Chemtrade Logistics Income Fund

Q1 2024

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8:30 AM

Operator: Good morning, ladies and gentlemen, and welcome to the Chemtrade Logistics Income Fund Q1 2024 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 "*" "0" for the operator.

This call is being recorded on Thursday, May 16, 2024. I would now like to turn the conference over to Rohit Bhardwaj, Chief Financial Officer. Please go ahead.

Rohit Bhardwaj: Thank you. Good morning, and thank you for attending Chemtrade Logistics Income Funds earnings conference call for the first quarter of 2024. Joining me on this morning's call is Scott Rook, our President and CEO.

We will begin this call by providing a brief recap of the first quarter results we announced yesterday in addition to our updated 2024 guidance. Scott will then provide comments on the outlook for our key products and provide thoughts on various growth initiatives. Following our prepared remarks, we will open the lines for questions.

Please note that this call has an accompanying slide deck, which is available on our website, chemtradelogistics.com. Before proceeding, we would like to note that today's call will contain certain forward-looking statements that are based on current expectations and are subject to a number of risks and uncertainties.

Actual results may differ materially from expectations. Further information identifying risks, uncertainties and assumptions and additional information on certain non-IFRS and other financial measures referred on this call can be found in the disclosure documents filed by Chemtrade with the securities regulatory authority available on sedarplus.com.

One of the measures that we will refer to in this call is adjusted EBITDA, which is EBITDA modified to exclude noncash items such as unrealized foreign exchange gains and losses. While our accompanying presentation refers to Adjusted EBITDA, we'll refer to it simply as EBITDA in our remarks.

Beginning now with our first quarter results, which we believe demonstrate a strong start to 2024. While the financial results we generated this quarter were lower on a year-over-year basis, it is important to note that Q1 of 2023 marked a record Q1 for Chemtrade, making a direct comparison difficult.

In Q1 of 2023, we benefited from several factors, including substantially higher realized caustic soda pricing than in Q1 of this year. That being said, the results we reported this quarter were ahead of our initial projections. This reflects the strong execution on the part of the entire Chemtrade team. Most of our businesses performed well.

The continued focus on reliability, productivity, execution, and commercial excellence across our diversified portfolio continues to yield strong returns and support our operational and financial performance. EBITDA margins remain robust, and we continue to generate very strong cash flow that is well above our distributions. Our balance sheet remains well positioned to pursue accretive growth and other value creation opportunities.

Looking at the sulfur and water chemicals segment, which I will refer to as SWC moving forward, revenue was $230.6 million, reflecting a decrease of 12% year-over-year. EBITDA for the segment was $51.4 million, a decrease of 7% over last year.

Water chemicals were once again a standout performer this quarter with higher selling prices contributing to margin improvements. In merchant acid, we had lower volumes year-over-year, which can be attributed mainly to reduced byproduct supply. As a reminder, roughly half of our merchant acid is obtained under long-term contracts for metal smelters. Merchant acid selling prices were also lower, but the pricing impact was mitigated by our risk-shared contracts with the suppliers which allowed us to keep our margins relatively flat. Merchant acid remains a very resilient business for Chemtrade.

After a decline during COVID, regen acid has performed well. And looking ahead, the regen acid market remains a relatively stable business line for us. In sodium nitrite, the maintenance activity to assess process improvements discussed last quarter carried into the first quarter of '24. While these improvements did negatively impact overall volumes for sodium nitrite in Q1, the work is now complete and the improvements are starting to pay dividends and should benefit the long-term performance of the sodium nitride business for Chemtrade with increased reliability moving forward.

In the Electrochem or EC segment, revenue for the first quarter was $187.6 million, reflecting a decrease of 10% year-over-year. EBITDA for the period was $82.5 million, which declined 17% compared to Q1 of '23. This decline was almost entirely attributable to materially low caustic soda pricing on a year-over-year basis. In Q1 of 2023, our caustic soda pricing was based on an index of over USD 650 per ton, where in Q1 2024, the index was USD 300 per ton lower.

The partial offset to lower caustic soda pricing was improved netbacks for both hydrochloric acid and chlorine, which offset about 25% of the decline in caustic soda. But in recent quarters, chlorine pricing was a more meaningful contributor to performance than hydrochloric acid, this dynamic has now flipped and hydrochloric acid pricing now having a bigger impact than chlorine pricing.

