Chemtrade Logistics Income Fund

Q4 2022 Results

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10:00 AM

Operator: Good morning ladies and gentlemen, and welcome to the Chemtrade Logistics Income Fund Q4 2022 and Annual Results Conference Call. At this time, all lines are in a 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 star zero for the operator. This call is being recorded on Thursday, February 23, 2023. I would now like to turn the conference over to Rohit Bhardwaj, Chief Financial Officer. Please go ahead.

Rohit Bhardwaj: Thank you, operator. Good morning, and thank you for attending Chemtrade Logistics Income Fund's Earnings Conference Call for the fourth quarter of '22. As always, joining me today on this morning's call is Scott Rook, President and Chief Executive Officer of Chemtrade. Please note that this call has an accompanying presentation, which is available on our website at chemtradelogistics.com.

I'll turn to the agenda now. The fourth quarter of '22 marked a strong end to a record year for Chemtrade. Many of the favorable trends that we saw during 2022 carried into the first quarter and our focus on operational execution, productivity, and reliability continued to allow us to capitalize on good market dynamics further bolstering our results.

On today's call, I will begin by discussing our strong fourth quarter and '22 performance. After which, I will walk you through the '23 guidance that we announced in January. I will then hand the call over to Scott, who will provide an update on the market fundamentals for our key products and the organic growth projects that we're undertaking. Scott will conclude by providing a high level recap of the items that give us continued confidence in our outlook for '23 and beyond, after which, we will open up the call for Q&A.

Before proceeding, 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 risks and uncertainties, and actual results may differ materially. Further information identifying 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 the securities regulatory 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 noncash items, certain unrealized foreign exchange gains and losses. For simplicity, although our accompanying presentation will refer to adjusted EBITDA, we will just refer to it as EBITDA in our remarks as opposed to adjusted EBITDA. Non-IFRS and other financial measures are fully defined in our MD&A.

Prior to discussing our fourth quarter performance, I would like to quickly recap our results for the full year. Chemtrade generated $430.9 million of EBITDA in '22, the highest level of EBITDA in our company's history by almost $100 million. Strong chlor-alkali market was certainly a contributor to this record performance, but by no means the only driver. We saw strength across most of our key product lines in '22, including regen acid, merchant acid, sodium nitrite, and water solution products in addition to chlor-alkali.

We also made significant strides on productivity and reliability in 2022, which included new commercial excellence initiatives. These measures enabled Chemtrade to fully capture value from the strong market fundamentals across our portfolio of products. Without the focus and hard work of all of our team members, these results would not have been possible. I would also note that these record results in '22 were achieved despite the biannual maintenance turnaround at our North Vancouver chlor-alkali facility, which although very well executed had a negative impact of roughly $17 million on EBITDA. We've established a strong foundation for future success in '22 and the actions we took as an organization will continue to bear fruit in '23 and beyond.

Turning to our consolidated results for the fourth quarter of '22. It was yet another quarter of strong year over year improvement across our key financial metrics. This included a 29% increase in revenue, a 13% increase in EBITDA, and a 69% increase in distributable cash on a year over year basis. However, our operating performance was even better than that suggested by our EBITDA growth as results in Q4 2021 included a $17.7 million gain related to the settlement of our NATO lawsuit. In fact, if you exclude corporate costs, EBITDA for our two operating segments increased by 42% year over year in Q4 '22. These results once again reflect strong performance and improvement in both of our operating segments with continued strength across most of our products.

Our plants also continued to operate very well in Q4, emblematic of our ongoing focus on productivity and reliability. We further strengthened our balance sheet in the fourth quarter with our leverage ratio ending the quarter at 2.2x. This improved financial flexibility positions us well as we continue to invest in the high return organic growth opportunities. And our $0.05 per month distribution, which equates to an attractive distribution yield of approximately 6%, remains very well covered by our cash flow generation with a payout ratio of only 30% in 2022.

We remain confident in our ability to balance the return of capital to our unitholders with our other capital allocation priorities, which include investing in organic growth and maintaining a healthy balance sheet.

Moving to our segmented performance. In the sulfur and water chemicals, or SWC segment, we generated revenue of $264.7 million during the fourth quarter of 2022, an increase of $52.6 million or 25% over the fourth quarter of '21. EBITDA for the quarter was $57.1 million, an increase of $3.5 million or 7% compared to the fourth quarter of '21.

Adjusting for the Specialty Chemical business sold in November ‘21, which contributed roughly one month of results in the prior year period, EBITDA increased by 9% year over year. The increase in SWC revenue was driven by higher selling prices for a number of our chemicals that included merchant acid, water chemicals, sodium nitrite, and regen acid. The higher selling prices more than offset increases in raw material costs, including high sulfur costs, resulting in year over year improvements in EBITDA.

Overall, product market fundamentals across the segment remained strong in the fourth quarter. And as Scott will discuss, we remain cautiously optimistic about the SW segment in

‘23. Although merchant asset does have broader exposure to industrial output in North America and could be negatively affected by an economic downturn, most of SWC's other key products are relatively defensive and should continue to perform well regardless of the economic backdrop.

