Chemtrade Logistics Income Fund

Q3 2022 Results

November 8, 2022

10:00 AM

Operator: Good morning, ladies and gentlemen, and welcome to the Chemtrade Logistics Income Fund Q3 2022 results conference call. At this time, all lines are in listen-only mode. Following the presentation, we will conduct a question and answer session.

If at any time during this call you require immediate assistance, please press *0 for the operator. This call is being recorded on Tuesday, November 8, 2022. I would now like to turn the conference over to Rohit Bhardwaj, Chief Financial Officer. Please go ahead.

Rohit Bhardwaj, Chief Financial Officer

Rohit Bhardwaj: Thank you, Fabio. Good morning everyone and thank you for attending the Chemtrade Logistic Income Fund third quarter '22 earnings conference call. As usual, joining me today on the call is Scott Rook, our Chief Executive Officer. Please note that this call has an accompanying presentation available on our website, chemtradelogistics.com.

The third quarter of '22 was a record quarter for Chemtrade with adjusted EBITDA more than double that of Q3 '21. Trends remain broadly favorable across our product portfolio, in terms of both market demand pricing. And our focus on operational reliability and productivity have ensured that we are capitalizing on market fundamentals.

We believe that the supportive market conditions we are seeing the various actions that we have taken as an organization to strengthen our business and drive future growth positions us well to deliver continued strong performance for balance of the year and into '23. To begin today's call, I will first walk you through our record, third-quarter results and the drivers of this performance. I will then outline the latest increase in our 2022 guidance, consisting of the third, consecutive quarter that we have raised this guidance.

Scott will then discuss the continued positive market fundamentals we are seeing across our business and will also provide an update on our various, organic growth projects. Scott will conclude by summarizing the various differentiated characteristics that set Chemtrade apart from many of its peers and position us for continued success, moving forward. Following the prepared remarks, we will open the call for your questions.

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

One of the 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, all the accompanying presentation will refer to adjusted EBITDA. We will just refer to the EBIDTA in our remarks as opposed to adjusted to EBITDA. Non-IFRS and other financial measures are fully defined in our MD&A.

Starting with our consolidated results for the third quarter of ’22, we once again delivered strong, year-over-year improvements across our key financial metrics. This included a 42% increase in revenue, a 104% increase in EBITDA and a 327% increase in distributable cash. While strong Chlor-Alkali performance was certainly a contributor to these results, it was, by no means, the only driver. The results improved significantly in both of our segments, with most of our products seeing improved performance. Additionally, our plans operated very well through the quarter, reflective of our continued focus on productivity and reliability. The improvements we are delivering also extends to our balance sheet and cash generation. Our $0.05 per month distribution, which equates to an attractive yield of over 8%, based on yesterday’s unit price, remains very well covered, with a pay-out ratio of only 32% on a trailing, 12-month basis.

Our leverage ratio has also improved dramatically, ending the quarter at only 2.4 times EBITDA as compared to the 6x a year ago. We expect to end the year with slightly lower leverage than the third quarter. This improved financial flexibility we have produced allows us to capitalize on the attractive, organic growth opportunities that we see across our business and to continue generating incremental value for our unit holders.

Moving to our segmented performance, in the Sulphur and Water Chemicals, our SWC segment, we generated revenue of $311.5 million in the third quarter of ’22, an increase of $82.9 million, or 36%, over the third quarter of ’21. EBITDA for the quarter was $69.5 million, an increase of $10.2 million, or 17%, compared to the third quarter of ’21. Adjusting for the specialty chemicals business, which was sold in Q4 of ’21, EBITDA increased by $13.8 million, compared to the prior-year period.

The increase in SWC revenue resulted primarily from higher sales volumes and selling prices for merchant assets, as well as higher selling prices for regen and our water solutions products. End-market demand across the segment remained strong in the third quarter. The higher selling prices of merchant asset and water solutions products offset the higher costs of sulfur and freight, compared to the third quarter of ’21.

As Scott will discuss, we have seen sulfur costs decline recently, which we expect will be a tailwind for our water chemicals business in the coming quarters. Transitioning to our electrochemical, or EC segment, this segment also had a very strong quarter. Revenue of $208.4 million, was up $72 million, or 53% year-over-year, and EBITDA of $88.2 million was up by $54.5 million, or 162%, year-over-year. The increase in EC revenue and EBITDA is reflective of higher selling prices for each of our Chlor-Alkali products -- caustic soda, chlorine, and hydrochloric acid.