Looking at corporate costs. Our corporate costs in Q1 were essentially flat on a year-over-year basis, which was in line with our expectations. Looking at the balance sheet, we ended Q1 in a very strong financial position with low financial leverage and significant financial flexibility.

At the end of our quarter, our net debt to adjusted EBITDA ratio was 1.9 times, which is up slightly from the end of '23, but an improvement from 2.2 at the end of Q1 '23. Based on our guidance, we expect this leverage ratio to remain at or below 2 time at the end of '24.

We have no debt maturities until September 2025. We also have significant undrawn capacity on our revolving credit facilities in addition to cash on hand. Given the significant improvements made to our balance sheet in recent years, we are now in a great position to be able to evaluate and pursue various potential value-enhancing initiatives.

Yesterday, we announced our Board's approval of the initiation of a Normal Course Issuer Bid. This will offer us another potential avenue to return capital to our unit holders.

We're also looking at other opportunities to further optimize our capital structure, including retiring the convertible debentures that are maturing next year at the earliest opportunity.

We're also looking to supplement our organic growth initiatives with M&A should we identify an opportunity that fit strategically within our portfolio and has synergistic value. The acquisitions we would target would primarily be those with annual EBITDA in the $10 million to $50 million range. Any opportunities we try to pursue will be aligned with our commitment to balancing capital allocation across our 3 core pillars: investing in strategic growth, maintaining a strong balance sheet, and returning capital to our unitholders.

Moving to our 2024 guidance. We now expect that 2024 EBITDA to be at the higher end of our previously communicated guidance range of between $395 million and $435 million. This update reflects our strong start to the year and our continued confidence in our ability to deliver strong performance for the balance of 2024. We remain well positioned to again deliver one of the best years for EBITDA in Chemtrade’s history.

I would like to reiterate a couple of points made during our last conference call that are still relevant when thinking about the trajectory of our earnings for 2024. We expect the second half of 2024 will be stronger than the first half of this year. This is primarily owing to the biannual turnaround at our North Vancouver facility, which we have just completed. We anticipate that the turnaround cost us roughly $15 million impact, and this will impact Q2 for EBITDA.

In addition, since the second quarter last year was the highest EBITDA quarter in Chemtrade's history, we can expect that EBITDA for Q2 2024 will be lower competitively speaking. Again, this is primarily due to the higher caustic soda pricing that we benefited from last year and we have the biannual turnaround this year.

Note that our guidance does not consider the impact of the anticipated labor disruptions that the rail companies used to transport our products. The impact would depend on the length of the disruption and since it is unknown, we have not factored this into our guidance.

The assumptions underpinning our 2024 guidance are available in our disclosure documents. Please refer to these for additional information. I will now hand the call over to Scott to provide some commentary on our outlook. Scott?

Scott Rook: Thank you, Rohit, and hello to everyone who is joining us on this morning's conference call. We value both your continued interest and support of Chemtrade and are pleased to be sharing our strong first quarter results with you today.

We believe we have established a strong foundation at Chemtrade in recent years. We have focused on improving both reliability and execution, and our first quarter results are reflective of these efforts. We anticipate this year will be another year of achievement and progress for Chemtrade, and we look forward to continuing to execute on the significant opportunities that lie ahead.

Looking across the key products in our portfolio, we continue to expect strength in a number of areas and relative stability in others. Starting in our SWC segment, we are expecting another strong year for our water chemicals business. Demand for these chemicals remains robust, and we are seeing good pricing as well. In addition, the investments that we have made in the water business, including capacity expansions for higher growth products, PAC and ACH continue to yield strong results.

While ALUM used to represent the bulk of earnings in our water business, we have grown our specialty water chemicals to be roughly 20% of the business. We are making additional investments in this business to drive growth in 2025 and beyond, which I will elaborate on shortly. In our sulfuric acid business, the outlook for regen remains strong with demand continuing to be solid, supported by vehicle driving activity and demand for gasoline alkylate.

In merchant acid, we're expecting a year of relatively normal performance. Our risk-sharing agreements are contributing to this stability. However, I would note that the merchant acid business had a fairly strong year last year, so we do expect some moderation this year. Our ultra-pure sulfuric acid business remains unchanged.