Transitioning to our Electrochemical, or EC segment. This segment also had another strong quarter, particularly relative to the fourth quarter of '21. Revenue of $192 million was up $50.3 million or 36% year over year, and EBITDA of $78.3 million, was up $36.5 million or 87% year over year.

The sharp increase in EBITDA reflects higher selling prices for each of Chemtrade’s three chlor-alkali products, caustic soda, chlorine, and hydrochloric acid, or HCl. These products have benefited from a number of factors, including global supply dislocations and elevated energy costs for our overseas competitors. For example, Northeast Asia caustic soda pricing upon which our realized cost soda pricing is based has been supported by reduced caustic supply from Europe given elevated European energy prices. Elevated energy prices overseas have also contributed to increased demand for natural gas exports from North America, which has in turn, boosted HCL demand from fracking.

Chlorine pricing has continued to benefit from tighter industrial supply in North America. Owing to these dynamics our realized MECU netbacks in Q4 were up approximately $770 year over year with roughly 40% of this increase attributable to stronger caustic soda pricing and the other 60% attributable to stronger pricing for chlorine and to a lesser extent HCl.

Our Brazil business also had another strong quarter in Q4 with improvement in pricing as well as demand. Lower sales volume of sodium chloride were a partial offset to our EC results in Q4 as we rationalized our footprint during the quarter with the closure of our Beauharnois, Quebec plant.

While our expectation is that the 2023 EC segment results are unlikely to match the record results in '22 that benefited from historically high caustic soda pricing, we remain optimistic about the outlook for EC moving forward. And in particular, we expect our advantaged position on electricity relative to overseas electrochemical producers to remain for at least the next several years, making our electrochemical production more competitive on a global scale. Scott will provide more details on our outlook shortly.

Turning to corporate costs. Our corporate cost for fourth quarter '22 was $31.1 million, up from $2.8 million in the fourth quarter of '21. And as previously alluded to, the large year over year increase resulted from several nonrecurring items. The lower corporate costs in Q4 '21 are mainly attributed to a $17.7 million recovery related to our NATO lawsuit settlement. Also, legal costs in Q4 2021 were lower because of successful projects that offset these costs during the period.

Higher realized foreign exchange losses and increased deferred unit plan costs also contributed to the year over increase in corporate costs, while lower short term incentive costs were a partial offset. Overall, our core corporate cost during the quarter was largely in line with our expectations, and we remain focused on prudently managing these costs into the future.

Moving to our balance sheet. We continue to deliver improvements in our liquidity and financial flexibility in the fourth quarter as I previously noted. This included a decline in our leverage ratio to 2.2x at the end of '22 as compared with 4.2x one year ago. We ended the fourth quarter of '22 with approximately US $377 million undrawn on our senior credit facility in addition to CAD $72.6 million of cash on hand. The balance sheet improvements we delivered over the past 12 months reflects not only the significant cash generation and EBITDA growth that we realized in '22, but also several proactive actions, including an $86.5 million equity financing in Q3 of '22 that will further support the investments we are making in high return organic growth projects.

Along with investing in organic growth and continue to return capital to unitholders through our distribution, maintaining a strong balance sheet is the top capital allocation priority for Chemtrade moving forward. We are focused on building unitholder value for the long term while preserving financial stability. 2023 is a bigger investment year for Chemtrade, as we have guided to $100 million to $140 million of growth CapEx on our organic growth projects this year.

During the construction phase, we are comfortable allowing our leverage to increase to about 3x, which is slightly higher than our long term target leverage. Once the growth projects start delivering the strong results we expect, we will reduce leverage. Before turning to our 2023 guidance, I want to provide a brief update on two balance sheet related items.

First, as I mentioned earlier, in December ‘22, Chemtrade was awarded $25 million and a favorable judgment related to a lawsuit we had against Superior Plus Corp. We received payment of the $25 million in January ‘23, but did not recognize the related gain as Superior Plus is appealing the decision and uncertainty therefore remains. Second, as noted in our MD&A and earnings release, due to the recent sharp decline in the real estate sector, we have elected to suspend the sale and leaseback process of our North Vancouver chlor-alkali facility.

Turning now to our guidance. In January, we announced our '23 guidance. And yesterday, we reaffirmed this guidance while highlighting that we expect to be above the midpoint of the range. We're expecting to generate EBITDA of $360 million to $400 million this year. While this implies a decrease relative to the record results we generated in '22, the midpoint of this guidance range of $380 million would still represent the second highest level of EBITDA ever generated by Chemtrade and will be $100 million higher than our '21 EBITDA. And as I mentioned, given the strong start to '23, we now expect to be above the midpoint of the adjusted range.

In our view, the 2023 guidance that we have laid out highlights that we expect another successful year across the business. Much of that strength we saw across our product portfolio in '22 has carried into the beginning of '23. And while we anticipate softening in certain areas as the year progresses, we expect continued strength or incremental improvements in others. We believe that this guidance helps illustrate our differentiation from our chemical peers, many of whom are facing mounting challenges in the current environment.