Continued favorable market fundamentals for Chlor-Alkali chemicals resulted in Chemtrade's MECU netbacks, which is selling price less freight, being up approximately $980, year-over-year, in the third quarter of '22, with approximately half of the increase in netbacks attributable to higher realized prices for caustic soda and balance attributable to higher realized prices for chlorine and, to a lesser extent, for hydrochloric acid.

Asian caustic soda fundamentals, which drive our selling price, were supported by reduced supply in Europe, due to very high costs for electricity, the main input cost of Chlor-Alkali. Demand for HCl was strong, due to increased fracking activity in North America. Chlorine benefited from generally-reduced supply in the industry. Our Brazil business also delivered a very strong set of results in Q3, benefiting from a broad improvement in demand and pricing across a number of the products. Meanwhile, our sodium chloride results were relatively consistent on a year-over-year basis. For both our Chlor-Alkali products and Sodium Chlorate, we see factors that give us optimist that some of the positive pricing trends we have seen recently should carry forward into 2023. Scott will provide more details on the outlook, momentarily.

Turning to corporate costs - our corporate costs for the third quarter of '22, were $20.6 million, down $5 million, or 20% from the third quarter of '21. The main driver of this year-over-year decrease were lower LTIP accruals, relative to the third quarter of 2021, when they were unusually high. Our operating costs remained relatively consistent with the prior-year period, as our team continues to focus on efficiencies to mitigate inflationary impacts.

Moving to our balance sheet, as I noted earlier, we continued to deliver improvements in our liquidity and financial flexibility. This includes our leveraged ratio declining to 2.4 times EBITDA at the end of the third quarter, as compared with 6 times a year ago. It also includes approximately U.S. $363 million undrawn on our senior credit facility as of the quarter end, in addition to $36.9 million of cash on hand. We expect to end '22 with slightly lower leverage than the third quarter of '22.

The stark improvement is reflective of the strong results we have delivered, year-to-date, as well as a number of proactive steps we have undertaken to strengthen our financial position, such as selling non-core assets. In addition, it also reflects the $86.5 million equity financing that we completed in the third quarter of '22, the proceeds of which will be used to partially finance our previously-announced high-return, ultra-pure sulfuric acid growth products in Ohio and Arizona.

We remain focused on maintaining a prudent amount of leverage, moving forward, and hope that our strengthened our balance sheet instills our unit holders with confidence about our ability to balance growth, a sustainable distribution, and finance our stability in the coming years. Turning to our guidance, yesterday, we announced an increase in our ’22 EBITDA guidance for the third quarter. We are now expecting EBITDA of $420 to $430 million this year, versus our prior guidance of $360 to $380 million. The latest increase in our guidance reflects the extraordinary results we have produced, year-to-date, in addition to the ongoing strength in market fundamentals we are seeing for most of our key products, including Chlor-Alkali chemicals. Notably, our guidance now assumes the average Northeast Asia spot price for caustic soda will be $650 per ton. This is US$360 per ton higher than ’21 and US$10 per ton higher than our previous assumption. Recall that every U.S. $50 per ton change in pricing translates into approximately $10 million of incremental EBITDA for Chemtrade. The remainder of our key guidance assumptions are set up on the slide deck in our MD&A. As with our prior guidance, this increased EBITDA guidance indicates a record year for Chemtrade. The mid-point of new guidance is $425 million, which represents an expected improvement of $176.5 million over ’21, after adjusting for the sale of the specialty chemical business, and the NATO lawsuit settlement in ’21. This is despite the impact of the biennial turnaround at our North Vancouver and Chlor-Alkali facility in Q2 of ’22.

While many chemical peers are facing challenges in the current environment, our continued strong performance and this latest increase to our guidance to help reaffirm to investors that not only are we seeing these same pressures so far, but we are, in fact, delivering outstanding results. Fundamentals remain very favorable and many cases have recently improved across our product portfolio. Further, we continue to successfully execute on our strategic plan to maximize the value for portfolio and our ongoing focus on reliability and productivity continues to yield positive results. With that, I will now hand the call back to Scott, who will walk you through some of the reasons why we believe our results should remain strong through the fourth quarter and into ’23.

Scott Rook, President and Chief Executive Officer

Scott Rook: Thank you, Rohit, and good morning everyone. Thank you for joining us on today’s call. And as Rohit said, we continue to see strong momentum across our product portfolio, with a number of varied drivers instilling us with confidence for our performance as we close out the year.

Starting with our sulfur products, market fundamentals remain supportive for all three of our sulfuric acid businesses. In the third quarter, fertilizer prices declined globally, but were still above historical averages. This resulted in downward pressure on North American sulfur prices, the key raw material for sulfuric acid. Despite the downward pressure on sulfur, our merchant asset market remained steady, given sulfuric acid's broad, industrial uses. The lower sulfur costs have led to margin improvement in parts of our portfolio.