There is a continued strong outlook in the ultra-pure market, which is supported by new semiconductor manufacturing coming online in North America over the next several years. Under the CHIPS Act, the U.S. government has awarded over $23 billion in the first quarter of this year to support new construction of semiconductor fabs.

We have shared the various investments we are making to maintain our North American leadership position in ultra-pure acid, and I'll provide an update on those projects momentarily. Moving to our Electrochemicals business. We continue to see benefits from our advantaged cost position relative to overseas manufacturers.

Our facilities are cost competitive on a global scale, given our access to stable, low-cost renewable hydroelectric power, and we expect this to remain the case for years to come. This advantage is leading to export opportunities for some electrochemical products while also contributing to improved pricing and demand. For instance, our Brandon Manitoba sodium chlorate facility is both one of the largest and one of the lowest-cost sodium chlorate plants in the world.

We are anticipating our sodium chlorate volumes to be about 5% lower on a year-over-year basis this year. This is due to pulp mill closures in Western Canada, but we expect much of the volume impact to be offset by continued strong pricing.

In chlor-alkali, as Rohit mentioned, we recently completed the biennial maintenance turnaround at our North Vancouver facility. The turnaround was completed on schedule. The plant is now back to operating at normal levels. We currently estimate the impact to EBITDA from this plant turnaround will be roughly $15 million. We will confirm this impact when we report our Q2 results in August.

Underlying fundamentals on the chlorine side of the chlor-alkali process remained favorable. Pricing and demand for both chlorine and hydrochloric acid remains strong. The North American merchant chlorine market remains tight. Canadian rig counts remain well above the 5-year average, and we expect continued steady demand for hydrochloric acid.

The new LNG pipeline and export terminal is coming online in Western Canada. It is expected to drive additional Canadian natural gas production and further support hydrochloric acid demand and pricing over time. We expect continued strong chlorine and hydrochloric pricing for the balance of the year.

Our guidance assumes our 2024 BCU netbacks will be about $210 million lower compared to last year.

Moving to caustic soda. Our guidance assumes that our realized caustic soda pricing this year is based on an average Northeast Asia index price of USD 375 per ton, which is down about $80 per ton year-over-year. As we have previously mentioned, the first half of last year benefited from higher caustic pricing relative to what we anticipate the first half of this year. This change significantly impacts our year-over-year financial comparisons. However, we have recently seen Northeast Asia caustic index pricing begin an upward trajectory. Based on Taiwan contract pricing and commentary from industry consultants, we are optimistic that index pricing has hit the trough and started to rebound.

As a reminder, every USD 50 per ton change in pricing has an annual impact on EBITDA of roughly $12.5 million. Given all this, we believe that caustic soda could return to a positive contributor for EBITDA on a year-over-year basis.

Turning now to our organic growth projects. We continue to expect we will allocate between $60 million and $90 million to growth capital expenditures this year. Approximately $40 million is dedicated to our ultra-pure sulfuric acid business, with the balance going to other areas, including water chemicals.

In the ultra-pure acid, our Cairo expansion and upgrade project is nearing completion. We expect that the additional capacity will start up early in the second half of this year. Following this, we will begin providing sample product to our customers for quality validation. Given that this plant will be the first in North America to meet the quality requirements for next-generation semiconductor nodes, our customers are eager to receive these initial shipments.

We're also undertaking continuous quality upgrades at our other ultrapure facilities this year. These investments will ensure that our plants are well positioned to serve this industry in the years to come.

In Water Chemicals last quarter, we announced that we are adding new PAC and ACH lines at several existing facilities this year. These additions support our ability to meet growing market demand. I'm also happy to announce this morning that we'll be building a new specialty water chemical line at our Augusta, Georgia facility this year. This project is in addition to the projects we have previously mentioned. While no single line is a large earnings contributor in itself in our water business, this is part of our broader strategy to aggressively grow our water chemicals business.

As an example, the new specialty line in Augusta is expected to add an incremental $3 million to $5 million of

EBITDA annually. We will continue to evaluate additional strategic and high-return organic growth opportunities across our business.