I would also like to point out that the midpoint of our '23 guidance implies a payout ratio of roughly 40%, again, highlighting the sustainability of our attractive distribution. The key assumptions underlying our '23 guidance are provided in our disclosure documents so I will not repeat them here.

I will now hand the call over to Scott, who will walk through the outlook for each of our key products and the factors that give us continued optimism for '23 and beyond. Thank you. Scott?

Scott Rook: Thank you, Rohit, and good morning, everyone. Thank you for joining us on today's call. I'd like to start out by saying that I'm extremely pleased by the strong fourth quarter results that we had to cap off the best year in our company's history. Our strong execution and operational initiatives put us in a great position to take advantage of the opportunities we had over the course of the year.

As Rohit said, we continue to see favorable market fundamentals across most of our product portfolio with a number of varied drivers providing us with continued confidence for the year ahead. Starting with our sulfur products, market fundamentals remain solid for all three of our sulfuric acid businesses. Demand and pricing for regen acid, which is used in the production of gasoline, fully rebounded in 2022 and has remained stable as we start '23. We expect this momentum to continue given that regen demand is tied to refinery utilization rates, which tend to hold up well in a typical recession.

Ultrapure sulfuric acid continued to see strong demand despite a general slowdown in the global semiconductor industry. Ultrapure continues to be the most significant growth opportunity for Chemtrade over the coming years. There are approximately 10 new semiconductor fabrication plants that have been announced and are currently under construction in the U.S. We expect the U.S. market for ultrapure acid to grow by 2x to 3x in the next five years as the U.S. seeks to become self-reliant for chip manufacturing.

We now have two projects underway to add additional capacity to capture some of this demand growth. I'll provide an update on those projects in a few minutes when I discuss our organic growth opportunities in more detail. We also expect sales volume and pricing for ultrapure acid to increase in '23 relative to last year, given the continued tightness in industry supply of ultrapure relative to strong market demand.

Merchant acid also continued to remain stable at the start of this year. Merchant acid is used in a broad range of industrial applications. If an economic recession were to occur this year, we may see some softening of demand as the year progresses. However, we have yet to see any noticeable weakening of merchant demand to date and two factors give us encouragement. First, economists are increasingly calling for a shallow recession. And second, global supply disruptions across various end use markets have led to increased demand for merchant acid in North America, which could help to dampen the impact of any economic weakness.

One more item I'd like to note with respect to our sulfuric acid business. In 2023, we plan to increase our spending at our plants for various reliability improvements. These projects will ensure that we continue to get the most out of our assets over the long term. And ultimately, we believe these investments will pay for themselves over time.

Moving over to our water treatment chemicals. We anticipate demand for our water chemicals will continue to grow steadily over time, particularly for PAC and ACH, which are growing at roughly 5% annually. To capture this growing demand for PAC and ACH we made some small investments in additional capacity last year. We expect these projects will start to contribute more meaningfully to the water business in 2023.

Raw material costs were a headwind for the water chemicals business in the first half of last year. However, these raw material costs have since stabilized and started to decline, so we are now starting to see a tailwind benefit to the business. We're hopeful that we will see stable margins during 2023. I would also reiterate that these chemicals are largely nondiscretionary, and we, therefore, expect to see limited impact on demand in the event that an economic downturn occurs.

Turning to the outlook for our Electrochemical segment. We continue to see a supportive market backdrop for the EC segment. 2022 was a record year for the EC segment by a wide margin. This was the result of strong chlor-alkali pricing, including historically high pricing for caustic soda. A number of factors contributed, including a global supply dislocations that resulted from geopolitical conflicts, increased freight cost and utility costs overseas leading to higher pricing, and finally, improved cost position for Chemtrade's production.

We foresee that many of the factors that supported the strong performance will carry into this year and beyond. Most notably, with the ongoing crisis in Ukraine, Europe has shifted its energy supply away from Russia to other higher cost sources. This shift has driven up energy prices in Europe along with other regions of the world. Conversely, Chemtrade benefits from access to British Columbia and Manitoba's low cost renewable hydroelectricity sources.

Chemtrade's EC plants operated these low-cost cost regulated energy markets, providing a significant cost advantage relative to competitors in Europe and Asia. This cost advantage will likely remain in place for at least the next several years, and we expect that benefit will continue to support increased demand for North American electrochemicals.

In our 2023 guidance for caustic soda, we assume that the average Northeast Asia index pricing will be USD $185 per ton lower than last year's average. This is based on industry forecasts that have called for moderation in pricing compared to last year. As a reminder, every USD $50 per ton change has a roughly $12 million impact to our annual EBITDA.

Shifting to chlorine, the North American merchant chlorine market remains stable with industry supply still tight and end market demand continuing to hold up well. The outlook for hydrochloric acid is also very positive. North American rig counts remain significantly higher than a year ago, reflecting the improving market conditions for HCl in early 2023. Elevated natural gas prices in Europe have also led to increased demand for exports of natural gas from North America. This trend will further support increased rig counts resulting in higher HCl demand.