In our regen acid business, we continued to see strong demand in pricing on the back of higher refinery utilization rates in the regions where we operate. In addition, our plants have been running reliably, allowing us to capitalize on the market strength. We could see a slight downturn in the regen business if a recession were to materially impact the miles driven in North America. But for now, we have not seen any impact.

Demand for UltraPure Acid also remained strong in the third quarter, despite the recent slowdown in the global semiconductor industry. UltraPure remains the biggest organic growth opportunity for Chemtrade in the coming years. The medium and long-term growth outlook for UltraPure Acid is underpinned by increasing semiconductor production capacity in North America, as the U.S. seeks to become self-reliant for chip manufacturing. While our projects in Ohio and Arizona will add UltraPure capacity to Chemtrade in the coming years, tight supply and demand fundamentals also lead us to expect improved demand and pricing in 2023.

Moving over to our water treatment chemicals, during the past few quarterly reviews, we have highlighted the headwinds that the water business was facing from higher raw material costs. We are now caught up on passing through those higher raw material costs to customers and are now starting to see the benefits of lower sulfur pricing. Although sulfur prices in Q3 were up, year-over-year, we have seen sulfur prices begin to decline in the third quarter, with Tampa pricing recently falling by about $200 per ton for the fourth quarter. Our water chemicals customers are primarily on annual, one-year, fixed price contracts, so we anticipate that the falling input costs will result in margin tailwind for the coming quarters. Demand for our water chemicals continue to grow steadily and it's worth reiterating that these chemicals are largely non-discretionary. In particular, demand for PACl and ACH is growing at roughly 5% annually and we are focused on capitalizing on this growth through expanded protection capacity, which is expected to come online in Q4 and contribute more meaningfully to our results next year.

Turning to the outlook for our electrochemical segment, as I stated on our previous conference call, we expect this to be a record year for the EC segment by a wide margin. Caustic soda has certainly been a significant driver of this strong performance, but our chlorine performance has also increased significantly and hydrochloric acid continues to improve steadily. Pricing for caustic soda has strengthened again recently, returning back to close to US$700 per tonne. Chlorine demand and pricing also remains strong. For both these co-products, tight industry supply and continued strength and in market demand have been helping to support pricing.

Another key factor supporting Chloro-Alkali pricing is elevated utility costs in Europe and Asia and increased global freight costs. These elevated costs for overseas competitors are impacting the pricing that they are able to charge customers. Given Chemtrade's access to low-cost electricity, we are not facing the same challenges and are advantaged, relative to overseas competitors. We are seeing a similar level of pricing gains, but without the corresponding increases in production costs. In addition, should energy prices in Europe and Asia remain elevated, near-term, we believe this could continue to support pricing for both chlorine and caustic in the coming quarters.

Meanwhile, the hydrochloric acid market continues to improve, in line with our expectations. Higher natural gas prices in Europe are leading to increased export activity of natural gas from North America to Europe. This, in turn, driving increased fracking activity in North America and increased demand in pricing for hydrochloric acid. We expect continued improvement into 2023, as this export activity and North America rig count continues to increase.

Finally, moving onto sodium chlorate. We are forecasting a significant improvement in sodium chlorate next year, owing to two factors. First, with our Chlor-Alkali chemicals, elevated electricity costs in Europe and Asia are significantly impacting operating costs for overseas producers. Producers in North America have not seen the same cost increases, which have given them a competitive advantage globally. And Chemtrade benefits from stable, low-cost, hydroelectric power in Canada. This trend is driving an increase in demand for North American exports to those higher-cost regions. Recall that electricity represents about 60% of the variable cost of sodium chlorate production. While energy prices fluctuate, over time, we think the recent crisis in Europe, coupled with higher inflation, have raised the baseline for non-renewable energy, resulting in a long-term benefit for our hydroelectric sites.

Second, industry capacity rationalizations taking place in North America are expected to result in improved industry operating rates. Given the planned closure of our Beauharnois facility this year, we will see its production volumes absorbed by our other facilities and we also expect to have improved cost structure for sodium chlorate next year.

With that, I would like to provide you with a brief update on the status of our various, organic growth projects. These projects are focused in areas where we see a market opportunity and also where we believe we are strategically positioned to capitalize on that market opportunity. Ultimately, the objective is to invest in high-return opportunities that generate sustainable returns and deliver incremental value for our unit holders.