As Rohit mentioned, our balance sheet is now in a position where we are increasingly considering various M&A opportunities in the range of $10 million to $50 million earnings per year. Rohit also highlighted that our Board has approved a Normal Course Issuer Bid, which will enable us to, from time to time, repurchase a portion of our units with available funds that are not required for operations or investment.

I believe Chemtrade is currently better positioned for long-term success than at any other point in my 5 years with the company. We're coming off back-to-back record years for earnings. As a result of the improvements we've made, our earnings and cash flow generation have undertaken a step change when compared to prepandemic levels.

We have a strengthened balance sheet and a compelling combination of defensiveness and growth. Our portfolio is diversified with significant regional market share across our key products. We have instilled a culture of operational and commercial excellence. On top of this, our unitholders receive an attractive monthly distribution.

We believe that by continuing to build on our established track record of success will ultimately see increasing confidence in Chemtrade's fundamentals and outlook, which will drive our valuation to more appropriate levels. We look forward to continuing to deliver for the benefit of our unitholders during the balance of this year and the years to come.

Before opening the call for analyst Q&A, I would just like to remind you that we'll be hosting our Annual General Meeting shortly after this call concludes at 10:00 a.m. Eastern at the TMX Market Center in Toronto. You are all welcome to attend, and we look forward to seeing many of you there.

With that, operator, please open the call for questions. Thank you.

Operator: Your first question comes from the line of Ben Isaacson from Scotia Bank. Your line is open.

Viktor Sayek: This is actually Viktor jumping on for Ben. So in regard to the Cairo plant, we know you will provide some return metrics once it's operational. And you've mentioned you will be sampling and marketing its production. But is there a big enough market in the U.S.? We've seen a lot of delays in semiconductor fabs. So anything you can tell us on current demand dynamics would be appreciated like late '24, early '25.

Scott Rook: Yes. So it is true that many of the fabs have delayed their expansions plans compared to their initial projections from 3 years ago. However, the new advanced node production, the first fab is starting the second half of this year with a second fab starting early next year and then other fabs continuing to come after that.

So our plan is going to be the first plant in North America capable of producing the quality to meet the advanced nodes and so there's a lot of interest in that. And so we are working with all of the fabs that are starting up. They're very anxious to receive samples. And so that process will start the second half of this year.

So we believe that we're still on track. So I'm not as worried about our Cairo expansion. So even though the fabs have delayed, let's say, the number of fabs that they're bringing on, I don't think that will have much of an impact on Cairo because the fabs that are being built are very interested in the material coming from Cairo.

I think that the delay in the fabs could have an impact in the total demand, let's say, that's going to come out that will be there 3 to 4 years from now, which could have an impact. I think that's part of the reasons why the joint venture is on pause. But specifically to answer your question, Cairo, I don't see that having an impact.

Operator: And your next question comes from the line of Jacob Bout with CIBC.

Jacob Bout: So you're talking about M&A now and just areas that you are looking at, are these going to be complementary or would you be looking at any other new areas or new products? And I guess the second part of the question would be is M&A dependent on what happens with the Arizona ultrapure plant?

Scott Rook: Let me start out and just to address that the joint venture is or the joint venture remains on pause. And so in our previous projections, we were anticipating that we might be spending money on the joint venture project now, but that project remains on hold. And so really won't share much of a comment other than it remains on pause.

I will share that our joint venture partner and Chemtrade, we are in discussions with the U.S. CHIPS office and so they're very active discussions. We understand that the CHIPS office will or has made money available for projects, but we're negotiating with the government and seeing what will come of that. But I think the fact that the fabs have delayed the timing of their projections could have an impact on that.

So I think we're in a position now to allocate money towards growing with M&A. So although we'll see what happens with the joint venture, but we have money now, I think, to grow the company. And as we've discussed with our Board, we think that would be a good use of capital.

Jacob Bout: And then are these in complementary areas or new products?

Scott Rook: So in general, we have a list of industries that we like that primarily would be strategic fits and complementary to our existing businesses.

Jacob Bout: And then it's got to be difficult, though, given where your multiple is right now for an accretive acquisition.

Rohit Bhardwaj: Yes. I think that's a very valid point. But we think that in order to grow the business for the right acquisition, we know we'll have to pay through our multiple, but we have created significant flexibility here. So we anticipate the kind of acquisitions we're talking about to not involve us having to raise equity or capital.