In our guidance for this year, we highlighted that total MECU sales volumes will be lower in this year than last year. This assumption reflects the potential for economic softening that could impact our ability to place a portion of our volumes in the market. But as we have noted before, the ultimate impact to our EC business in an economic downturn will be determined by the relative impact on caustic demand versus chlorine demand. If chlorine sees a more outsized demand reduction than that of caustic, then the overall price we realize for MECU could, in fact, increase. Additionally, the global supply dislocations and elevated energy prices that I just spoke to could mitigate the potential downward movements in pricing for our electrochemicals in an economic downturn.

Finally, moving on to sodium chlorate. The elevated global electricity costs have also improved the cost position of Chemtrade's sodium chlorate business. Similar to chlor-alkali, Chemtrade's sodium chlorate business benefits from low cost hydroelectric energy that is regulated. Approximately 75% of the variable cost to manufacture sodium chlorate is attributed to input cost of energy. This gives Chemtrade a particularly strong position, especially given that our Brandon plant is the largest and lowest cost sodium chlorate plant in the world. As a result of the increase in electricity costs in Europe, previously a net exporting region for sodium chlorate, they are now a net importer. And again, this is an advantage that we expect will remain in place for at least the next several years.

Most of our sodium chlorate agreements are negotiated annually, which limited our ability to benefit from the changing market conditions last year. However, starting in the first quarter of this year, we see a significant improvement in this business performance, reflecting the global shift in operating rates. However, I would note that our guidance assumes lower sales volumes of sodium chlorate this year compared to last year, owing to a potential economic softening and the related impact on chlorate demand in industrial end markets.

I would now like to provide you with an update on our various organic growth projects. Chemtrade's objective is to deliver sustained earnings growth and generate value for our unitholders. These organic growth projects are high return opportunities that we expect will create incremental value for the long term. We estimate these various organic growth projects will contribute an incremental $45 million of EBITDA by the end of 2025 and an incremental $75 million in EBITDA by the end of 2027.

At our inaugural Investor Day this past November, we provided more detail on some of the organic growth projects that Chemtrade is undertaking over the next several years. For more information on the Investor Day event, the presentation slides and the video recording can be found on our website's Investor page.

As I mentioned in the SWC outlook, our ultrapure sulfuric acid remains the largest opportunity for growth for Chemtrade. Over the next five years, we expect demand for ultrapure to increase by 2 to 3x. And with this step change in demand, there will also be a step change of quality needed to meet the requirements for the next generation chips produced in the U.S. We have two projects that we announced last year to capture some of the demand growth. These projects include a quality upgrade and expansion at our facility in Cairo, Ohio as well as a new joint venture, KPCT Advanced Chemicals to build a world scale plant in Casa Grande, Arizona.

Our Cairo, Ohio expansion project will be the first plant in North America to make the new quality sulfuric acid that will be required by these new semiconductor fabs. In December, we hosted a well-attended ground-breaking ceremony to celebrate this important milestone for Chemtrade. This project is underway and all of the long lead time equipment required for the project has been ordered. So Cairo is progressing well, and we expect construction to be completed in the first quarter of 2024 and with commissioning and start up later in '24.

Our Casa Grande, Arizona ultrapure project also continues to progress well. We are currently undertaking a front end engineering design study which remains on track, and we will provide updated capital cost and schedule for this project by mid-2023. And we will continue to share more information on this important project as the year progresses.

Turning to our water chemicals projects. As I noted earlier, the small projects we undertook last year were successfully completed. These projects added additional production capacity of both PAC and ACH, which are the two higher growth water chemicals that we manufacture. This incremental production capacity is currently installed and we expect the business to see a benefit this year. Meanwhile, we are continuing to assess additional growth opportunities in the water chemicals business.

Regarding our green hydrogen projects, our previously announced project at our Prince George sodium chlorate plant has been delayed. One of Chemtrade's partners for that project decided to conserve their capital with current ongoing economic uncertainty. However, it's important to note that our other hydrogen projects are unaffected and continue to move ahead. We'll continue to provide updates on these projects as they move forward. To support these organic growth projects, we plan to allocate $110 million to $140 million to growth capital expenditures this year, with the majority of this growth capital going towards our two ultrapure acid capacity expansion projects.

Finally, ongoing productivity and reliability improvements remain a core focus for Chemtrade this year and beyond. The improvements we made in past years will continue to bear fruit, and we intend to make further improvements over the course of the year. We remain committed to our target of generating at least $15 million of incremental savings each year from these improvements, which will help mitigate the impact of inflation across our business.

Before opening the call to analysts or to Q&A, I'd like to quickly reiterate some of the notable points we made throughout this call and summarize some of the key characteristics of Chemtrade for our investor audience who may be listening for the first time. First, I would like to reiterate that we are differentiated from other chemical companies for a number of reasons that we'll highlight on this call. We have a diversified product portfolio with significant regional market share across our key products.

In addition, many of our key products have historically exhibited defensiveness through economic downturns and others are seeing strong tailwinds that could help limit their downside in an economic downturn. We have a significantly strengthened balance sheet. For these reasons, we believe we are in a much better position than many of our chemical peers should the economy enter a recession.