Staring with our largest growth opportunity, which is UltraPure Acid, both of our projects continue to proceed on schedule. The 15,000 metric ton capacity expansion in Cairo, Ohio is expected to start up in 2024, and we will be hosting a ground-breaking ceremony at this facility on December 9th. Notably, attendees at the event are expected to include representatives from the American Chemistry Council, various major global foundries, and U.S. Congress. Our 100,000 metric ton joint venture in Casa Grande, Arizona, with Kanto Group, also remains on track. We contributed US$4.5 million of capital towards this joint venture in the third quarter. We are undertaking a feed study for the project and expect to have more detailed engineering plans and cost estimates in the coming months. Once both projects are completed, we will have approximately 130,000 metric ton of combined, new production capacity for UltraPure Acid, strengthening our position as the North American market leader for this product and capitalizing on the explosive industry growth expected in the coming years.

Meanwhile, our smaller, organic growth projects in water chemicals are nearing completion. The additional production capacity of PACl and ACH that we are adding, is expected to come online before year-end, contributing more meaningfully to results next year. We will evaluate additional, small water chemical projects that we see both the market opportunity and an opportunity to generate incremental value for our unit holders.

Finally, we continue to progress on a project for green hydrogen monetization in Prince George, B.C., which is expected to be completed next year. We will provide additional updates on this project and on the potential larger project in Brandon, Manitoba, when we have more meaningful developments to communicate.

Before concluding, I wanted to highlight the various strategic initiatives that we are undertaking on ESG. I would encourage you all to visit our website to review our recently-published sustainability report. We look forward to updating you, over time, on the progress we are making across the spectrum of environmental, social, and governance.

Now, to reiterate and conclude. Number one, our Q3 2022 EBITDA was more than double one year ago levels and Chemtrade is poised for a record year in 2022. Number two, the vast majority of our product portfolio continues to see strong market fundamentals and we expect much of this strength to carry into next year. Number three, we have significantly strengthened our balance sheet. Number four, we continue to deliver improved productivity and reliability. And, number five, we have a number of high-return, organic growth projects that will deliver incremental value in the coming years.

On top of all of these positive characteristics, our portfolio is also much more defensive than that of a typical chemical company. We have previously outlined all of the reasons that enhance the defensiveness of our product portfolio and that gives us confidence that we will still perform well when an economic downturn does occur. Some of these reasons include the non-discretionary nature of our water chemicals business, the limited economic sensitivity of the Regen Acid market, the significant growth anticipated in the UltraPure Acid market, and our advantaged access to low-cost electricity, relative to overseas electrochemical competitors.

Despite all the positive attributes of Chemtrade, we have found that our unit price has been dragged down alongside other companies, most of which do not share the same characteristics. However, we remain confident that as we continue to execute on our strategic plan, investors will increasingly realize our differentiated qualities and the long-term value creation that we are delivering. We look forward to providing even more detail on what makes us different and how we are creating value, at our upcoming, first-ever investor day on November 18th. Further details are available on our website. We hope to see you all there. With that, we will now open the call for Q&A and Rohit and I would be happy to address any questions you may have. Thank you.

Operator: Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. First question comes from Joel Jackson from BMO Capital Markets. Please go ahead.

Question and Answer Session

Joel Jackson, BMO Capital Markets

Joel Jackson: Hi. Good morning, gentlemen. Could you help us bridge -- so you raised guidance by a little over $50 million for the year, EBITDA, probably see it on the second half -- can you bridge, as much as you can, as granular as possible, where is the $55 million coming from, between caustic pricing, other pricing, volume, costs, currency, you tell me?

Rohit Bhardwaj: Okay. So, when we gave our guidance in the middle of the year, there were a few things we were, you know, looking ahead into and thinking about, including there was some caution due to the potential rail strike and the other thing, which I don't know if you were aware, there was a Seaspan strike in Vancouver that was a second kind of incoming shipments of salt and caustic. So those were some of the things weighing on our mind when we gave that guidance. In addition to that, we were looking at the strength and, particularly chlorine and HCl. I think caustic -- we had -- we didn't change presumption that much, but chlorine and HCL delivered really strong results. Our regen and merchant business performed extremely well. Our water business that we had been concerned about, started to improve, with some easing of raw materials and some initiatives that were taken in pricing. And then, our focus on reliability and operational performance resulted in very little unplanned downtime compared to previous years. Our Brazil business did extremely well and they are poised to have a really good year, better than most years they have recently. And so there are several things that contributed to the increase in guidance. But, there was a bit of caution because we were in the middle of the year when we gave it and there were a few things on the horizon that we were concerned with. Yes F/X helped a bit too. But, it was really a number of, like I said, a variety of things that helped us.

