you actually do to move things forward towards those mid-cycle levels? Thank you.

Scott Rook, President & Chief Executive Officer

Sure. So, let me first start out with a bridge. And, so you take out our range that we said 245 to 260 and if you compare the comments that we have made in the past about the 300 to 350 going forward longer term, I think the first thing that you do with that number is you look at the impact of FX, which is somewhat of a more recent event. And that is certainly in the range of $20 million and a month or so ago, we might have said that it would have been greater than $20 million.

The next thing I think that we look at is the impact of the Vale strike, which is 5 to 10, and so I think that probably is a very significant bridge to get there. And, then also the next part of it is the single largest factor that has negatively impacted Chemtrade earnings over the past two years has been the fall of caustic soda pricing and the drop in HCL demand tied to fracking. So, that's been the single largest impact to this business.

And we believe that caustic soda has troughed, and prices are clearly moving up. And, as I've said, if caustic soda just stays flat with where it is right now, that's a $20 million pickup. We've already seen pricing tick up, move up in hydrochloric and chlorine. Perhaps there's still higher room to go in that, and so that can add on to that $20 million as well.

So, I think for us, the way that we're looking forward is that Regen is going to continue to be strong. I mentioned that we had a weak first quarter because of the stay-at-home orders and the storm, the cold weather storm. So, looking ahead, I think our Regen business is going to follow North American refining, which I think is going to be strong.

And, then next, the ultra-pure business has been recovering nicely. At the beginning of this year, I said that it might take 18 to 24 months for our ultra-pure business to recover and now, we see ultra-pure business being back at the 20 levels by the beginning of next year. And, so I think next year, ultra-pure will be back and as we look forward, ultra-pure is a very large growth opportunity for us.

We've obviously seen a negative impact to the business in the sodium chlorine. I mentioned the 50 percent reduction in office paper, and we do expect that to come back. But I don't think office paper is going to come back fully. So, I think that is going to work against us.

So, that's kind of the bridge, I think, from how you get from our guidance to what we have said in the past.

Ben Isaacson, Scotia Bank

So, that's great, Scott. So, just to wrap up, I've got a question then. If we take your midpoint at your 245 to 260, so we'll call it roughly 255 or so, and we add back the 20 for FX, let's call it 5 for Vale and 20 for caustic, that brings us back to around 300. So, is it fair to say that you expect us to exit '21 at around a $300 million run rate? Is that fair?

Scott Rook, President & Chief Executive Officer

Well look, I don't think we can, in that exercise, dismiss the impact of FX. You know, if you want to do that, we would love that, but look, the FX impacts are real on us. Now, we have obviously a significant business that's in the U.S. and we generate those returns in the U.S. and then as we release them and account for them, we account for them in Canadian dollars. So, the impact is real, but again, what we said before is that our debt is primarily based in U.S. dollars and so there's the benefit of the debt reducing with this dollar.

Ben Isaacson, Scotia Bank

Perfect, thank you very much.

Operator

Your next question is from Endri Leno of National Bank.

Endri Leno, National Bank

Hi, good morning. Thanks for taking my questions. Most of them have been answered already, but one I was wondering if you can talk a little bit about Scott, is that you plan to increase capacity in ultra-pure acid. I was wondering if you can provide any color in terms of the timing that you're thinking, even in broad strokes, and what kind of CAPEX might that require?

Scott Rook, President & Chief Executive Officer

So, we will plan on adding capacity here over the next couple of years. So, I'm not prepared to make specific comments on that or capex, but we'll just say that the market in North America, has significant growth and we are actively looking and working through our options on how we can participate in this market space.

Endri Leno, National Bank

Okay, great and one follow up there. So, assuming you'll increase in capacity and you reach 2019 levels in early '22, would you be operating at capacity in ultra-pure or would you still have some spare room to increase if need be?

Scott Rook, President & Chief Executive Officer

I'll say we'll be close to our capacity.

Endri Leno, National Bank

Okay, great. Thank you. That's it for me.

Operator: Your final question is from Steve Hansen of Raymond James.

Steve Hansen, Raymond James

Yeah, just a follow up on the ultra-pure question. Can you just remind us the size of that business in revenue or EBITDA terms at that 2020 level? And, then perhaps just remind us of the hit that you've taken. I don't know if you actually quantified it. I'm just trying to understand the bridge between last--the 2020 year and then going back to 2022.

Rohit Bhardwaj, Chief Financial Officer

So sure. So, what we have said in the past is that--and this is now at 2020 levels, not for this year--is that the three types of acid account for about 80 percent of SPPC EBITDA and Regen is about half and Merchant was a quarter and ultra-pure was a quarter on EBITDA, so that gets you to EBITDA.

We didn't quantify the hit we took, but it was a very significant customer, you know, and this is a high margin business. So, I don't think we want to go further into the possibility of that one account, but, you know, you can kind of do some math based on what I've told you.

Steve Hansen, Raymond James

That's helpful. That's all I needed. Thanks, appreciate it.

Operator

There are no other questions in queue. Do you have any closing remarks?

Scott Rook, President & Chief Executive Officer

No, thank you. We're good.

Rohit Bhardwaj, Chief Financial Officer

Yeah, thanks, everybody.