Second, I want to stress the significant cost advantage we have in the Electrochemicals business. Our access to regulated and renewable hydropower puts us in a great position relative to our international competitors, benefiting both from the pricing and demand we are seeing across our EC portfolio. Again, this is not an advantage that we expect will be short lived as many of the underlying factors impacting elevated global energy prices overseas will not be easily resolved. Consequently, we believe this will provide a competitive advantage for the EC segment for the foreseeable future.

Third, we remain keenly focused on operational excellence, which includes improved productivity and reliability and strong operational execution across our footprint. This focus allowed us to capitalize on strong market dynamics last year and supports our expectations of having the second strongest year in our company's history in 2023.

Fourth, our organic growth projects continue to progress well, and we believe the opportunities we are pursuing will generate attractive, sustainable, and long term returns for our unitholders. We now have the balance sheet to support these investments while maintaining good financial flexibility, and we remain committed to the targets we have established, including generating $75 million of incremental EBITDA over the next five years from these projects.

Fifth, we continue to make great strides in our ESG initiatives and are positioning Chemtrade to be an industry leader on this front.

And finally, recognizing the importance of balanced capital returns for our unitholders, we continue to pay an attractive and sustainable distribution with a current yield of approximately 6%. I am incredibly proud of our company, and more specifically, our team of almost 1,400 dedicated employees. I believe that Chemtrade is truly a great company that's just beginning to show its true potential, and I look forward to another successful year in 2023.

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 at this time. Thank you.

Operator: Thank you. Ladies and gentlemen, we will now begin the question and answer session. Should you have any questions, please press star followed by the number one on your touch tone phone. You will hear a three tone prompt acknowledging your request.

Your first question comes from the line of Jacob Bout from CIBC. Your line is now open.

Jacob Bout: Good morning. My first question is on the dividend and your CapEx. So if we take the midpoint of your EBITDA guidance range and we back out to midpoint of maintenance growth CapEx, cash interest, tax, and lease, the free cash flow doesn't cover the dividend. So A, I guess, how committed are you on the dividend? And then just on this CapEx guidance that you provided, are you front loading this ultrapure project?

Rohit Bhardwaj: Okay. So I can talk about the math you just did. So the way our approach to funding the organic growth is that we do have strong internal cash flow. But as you know, we did raise some equity last year. And so our dividend decision, obviously, is the board decision, but Scott and I advise the board well on that topic. So we don't think that our distribution should be affected by organic growth CapEx because the distribution is really what the business can sustainably offer in the long term. In the short term, if we have the funding requirement, we are going to fund it from excess cash flow. We've been able to bring our leverage down to 2.2% as we mentioned. We are comfortable getting leverage to go up to roughly 3x in the construction phase. So I think that should tell you that we are very committed to our dividend. Clearly, it's a board decision, but we are committed to it.

And in terms of front loading, I think we'll give you a better idea of CapEx for the growth project, the big one in Arizona, in middle of this year, when we have our FEED study done and we've reviewed it -- we'll give an update on both project timing and on project cost and some idea of how the cost will be spread out. But Ohio is well underway, as you know. So a lot of that spending will be happening in '23.

Scott Rook: Just to add to that, it's clear, I think, that our organic growth spending is going to happen. So we do that obviously in advance of generating revenue, as you know. But that's going to be a one or two year event and it's not going to be an ongoing basis. If we thought we were going to spend that much on organic growth every year, that would be a different story. But this is a short time period. And as we said, during this period where we're spending more, we're comfortable with allowing our leverage to move up to around three. And we think we can get these projects done while it's at three and then after that they're done, it will -- our leverage will return to more historical lower levels.

Jacob Bout: Thanks for that. And maybe just a secondary question on chlorate. You're commenting that '23 guidance will be above midpoint talk about tailwinds and electric chemicals. How much of that is actually coming from chlorate? And maybe just help us out here a bit on the math. I know during the Canexus days it used to break out what that chlorate division would generate. And it was roughly, say, call it, $70 million to $90 million in EBITDA. How did that drop during the pandemic with everyone staying at home? And how big of a tailwind can we expect in 2023?

Rohit Bhardwaj: I think your memory on Canexus is right. So what we have said is that demand in general for chlorate had dropped about 8% during the pandemic. This is for the industry. So you can assume that that affected us as well, and it is a profitable business, I should say, high variable margin business. So when you lose volume, it is quite painful.

In terms of what we have talked about in our guidance, we think we're going be about the midpoint now is because more because the chlor-alkali segment because in Northeast Asia has remained higher than we had initially estimated. And also the other elements of the other products in chlor-alkali are doing better than we had expected. So I would say it's more to do with that and to some extent, chlorate as well. But then the other thing I should point out just in case there's any confusion is that we did not update our assumptions in our guidance, so the assumptions are still pointing to the midpoint of the guidance. So just to clarify that in case there's any confusion about it.

Jacob Bout: Thank you.