Joel Jackson: Okay, let me the try the question a different way. $55 million higher guidance. How would you break that down in that bridge, between SWC and electro chem?

Rohit Bhardwaj: Probably, I would say 40% in SWC and 60% in EC.

Joel Jackson: Okay, and then my final question would be, we've seen a lot of volatility in sulfur prices the last bunch of months. Obviously, you have a bit of a different business, in terms of contract and pass through. Talk about how the volatility of sulfur prices impacts your business second half of this year and what I might look like, going into '23, as you reprice somethings.

Rohit Bhardwaj: Well, there are two aspects to that. One, is our acid business. And our acid business is generally quite immune to sulfur variable, to offset sulfur up or down. And there's some contractual, but there's some just market-driven things that happen. It's our water business that was hurt by high sulfur because, as you said before, a lot of that business is municipal, fixed -- one-year fixed contracts.
So typically what happens, in a rising raw material environment, your margins are squeezed and then when raw materials ease off, you start to pick up the benefits. So the sulfur reduction you're talking about just happened in Q4. So really, there was a bit of impact and a bit of impact in Q4, but it's really positioning up well for next two years. Typically, in the water business, it takes a couple of years, once raw materials stabilize and go down, then margins might come down. But for the first couple of years after raw materials stabilize, historically at least, margins have all been improved.

Joel Jackson: Thank you.

Operator: Thank you. Your next question comes from Steve Hansen from Raymond James. Please go ahead.

<u>Steve Hansen, Raymond James</u>

Steven Hansen: Yeah, thanks. Could you maybe just elaborate just a bit more on the Brazilian business? We haven't heard a lot from the Brazil business, of late, and I think you just referred about it being strong. But maybe some additional color there on what's driving those results, statistically, would help.

Scott Rook: Yeah, this is Scott. So, number one, what we are seeing in Brazil are very, very strong results and a very strong year. Number one, the exports of pulp, at least from our customers have been strong and picking up. And so, we work with one large customer. That customer has been adding capacity. And so, we're benefiting from that, number one. Number two, we have a Chlor-Alkali business there and so that business is strong. We also sell remaining chlorate and so we're seeing strong results from say, in chlorate there, as well. But strong performance across practically all of the products that we have in Brazil, both demand and pricing.

Rohit Bhardwaj: If I can add one thing, Scott. So, as we've talked in the past, our main customer there announced a couple of years ago that they wanted to invest significantly in the mill that we are connected with and made better, more cost-competitive mill. So some of that has been happening and so we are benefiting from the better cost positioning of the mill that we supply.

Steve Hansen: No, that makes sense. Okay, that's helpful. Just on the asset on the UltraPure side, in particular. Yeah, it's been quite a reversal of that business. It wasn't that long ago you were looking to find a home for some of your capacity. Now the market's tightened up quite a bit. I think, Scott, you had referred to improved demand in pricing in '23. Is that -- can you just remind us, is that a contract structure system that works through there? And have you entered into those negotiations, as yet, or already firmed up pricing? Just, where are we at with that sort of look into next year?

Scott Rook: Yeah, so I would say we've lined up a lot of pricing. And this market, the production in North America does not meet all of the demand. And so, there's imports coming into meet the total demand. And as I have said before, I think we can sell everything that we can produce.
And so, we have a big focus to improve our reliability, improve our production. The market's tight, in spite of what we've talked about with demand, short-term demand for chips dropping a bit, but the overall supply and demand balance for UltraPure Acid is very strong right now.

Rohit Bhardwaj: And Steven, what happened -- what really happened when we mentioned that our demand had dropped -- it was not so much that demand had dropped, it was one, big customer who had decided to make different supply chain choice and started bringing in imports. And as you can imagine, the whole world has changed now and the push to onshoring and so I think strategically, people are making different decisions now, so.

Steven Hansen: No, I should not -- that's helpful context. And just lastly, for me, is around, future capital allocation -- you've clearly have some growth projects lined up here. Have you contemplated the buy-back of magnitude here, just thinking about fundamentals carrying over into next year? Arguably, you've got even some additional tailwinds around not having to face the turnaround. For example, other things --

you're having to make incremental cash flow to allocate here. So, how do you feel about the buy-back at this point?