So we are comfortable for the right acquisitions for the right reasons to pay through our multiple because we know that it's important to grow the business, and we can't see a path of buying something at our multiple.

Jacob Bout: And I wanted to go back just to some of your prepared commentary there about netbacks. And you made a comment about being down about $210 a ton. Is that for the year or for the second quarter?

Rohit Bhardwaj: That is for the whole year that is 210 per MCU.

Jacob Bout: And so that includes first quarter being down roughly about 260 a ton?

Rohit Bhardwaj: Yes, it does. If you think about last year, if you look at caustic, we started the year at an index use of pricing of over $600, and we ended at $365. This year, we started at $370, and we expect it to go up over the years. So that's where the delta gets smaller for the whole year.

Operator: Your next question comes from the line of Anthony Taglieri with BMO Capital Markets.

Anthony Taglieri: Question on capital allocation. What would be your priority or pecking order in terms of buybacks, M&A if Arizona was unsuspended, that kind of thing? Like what would happen first? How much could a buyback look like this year, that kind of thing? If you could just give us more color on that.

Scott Rook: Yes. So I would say that this is obviously a discussion that we have with our Board all the time with that. So we see the importance of growing earnings in the company. And so our first priority would be, I'll say what we think are very attractive organic growth projects. We see those as offering the highest returns.

And as we look at what we've done over the past 3 years, I think we've had a lot of success with that with high-return projects. We also see advantages in making strategic acquisitions for the business to address or to make our businesses stronger. So we see that.

But because of the multiple particularly where we're trading right now, we think organic growth has priority over M&A. But we're also, again, now, and as we've announced our NCIB, looking at that as well. Typically, I think growing our earnings is more important than bringing back units, but we are looking at all of those options.

Rohit Bhardwaj: Yes. So I think to answer another aspect to the question is we don't see it as mutually exclusive. We believe we can allocate the capital along all of these initiatives. We also, as we mentioned, we've got our convertible debentures coming due next year, which can be callable this year. So we also have that in our mix of capital allocation. So we think we can achieve all of these with the flexibility we have.

Operator: Your next question comes from the line of Gary Ho with Desjardins Capital Markets.

Gary Ho: I think you mentioned in your prepared remarks the Water Solutions portfolio being a standout. Just wondering your outlook for the remainder of this year. I think in last quarter's call, you mentioned the higher raw material costs that could have a negative impact on the margins.

Scott Rook: Gary, I think we're seeing that is fairly minor and we feel very good about the performance in our water business. Across all of the product lines demand and pricing, we feel good. And we've added capacity, of course, in our PAC and ACH business.

We've added a number of lines, and those are performing well and enabling the growth that we're seeing. And as we've just talked about, our Board approved yesterday a new project to build a new specialty product line at our Augusta, Georgia facility. So we're seeing strong growth, strong performance in our water business, and we want to continue to grow that business.

Gary Ho: And then my second question, taking a slide deck, you have provided helpful pie chart to connect the year-over-year change in EBITDA. Just given that you're now expecting to come in at the higher end of your guidance range, wondering if you can help us kind of think through which piece of that pie chart is outperforming or what are the puts and takes?

Rohit Bhardwaj: So as you would have noted, we did not change the assumptions underlying the guidance because we do have a few moving parts and we didn't want to get that granular since we are still maintaining the range and just telling you will get the right under the range. But if you want to tweak some of your own assumptions, you'd be safe in looking at the ECU netbacks, and we think that we may do better than that.

So basically, a lot of it would be from the EC on the Electrochem side. And there'll be some from the water as well because as we had mentioned, we had thought there will be a bit more of a margin squeeze, which we are not seeing yet.

Gary Ho: And then just on the buyback, just wondering your intentions there? How aggressive will you be? You mentioned up to 10%. Just wondering how active you'll be and what's the potential buyback range in terms of dollars that you can execute?

Scott Rook: So firstly, we are applying to the TSX for approval. So let's get that part done. And I think we'd rather not get into our approach on the buyback, but we will be seeking approval for up to 10% of our float, which is basically 10% of our practically of our outstanding and let's leave it at that.

And we will, of course, start reporting as there's any activity we are required to report it and we will do so.