Operator: Your next question comes from the line of Joel Jackson from BMO Capital Markets. Your line is now open.

Joel Jackson: Hi. Good morning, everyone. A few questions. Maybe just on something that, Scott, you said a little couple of minutes ago with Jacob, you're comfortable if leverage was up to 3x. Does that imply that in a bare case scenario, you see EBITDA falling to about $300 million? Just wanted to get the implication of what that meant?

Scott Rook: No, we do not have -- we've issued our guidance and we stand by that. So no -- we do not --

Joel Jackson: Sorry, Scott, I'm talking -- I'm not talking about guidance for '23, but you said you're comfortable getting leverage -- sorry to interrupt -- 3:1, 2x leverage, net debt is about $900 million.

Rohit Bhardwaj: Joel, sorry to interrupt. I can help there. I think what that comment was the fact that when we are spending on organic growth, we're going to be borrowing money from our bank line to pay for the organic growth. So during that construction phase, leverage could creep up from the 2.2% it is today to around 3%, and we are comfortable in the construction phase for a couple of years to live with that higher leverage. And then when the projects start paying off, which are very attractive returns, then we will bring leverage back down to below three, which is where we would like long term to be below three level.

Scott Rook: That's exactly right. We're comfortable as we're spending the $110 million to $140 million on organic growth, that will -- could move our leverage up to around three from where it's at -- where we finished at the end of last year at 2.2.

Joel Jackson: Okay. What do you think corporate costs would look like in 2023, Rohit or Scott?

Rohit Bhardwaj: Well, yes. So I think for modeling purposes, you can look at about $80 million for the year. I think some of the things that are harder to predict are foreign exchange losses because we have an assumption on the dollar, but things can change. And then the other thing is, of course, our long term incentive plans get affected by unit price and what else is happening on a relative basis. So I would say in a normal case, we expect 80, but we will try and give you some visibility on our LTIP assumption every quarter, so you can take that into account. But that's what we expect it to be roughly.

Joel Jackson: Okay. And then you indicate now let you think that you'll be able to come in a bit below -- sorry, above the midpoint of the 380 midpoint guidance. I don't know if that means $2 million, $5 million, $10 million. I don't know if you can tell me what it is, but you didn't change any of your key modeling assumptions. So can you maybe tell us where was the upside? Could you try to scale it for us?

Rohit Bhardwaj: Sure. So I don't think you want to get into precision about how much above the midpoint we expect to be. And that's one of the reasons why we didn't want to tinker with the assumptions either because still sitting here on February ‘23, a long way to go this year. But to give you some idea, it's principally coming from the electrochem segment. And if you look at our Northeast Asia assumption, you will see that our assumption basically -- the caustic is higher than -- it's coming in higher than our assumption because Q1 pricing sets Q2 and our Q1 assumption is lower than where it is today. And also the other parts of the hydrochloric acid and chlorine are showing more strength than we perhaps might have forecast earlier when we did our guidance. I think I'd like to leave it at that for now. Obviously, in Q1, we will give you updated assumptions and give you more color on how we see the year shaping up.

Joel Jackson: Thank you.

Operator: Your next question comes from the line of Steve Hansen from Raymond James. Your line is now open.

Steven Hansen: Good morning, guys. Thanks. Scott, Rohit, you mentioned earlier in your commentary that you expect to see stable margins in the water chem space. But I think at the same time, you were also suggesting that pricing has finally caught up to the headwinds that we were facing last year. So I'm just trying to square those two comments. Should we expect to see margins stable or slightly better as we roll forward in some of those contractual elements start to catch up?

Scott Rook: Well, I'll say, look, as we are hopeful to see expanding margins in water, we're somewhat cautious because sulfur has fallen, but sulfur is also forecasted to go up. And so if sulfur goes up per the forecast, then that might be -- that would probably mean more of stable water margins.

Steven Hansen: Understood. Okay. That's helpful. And just maybe a second comment about portfolio composition. This goes back some time now, but I recall when the transaction happened, there was some debate about the volatility in EC and how that would fit longer term within the portfolio. Clearly, it's been a good source of cash flow of late. But as you think forward to when the organic projects are finishing off, do you still think that EC will fit in the portfolio longer term? In other words, would you ever contemplate selling it as some of these other projects are finishing off? Or how do you feel about that mix today?

Scott Rook: Well, look, I think as we look at the business today, I think that fundamentally, the electrochemicals business is more competitive now -- that our electrochemical business is more competitive now perhaps than it ever has been. And that's because of our cost position, low cost position with electricity relative to what's happening in the rest of the world. And so as we look at that and think about it for the next many years, we think that's going to remain. So we'll leave it at that.

I think that chlorate -- the chlorate market use is the pulp and paper industry, which does have some concerns in North America, both from a supply standpoint, but also from a demand standpoint. While we did have some concerns there. Now what's happening is that the whole global supply and demand balance has changed, where the European region was an exporting region. And now because of the change in energy prices, Europe is not exporting and now they're importing, and so that’s had an impact. So the bottom line with that, the trends that we see right now look very favorable, and we'll continue to reassess those as time goes on.