Rohit Bhardwaj: So I think, clearly a buy-back is attractive. But on the other hand, we really -- one thing we have said is, we are balancing three things here. One is the sustainability of our distribution. Second is, maintaining the strength in our balance sheet. And third is organic growth. And we have very attractive organic growth opportunities here. So I think at this stage, obviously, our board looks at our capital allocation and Scott and I obviously spend a lot of time thinking about it. But, at this stage, we think it's in the best interest of our unit holders that we continue to invest in the business, grow the business. We have very attractive opportunities. And, we are very mindful of leverage. I mean, we were in the penalty box for a couple of years. We don't ever want to get close to that again. So, we want to maintain strength on the balance sheet.

Steven Hansen: Fair enough. Appreciate the time.

Operator: Thank you. Your next question comes from Ben Isaacson from Scotia Bank. Please go ahead.

<u>Ben Isaacson from Scotia Bank</u>

Ben Isaacson: Hi. Good morning and congrats on the results. I have a high-level question about how Chemtrade is positioned for a recession or for a weaker macro backdrop. It's really a three-part question. I'll just ask it all at once if I can. So number one, can you talk about, in past recessions, what has the relationship between chlorine and caustic looked like and is this time going to be any different, given what's happening with European energy prices? Number two, can you just give us -- your business model has really evolved over the last few years and can you just give us a better -- maybe some goal posts? I'm not looking for guidance, but just some goal posts, in terms of what the segments could do, on the downside in a recession. And then, finally, can you just talk about how is Chemtrade better positioned for a recession? You've obviously got your leverage down. You've cut the distribution in the past. Are there other things that investors should be aware of, in terms of the cushion that Chemtrade has, going into a period of macro weakness? Thank you.

Scott Rook: Yeah, so I'll -- let me see, I'll address those questions. Rohit can add if he'd likes at the end. So, in past recessions, the relationship between chlorine and caustic probably has been different. And so, the relationship has been different in the past. I believe what's different now is that, with Chlor-Alkali, 60% of the variable cost is tied to utilities. And that -- and we're just in a very different environment with global utilities than we have been in, with past recessions. And so, I believe that that's going to have an impact, going forward. We'll -- and so, -- in terms of your second question, with our business model and how are, again, how are we set up for a recession? Number one, our water business is non-discretionary. So, non-discretionary for municipalities and then, the growth in industrial uses is more tied to regulatory actions. And so, those are continuing. And so, we see continued growth for our water treatment chemicals, in spite of any economic slowdown. Next, in the past, as we've look at this, in typical recessions, we have seen -- we've seen refining rates drop, maybe one to two percent, but not very significant. And so, we're looking at that and we think that it's possible we may see some refinery drops. But as you know, the refineries in the U.S. are running pretty strongly right now. Driving is still there. And so, we're optimistic that we will not see a significant slowdown in driving. And then, the other thing about our business, that the chlorate market -- I think the chlorate market is poised for stronger results. We have -- we've seen chlorate been -- we've seen weakness in the chlorate market for the past couple of years. But again, as we look at what's happening globally, there is strong interest, again, for exports for chlorate and I think that's having an impact, or that will have an impact, going forward.

Rohit Bhardwaj: So, if I can add just a couple of things there. So, on the chlorate, there are two things going on. One is the people returning back to office and schools, et cetera, which will drive demand up a bit. I think even in a recession, that will offset any kind of drop in demand during a recession. Then, of course, as Scott said, the big thing is the change, fundamentally, in North America versus the rest of the world and North America has become a lot more competitive, and especially Canada, with hydroelectric power. The other thing I'll add is, water tends to be actually countercyclical, a bit. Because, as raw materials come down and as Scott said, then there's non-discretionary, so demand stays steady, raw materials come down, so margins actually expand in a recession. And then, I know there's a bit of talk on the semiconductor side, where demand for chips has been slowing down. But I think the bigger factor there is, yes, that's true. But firstly, that is not going to impact the investments that people are making. Because U.S. has to become self-reliant and so that investment will continue. And on the other hand, even if globally, demand for chips has been dropping, because so much of acid was being imported from offshore, we think that the U.S. side is going to be very strong for acid. And as Scott said, we can sell every drop we can make and we don't see that changing in a recession at all. So, I think in general, we are up, but, hopefully, we'll stay resilient in a recession.

Ben Isaacson: Great. Thank you very much.

Operator: Thank you. Your next question comes from Nelson Ng from RBC Capital Markets. Please go ahead.

Nelson Ng, RBC Capital Markets

Nelson Ng: Great. Thanks. And congrats on the strong results. My first quick question is just the PACl and ACH capacity expansions. Can you just remind us how much the total investments for the expansions were and what the potential incremental EBITDA contribution would be?