Gary Ho: Okay. Great. And then if I can just sneak one more in, the clarification for Scott. Just your last comment there on growing earnings, are you talking about absolute dollar or growing earnings per share because you can essentially do buybacks and also grow the earnings per share as well?

Scott Rook: So growing number one, growing our total earnings, but we're also focused on earnings per share, but total earnings. So to answer your question, it's total earnings growth.

Operator: Your next question comes from the line of Steve Hansen with Raymond James.

Steven Hansen: Just a couple of follow-ups. Can you be a little more specific about this new specialty line at Augusta? I understand it's going to be $3 million to $5 million of EBITDA potentially. But what exactly is it that you're adding in cost time frame, et cetera? That will be appreciated.

Scott Rook: So at this time, all I'm prepared to share is that it will be a specialty product line that will be a new product for us going into one of our existing markets but a brand-new product, brand-new chemistry.

And so the timing of that is so we've just approved the project. We'll have construction. We should finish this project about a little over a year from now. So we'll finish this project next year with a start-up in the second half of next year.

Steven Hansen: And is this a precursor for additional follow-on lines and just something to follow? I'm just trying to understand how it fits what is the portfolio and what the market opportunity is.

Scott Rook: We think it definitely has potential for follow-on lines.

Steven Hansen: Just going back to the JV, it sounds like it's being pushed out a little bit in timeline along with some of the fab delays. That's all fine. Is there a specific set of decisions that you're looking for that would allow that to accelerate or is it a funding mechanism piece? I'm just trying to get a sense for what the catalyst would be to reignite the JV from being on pause.

Scott Rook: We shared early on that the greenfield site that we were proposing was going to be 3 ultra-pure lines in that and roughly 100,000 tons. And so the key that we're looking for would be, is there enough demand in the market to ramp up to fill up that plant roughly 100,000 tons.

And so with the delay of the fabs, that has called into question the amount of time when would the market need 100,000 tons. So that's what we're looking at. Look, there's a lot of moving pieces to that, but that's what we have our eye on.

Steven Hansen: And just maybe as a derivative question to that, is there an ability to tack on some incremental smaller doses of capacity at Cairo as opposed to going with the full greenfield?

Scott Rook: Interesting thoughts. Stay tuned. But that is something that we're looking at very closely. But nothing that I have prepared to share more on that right now, but it is something we're looking at for sure.

Operator: Your next question comes from the line of Zachary Evershed with National Bank Financial.

Zachary Evershed: How are the lease negotiations going in Vancouver?

Scott Rook: So what we are prepared to share this morning is just that we are in negotiations with the port for an extension of our lease. And that's about all that I can share, active discussions, active negotiations.

I will say that I think the port appreciates the fact that our plant supplies the chlorine that is used to treat 70% of the drinking water in Western Canada and 60% of the drinking water in Western U.S. And our plant produces 40% of all of the liquid chlorine available in Canada and chlorine is essential in drinking water. So, I think government officials are more and more aware of that and I think the port is aware of that. And so that has been, I'll say, instrumental with the negotiations. But that's all I'll say right now.

Zachary Evershed: And then we noticed the new Olin CEO recently took actions to increase chlor-alkali capacity. Do you view this as a potential shift in strategy on their part? And how does that affect you in terms of the marginal ton pricing?

Scott Rook: So we don't really think so. Well, yes, I can't comment on really what their strategy is at all. I would say that we also know that there are public announcements of old technology coming out of the market.

So I won't comment at all on what their strategy might be. But do keep in mind that, again, there's the announcements about older technology coming off-line.

Zachary Evershed: Then just last one for me. We're seeing reports of price increases for chlor-alkali from major producers. Any news on how that's been received by buyers?

Scott Rook: No comment I think on that other than look, I think as we've mentioned the results that we have seen in chlorine and hydrochloric and I think we'll just leave it at what we've already shared.

Operator: And we currently have no further questions at this time. I would like to turn it back to Scott Rook, President and CEO, for closing remarks.

Scott Rook: Well, thanks very much for attending today, for the questions. And I hope everyone has a good rest of the day. If you have time, please come join us for our AGM meeting in a little over an hour at the TMX Center. Thank you.

Operator: Thank you, presenters. And ladies and gentlemen, this concludes today's conference call. Thank you all for participating. You may now disconnect.