Rohit Bhardwaj: And if I can just add one clarification, Steve. We never -- when they talk about the margins was all around the chlor-alkali business, never the sodium chlorate business. That was kind of one of the big reasons why we bought Canexus is because we believe having the lowest cost plant in the world is a good thing. And so -- and as Scott mentioned on the chlor-alkali side, the business is fundamentally different from what it was when we acquired it for the better.

Steven Hansen: That's helpful. Thanks. And just last one, if I may, is around -- Scott, I think you referenced additional opportunities being contemplated in water chemicals. This is over and above the pack and ACH expansions. What exactly does that imply? What are you looking at? Is it additional organic growth? Or are you looking at some other types of opportunities as well?

Scott Rook: Well, we are -- I'll say we are looking at and thinking about what could be additional capacity expansions in PAC and ACH. And then we have some ideas that could be new products, and I'll just leave it at that. So there -- we feel that there are other growth opportunities in water that we're exploring.

Steven Hansen: Okay. Very helpful. Thank you.

Scott Rook: Yep.

Operator: Your next question comes from the line of Gary Ho from Desjardins. Your line is now open.

Gary Ho: Thanks. Good morning. Maybe just going back to sodium chlorate. Volumes in your '23 guidance versus '22 actual, I think down roughly 10%, but you also highlighted higher selling prices for sodium chlorate. I think you've actually added significantly higher this quarter. I'm assuming the price will more than offset the volume drop. Maybe just give us an update on that side of the business and what your outlook.

Rohit Bhardwaj: Okay, the volume drop is basically we shut down our higher cost plant in Quebec. So that's really the volume. And this is a business where we're optimizing margin here. The volume is I think it made sense for us to shut that and cut some fixed cost out of the business and focus our business on the two plants that are remaining. And so I don't want to get into price versus volume. But yes, for sure, the decision was made basically to shed fixed costs and pricing has been probably independently affected because of what's happening globally with energy costs and the fact that, as Scott mentioned, from a global supply demand perspective, there's been a fundamental shift with Europe becoming a net import zone from an export zone, so that has a knock on effect on pricing. Plus the ceiling -- the floor for sodium chlorate pricing is a lot higher now because as you know, 60% to 70% of cost there's a variable cost of electricity. So as globally electricity goes up, and in fact, not even globally, a lot of parts of the U.S. have seen much higher electricity as well, but that just sets the floor for pricing at a much higher level than it has been in the past.

Gary Ho: Okay. That’s helpful. And then on caustic, the Northeast Asia prices have softened somewhat. I know still above what you have assumed. What's your outlook there? Are you expecting this to stabilize? Maybe give us an update in terms of market dynamics, that would be helpful.

Scott Rook: Yes. So I'll do that. Look, we talk to the same industry experts on the outlook for caustic as you do. We have offered in our guidance what the outlook for that is. And so far, the caustic pricing has been above what we have said. So what's going to happen, as we look forward, the outlook that we read or that we look at does call for gradually increasing caustic and those are public documents, so we can see that. And we're hopeful that that will still transpire. So caustic goes into the biggest market is aluminum. And so that has an impact, but there's growing demand for caustic for use in batteries for electric vehicles. So that's creating, I think, new demand for caustic, which will increase demand.

Gary Ho: Okay. Great. And then my last one, maybe for Rohit. You gave us added disclosure around the average MECU netback ultra ‘23 versus '22. Any rule of thumb you can give us in terms of sensitivity of that metric to EBITDA perhaps? You've given us some sensitivity on the caustic side to EBITDA. Just wondering if you have the numbers there.

Rohit Bhardwaj: Yes, sure. So I mean, if you look, we do give you our MECU sales volume and basically by telling you that the netback is going -- so every dollar change in netback is basically that times the annual volume, which we've given you what our assumption is for this year. So that's probably where you can do the math, it all drops down to the bottom line.

Gary Ho: Okay. Okay. Great. That’s it for me. Thank you.

Operator: Your next question comes from the line of Nelson Ng from RBC Capital Markets. Your line is now open.

Nelson Ng: Great. Thanks. Just a quick question on the ultrapure acid side. So I know you're obviously going through the FEED process at the Casa Grande project. But can you just comment on what's the ability or likelihood is in terms of increasing the production capacity? Or obviously, is on it such that an expansion at a later date could be pretty easy given all the, I guess, semiconductor activity we're seeing in the U.S.

Scott Rook: Yes, sure. I'll comment on that. So the capital cost that we've shared publicly on that, we believe will be enough capacity to meet demand in that region for the next three to five years. And so we still think that that's the case.

It's certainly possible that while the industry will need more capacity beyond that. And so the industry is going to need more capacity most likely in the Arizona region, actually in Texas as well as Ohio. And so we are currently thinking through those market opportunities and how best to address that in the future. But again, what we have in our capital estimate that we've shared, that will be enough production, we think, to meet the demand there for the next three to five years.