Scott Rook: Yeah, we have not shared specific numbers on that. But, yeah, and I'm not prepared to share what those actual specific numbers are. They are smaller in size, relative to our UltraPure announcements. But there are multiple, I'll say, multiples -- small expansions. But we have been -- I'll say that this market's growing at least 5% or so a year. And as I've mentioned a couple of times, our assets are running full. We've been out of capacity. And so we're -- we've been adding capacity so that we can meet this growing market demand. And so, we have several smaller projects that we've been executing this year. Those projects will be coming online in Q4. And we'll be positioned for growth next year.

Nelson Ng: Okay. Got it. And then just moving to UltraPure -- in terms of the JV, you mentioned that you're working on the feed. Can you just give us a quick update, in terms of timing? So, are you still in the, like, early stages of design, engineering, and costing? And when should we expect a narrowing of the, like, Capex expectation?

Scott Rook: We'll have a narrowing view of that in Q2 of next year. Yeah, so the front-end engineering design is being worked right. We'll finish that late Q1, early Q2. They'll be some time to refine that estimate. And then, I think we'll be sharing an updated view a little before mid-year next year.

Nelson Ng: Okay. And then, so, if the updates in Q2, would construction potentially start by the end of next year?

Scott Rook: Yes.

Nelson Ng: Okay. Got it.

Scott Rook: Yeah.

Nelson Ng: Okay. And then, my next question is, in terms of your funding structure, so I believe you currently have about, I think $325 million of debt that's hedged, from an interest rate perspective, out to December 2024. Is the plan -- can you just talk about your, I guess, interest rate exposure to your higher interest rates. So, I think most, if not all, of your senior debt is hedged. And then, I guess when you eventually draw down on your credit facility to construct that UltraPure facility, you will, obviously, be less hedged? Like, can you just talk about what your floating rate exposure is right now?

Rohit Bhardwaj: Yeah, so sure. Right now, it's nothing because all of our debt fixed, in fact. We may be slightly over hedged on our revolving. So one thing you may have noticed from our statements is we de-designated some of our hedges, just because we've been generating excess cash flow and we did the equity raises, actually ended up being in an over hedged position. So we de-designated hedges.
So, we think that as we draw next year and start constructing, it's not going to be material. It's probably not very material, in terms of what our exposure to floating is going to be, even through next year. Because, clearly, if you look at the amount of excess cash flow we are generating and expect to generate, we don't think it's going to be a material item for us.

Nelson Ng: Okay. Thanks. And then, one last question. I know you're not looking to provide an update on your sale and lease back. But obviously, interest rates have moved up and there's, like, a looming recession in the, like, the -- that people are generally expecting. Is there anything we should read through, in terms of how that process is coming along?

Rohit Bhardwaj: So, I think its a live process and, clearly, we are -- what we had told you at the start was that either we announce a transaction or announce that we are suspending the process and we have done neither. So you can read what want in that. Obviously, it's taking a little bit longer, but this is a complex transaction. It -- this is not a -- this is a very unique parcel of land and it has complexities, as you'd expect on industrial property of this nature. So, it's taking longer, but it's still a live process.

Nelson Ng: Great. Thanks for the update. I'll leave it there.

Operator: Thank you. Your next question comes from Gary Ho from Desjardins Capital Markets. Please go ahead.

<u>Gary Ho, Desjardins Capital Markets</u>

Gary Ho: Thanks and good morning. There's been quite a few questions just on the slowing macro environment and potential recession. Maybe just on that, to close it off. Wondering if you can help us, maybe at least qualitatively, if you hit the 420 to 430 EBITDA target, in the slowing environment, how much of that id repeatable and how much do you think could go away? Or, do you think all of that could be repeatable? Just wondering if you can help us, at least qualitatively, think through your results, looking out next couple of years?

Scott Rook: So, well, we will not be issuing guidance right now, for 2023. We've obviously shared a lot of comments on what we expect in the market conditions. But we're not releasing any guidance right now. We will be, though, early next year. But, in general, the market comments that I would make, at least the general directions to reiterate what we've said here. We see next year, let's say, strong demand growth, both pricing and let's say a strong outlook in UltraPure Acid. In particular, we see the water business we've got capacity expansions in the water that we've talked about. And I think that the market fundamentals in chlorate, as we have -- just as we have covered, are quite strong. Very strong. Our -- the Chloro-Alkali business is very, very strong right now. And we don't see it changing significantly for a while. And, within that, we see hydrochloric both growing, in terms of demand tied to increased fracking activity. So I think that bodes well. And, again, I think that strength in Chloro-Alkali is tied to the factors that we've gone over. Regen -- even in a recession, our regen business should be pretty strong. And, again, we -- and we've talked about water, as well. So, that's a, I think that's our outlook, without any giving -- without putting numbers on it. That'll -- you can do that.