Operator

Ladies and gentlemen, this concludes today’s conference call. Thank you for your participation. You may now disconnect

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(1) Non–IFRS Measures

EBITDA and Adjusted EBITDA –

Management defines EBITDA as net earnings before any deduction for net finance costs, income taxes, depreciation and amortization. Adjusted EBITDA also excludes other non-cash charges such as impairment, change in environmental liability, net gains and losses on the disposal and write-down of property, plant and equipment, and unrealized foreign exchange gains and losses. EBITDA and Adjusted EBITDA are metrics used by many investors and analysts to compare organizations on the basis of ability to generate cash from operations. Management considers Adjusted EBITDA (as defined) to be an indirect measure of operating cash flow, which is a significant indicator of the success of any business. Adjusted EBITDA is not intended to be representative of cash flow from operations or results of operations determined in accordance with IFRS or cash available for distribution.

EBITDA and Adjusted EBITDA are not recognized measures under IFRS. Chemtrade's method of calculating EBITDA and Adjusted EBITDA may differ from methods used by other income trusts or companies, and accordingly may not be comparable to similar measures presented by other organizations.

A reconciliation of EBITDA and Adjusted EBITDA to net earnings is provided below:

	Three months ended June 30		Six months ended June 30	
($'000)	**2021**	**2020**	**2021**	**2020**
Net (loss) earnings	$ (14,078)	$ 4,499	$ (34,526)	$ (93,376)
Add:				
Depreciation and amortization	60,571	69,009	122,964	132,926
Net finance costs	19,122	2,706	40,620	70,158
Income tax (recovery) expense	(6,615)	6,122	(15,211)	(14,999)
EBITDA	59,000	82,336	113,847	94,709
Add:				
Impairment of goodwill	-	-	-	56,000
Change in environmental liability	-	362	-	3,743
Net loss (gain) on disposal and write-down of property, plant and equipment	404	13	555	(469)
Unrealized foreign exchange loss (gain)	5,760	(7,183)	6,190	2,425
Adjusted EBITDA	$ 65,164	$ 75,528	$ 120,592	$ 156,408

Segmented information

SPPC -

($'000)		Three months ended June 30 2021		Three months ended June 30 2020		Six months ended June 30 2021		Six months ended June 30 2020
Revenue	$	105,193	$	103,960	$	197,160	$	216,982
Gross profit		11,355		9,494		18,578		23,955
Adjusted EBITDA		30,492		31,614		58,463		66,246
Net (loss) gain on disposal and write-down of property, plant and equipment		(232)		(32)		(244)		17
EBITDA	$	30,260	$	31,582	$	58,219	$	66,263

WSSC -

($'000)		Three months ended June 30 2021		Three months ended June 30 2020		Six months ended June 30 2021		Six months ended June 30 2020
Revenue	$	108,592	$	113,456	$	207,378	$	226,794
Gross profit (loss)		15,112		16,955		28,923		(25,415)
Adjusted EBITDA		23,514		27,240		45,317		52,946
Impairment of goodwill		-		-		-		(56,000)
Change in environmental liability		-		(362)		-		(3,743)
Net (loss) gain on disposal and write-down of property, plant and equipment		(194)		-		(276)		457
EBITDA	$	23,320	$	26,878	$	45,041	$	(6,340)

EC -

($'000)		Three months ended June 30 2021		Three months ended June 30 2020		Six months ended June 30 2021		Six months ended June 30 2020
North American sales volumes:								
Sodium chlorate sales volume (000's MT)		91		94		183		196
Chlor-alkali sales volume (000's MECU)		45		33		86		69
Revenue	$	123,485	$	130,118	$	245,172	$	270,659
Gross (loss) profit		(2,200)		6,173		(2,305)		13,026
Adjusted EBITDA		23,761		34,689		50,938		66,668
Net gain (loss) on disposal and write-down of property, plant and equipment		22		19		(35)		(5)
EBITDA	$	23,783	$	34,708	$	50,903	$	66,663

Cash Flow –

Management believes supplementary disclosure related to the cash flows of the Fund including the amount of cash available for distribution to Unitholders, repayment of debt and other investing activities provides useful additional information. A cash flows table presenting this information is included in the Fund's MD&A filed on SEDAR. The table is derived from, and should be read in conjunction with, the condensed consolidated interim statements of cash flows. Certain sub-totals presented within the cash flows table, such as "Adjusted cash flows from operating activities", "Distributable Cash after maintenance capital expenditures" and "Distributable Cash after all capital expenditures", are not defined terms under IFRS. These sub-totals are used by Management as measures of internal performance and as a supplement to the condensed consolidated interim statements of cash flows. Investors are cautioned that these measures should not be construed as an alternative to using net earnings as a measure of profitability or as an alternative to the IFRS condensed consolidated interim statements of cash flows. Further, Chemtrade's method of calculating each measure may not be comparable to calculations used by other income trusts or companies bearing the same description.

A reconciliation of these supplementary cash flow measures to cash flow from operating activities is provided below:

	Three months ended June 30		**Six months ended June 30**	
($'000)	**2021**	**2020**	**2021**	**2020**
Cash flows from (used in) operating activities	$ 50,846	$ 66,913	$ 44,450	$ 97,234
Add (Less):				
Lease payments net of sub-lease receipts	(12,671)	(14,367)	(25,699)	(28,162)
Changes in non-cash working capital and other items	(1,361)	(8,827)	44,134	23,921
Adjusted cash flows from operating activities	**36,814**	**43,719**	**62,885**	**92,993**
Less:				
Maintenance capital expenditures	15,583	12,055	23,770	23,098
Distributable cash after maintenance capital expenditures	**21,231**	**31,664**	**39,115**	**69,895**
Less:				
Non-maintenance capital expenditures	974	794	1,556	1,540
Distributable cash after all capital expenditures	**$ 20,257**	**$ 30,870**	**$ 37,559**	**$ 68,355**