Nelson Ng: Okay. And obviously, you don't want to overbuild more than that? And do you think the 3% to 5% is that good --

Scott Rook: Yes, we think that right now, that we think that's the appropriate volume to build to meet demand. And then look, we'll adjust from there. But we want to make sure that this plant that we build it, start it up, we run it, right quality, that it meets the specs for our customers. And while we're doing that and as our confidence grows, we'll get more serious about what's coming after that.

Nelson Ng: Okay. Got it. And then just moving to the hydrogen side. So obviously, you mentioned that the Prince George hydrogen project is getting delayed. And I know that that project wouldn't have contributed anything material for several years. But could you just give a bit of color as to whether this is like a slight delay like a few quarters? Or does there need to be more visibility on a potential recession and that could obviously take like a year or two?

Scott Rook: Well, I would say, at this time, we don't know how long this delay is going to last. And as what we've shared before, too, is that this impact in terms of our numbers, it's a very small, almost negligible impact. It's $3-$4 million in the future. So we don't know right now how long that's going to delay, but I'll say we're actively working to try to bring that project online. And that will have no impact on our other projects that we're working on, in particular, as I keep talking about Brandon has the potential to be our largest hydrogen project. And this delay at Prince George will have no impact on what we decide in Brandon.

Nelson Ng: Okay. And then just one quick follow-up on the Prince George one. Do you have the flexibility to switch partners?

Scott Rook: I won't comment any more on that. I'll just say we're working to get a project back on track, and I'll just leave it at that.

Nelson Ng: Okay. Got it. And then just one kind of last big picture question. So obviously, everyone's heard about the train derailment in Ohio. And I guess, you guys rely on rail transportation as well. Can you just talk about the cost of transportation and the cost of insurance for some of your more, I guess, hazardous materials?

Rohit Bhardwaj: Maybe I can take that. Rail is a big part of the cost, but it affects the entire industry. And so actually in some cases, the higher the rail cost, it actually is beneficial to us just because it makes the optimization of our network more valuable. But it is a significant cost. We keep an eye on it. We more than meet safety standards. We often win safety awards from the railways. So clearly, the railways -- they have to be responsible for their own performance. But as we are concerned, we take all the right steps to have our product safely transported. And so I think we worry more about the reliability of the service. Obviously, cost is a concern, but costs particularly affect our industry and gets passed through to customers. So it's really more on the reliability, making sure that we don't have disruptions to the rail service. Those are more critical things for us.

Nelson Ng: Okay. Thanks. I'll leave it there.

Operator: Your next question comes from the line of Endri Leno from National Bank. Your line is now open.

Endri Leno: Hey. Good morning. Thanks for taking my questions. A couple for me. But the first one, I just wanted to clarify something back to the export opportunities in the EC. Is this only for sodium chlorate? Or is there any possibility to export caustic as well?

Scott Rook: No, it would just be for chlorate. There could be caustic let's say, exported from North America, but we're not in a position at our plant in Vancouver really to do that.

Rohit Bhardwaj: In fact, our core market there, the Western Canadian, Northwestern U.S. market is actually short domestic products. So about half of the product actually comes in as imports. So caustic is very different because that's getting imported from Asia. Now the other parts of the U.S. that can export from the costs, et cetera. But our market is actually short product. And so we don't have any reason to look at trying to export caustic.

Endri Leno: No, that's great. That's what I thought, but I just wanted to clarify. And a follow up on that then. So if Brandon has the best cost structure in the industry, do you contemplate like any scenarios where you could add capacity there, for example, to take advantage and take market share and export to Europe? Or you don't see that happening at any point?

Scott Rook: We will look at that and see if there could be options to expand capacity there, we'll consider that. Right now, we'll leave it at that. We'll look at that. Brandon is not close to a port. So the freight part would be a key component.

It is the largest chlorate plant in the world, and it's a low cost position, but it's not located close to a port.

Rohit Bhardwaj: I think what's important is that so long as production from North America is being exported, it doesn't really matter who is exporting it. It's just good that the product is leaving North America because, clearly, in the end, we are here to optimize margin and not necessarily optimize volumes.

Endri Leno: That's great. Makes sense. And one other question for me. On the water product, and I'm not sure maybe you've disclosed this before, but are you able to give us a breakdown on your end markets? What is industrial versus what is municipal? And should there be, for example, an economic slowdown? I mean would you anticipate any impact to the industrial water products?

Scott Rook: Yes. So I would say no. What's happening is the demand coming from city municipalities is independent of what I'll say, of any economic impact. That's more just driven by the population. And so that has no impact. And the other more industrial uses, they're growing mainly because of requirements to regulations. And so that's driving growth. And we don't see that really changing. I don't see that changing, and that's not, in the past, been subject really to economic pressures.

Rohit Bhardwaj: In fact, typically, as we've said, what happened in the recession is raw materials drop. So actually, water margins tend to expand in a recession as opposed to go the other way.

Endri Leno: That’s great. Thank you. That’s it for me.

Operator: There are no further questions at this time. Please proceed.

Scott Rook: All right. So we would like to thank everyone for participating, and have a good rest of the day. Thanks, everyone.

Rohit Bhardwaj: Thank you.