Rohit Bhardwaj: I'll add -- I'll just add one comment. I think you want -- I think it's very important to think through the ramifications of the energy crisis in Europe. Because that a different thing and that's -- there's no quick fix to that. And so, that has fundamentally changed, kind of our electrochemical business. Because we are benefiting from regulated industries and hydroelectric power. So, that fundamentally changes the equation. And so that's something to think through, even in -- while this recess -- if there's a recession now, but may play out differently than in the past.

Gary Ho: Okay. Perfect. Thanks for the color. And then, just working with your comment there, you sounded cautiously optimistic, just on the sodium chlorate side for '23. How quirky can that segment be, in particular? Not sure if you can kind of give us some guide-post on that one, as well?

Rohit Bhardwaj: I'll give you -- so here's what -- I'll point you in a direction that might help you. So if you look back at when Canexus was a reporting issuer, or even after we bought Canexus, there was still a reporting issuer, for a couple of years because of their public debt. And their operating segments were structured as Chlor-Alkali, Chlorate, and Brazil. So, you can go back and check what the historic chlorate margins were. And there was deterioration in the last five years. So were not going to say you're going to go all the way back but you can see, directionally, what the potentials of that business might be. And this is prior to the European crisis. Because back then, Europe was a net exporter of chlorate, globally. And now, they're a net importer, so that has changed. And we believe that the market -- there's a rational behavior in the market. So anyway, that will give you a sense of what -- what's the potential for chlorate.

Gary Ho: Okay. Great. And then the last one, Rohit, now that I have you here. You mentioned you want to maintain balance sheet strength and not go back to elevated leverage. So what do you think is the optimal leverage for your business, looking out?

Rohit Bhardwaj: So we are targeting a leverage ratio below -- a total leverage ratio below three. Clearly, right now, we are quite a bit below that. But, as you know, we've some investment cycles coming up. And the one thing we've said is -- so we are morphing from an M&A company to an organic-growth focus, at least in the mid-short to mid-term. And what happens with that is, it takes a couple of years to start getting the returns on your investments. Once you start getting returns, then it becomes self-perpetuating. But during the initial investment cycle, you have cash outflows and no inflows coming in from the projects, so you do get a little bit higher leverage. So, we think three and below is good. And so, that kind of what our target would be.

Gary Ho: Okay. Great. And those are my questions.

Operator: Thank you. Your next question comes from Endri Leno from National Bank. Please go ahead.

Endri Leno, National Bank

Endri Leno: Hey, yeah, good morning. Thanks for taking my questions and congrats on the results. Lots of them have been answered, but just a couple. First, you appointed a new board trustee, announced last night. And the experience that the new trustee has, it's extensively in water. I mean, and I know you're extending -- you mentioned that several times, water, but you -- is there something kind of consider is that water could be more of a focus for you guys, going forward?

Scott Rook: Well, I -- so, number one, yeah, so we did expand the board and so this new board member comes in with experience in water, but also comes in with a lot of experience in building and construction.

So he spent his career working at engineering companies. And so that was something that we did not have as well represented on the board as we would like. And so, given our significant plant capacity expansions, we thought it would be helpful to have someone on the board with more background in that area. And it's also a plus that he's coming in with water.

Endri Leno: Okay. That's great to hear. Thank you. And last one for me. There was some announcement from Valley. I think they're expanding a project in Sudbury and there's more expansion coming. Could there be any incremental suppliers for chloric acid for you there? Anything you can talk to?

Rohit Bhardwaj: So I think one of the challenges that that site has, is that they have some restrictions on their environmental permits on how much they can release into the atmosphere. So that's what they were butting up against. So, there might be some incremental asset, but they would have to make a pretty sizeable investment in kind of environmental compliance there. The reason they went from two furnaces down to one a few years ago, was back then, they had to spend a significant amount of money on the environmental compliance to capture the rest of the emissions that they needed to, so they decided not do it. Now, fundamentals changed, and they made that investment, sure, then, before they were supplying almost double the assets that they are now. But we haven't seen anything more than that. And frankly, even if we had any private discussions with them, we are not in a position to have our -- bring -- we rely on the public statements that are made, as well, so.

Endri Leno: Okay, Okay. No, that's it for me. Thank you. Good quarter.

Scott Rook: So, we'd like to thank everyone for your time. I'd like to thank our employees, again, for delivering the results and wish everyone has a very nice day. Thank you.

Rohit Bhardwaj: Okay. Thanks. Bye.