Q1 2016 Results Conference Call (Script)

Mark Davis

Good morning, ladies and gentlemen. Thank you for joining us for our conference call and webcast today.

As usual, joining me today is Rohit Bhardwaj, our Chief Financial Officer.

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

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

Overall, most of our businesses performed well in the first quarter. Our water chemicals business, which has been under some competitive pressure, is beginning to show more signs of stability and we are gaining traction from our strategy of adding new plants and expanding our product range. Our first quarter results continued to benefit from the strong US dollar but were adversely affected by some specific issues in our SPPC segment and lower International results when compared to their very strong first quarter in 2015.

In the first quarter of 2016, we generated Distributable cash after maintenance capital expenditures of $37.5 million, or 54-cents per unit, compared to $41.7 million or 61-cents per unit for the same period last year. EBITDA for the quarter was $54.0 million, which was $4.1 million lower than the first quarter of last year.

As you know, SPPC is our biggest segment, and sulphuric acid is that segment's largest product. In the first quarter, we continued to benefit from the strong market for regen acid as the North American refining industry continues to run at high rates. However, the results from our merchant acid sales were less than last year due to some specific supply side issues.   From the demand side, our merchant acid sales volumes were close to last year's levels. The issue in the first quarter was that we had to source the merchant acid we sell in a less than optimum manner, and that adversely affected results.

As we've noted before, the acid business is regional and market fundamentals vary significantly across different regions. In the first quarter this year, two of our key regions experienced unrelated events which had an impact on our results. In the north-east, although demand was close to expectations, our major by-product supplier produced a significantly higher volume of acid. Being able to accommodate our by-product partners' production volatility is one of the key values that Chemtrade adds.

Due to our extensive network, we were able to sell this product into the market. However, while we were able to place this acid, it resulted in higher costs due to excess freight and also because we reduced the production rate at some of our sulphuric acid plants.

In the west, the opposite occurred. Our major supplier produced at lower than expected rates. Again, part of our value-proposition is being able to keep our customers supplied regardless of the swings in production of our by-product sources. In this case, in order to keep our customers supplied, we incurred higher costs to procure and ship alternative supply.

Finally in the south, one of our key, pipeline-connected customers turned down their production rates, leading to a reduced need for acid.

In summary, while our first quarter results were negatively affected by these factors, our ability to handle these issues confirms the long term value proposition we offer to our customer, be it end-market consumers or by-product producers.

Turning to our WSSC segment, it produced steady results. We have commented that the competitive pressures we faced in this business last year have been stabilizing. Our results this quarter are indicative that this is the case and that our strategies to extend our product portfolio and protect our market share and leadership position in the water treatment market are working.

Generally, business conditions remained stable for Chemtrade and generally our customers seem to be doing well. Apart from the regional supply side issues faced by our merchant acid business (and that one pipeline customer that I mentioned) we continue to see good demand for our products and services. The relatively muted effect of the merchant acid issues I described this quarter was another example of the benefit of having diversified our sources of earnings, products and customer base.

Rohit will now provide you with some additional details on the first quarter financial results.

Rohit Bhardwaj

Thank you, Mark and good morning everyone.

In general, our businesses operated well in the first quarter. Financial results benefitted from the stronger US dollar; however, this was offset by the merchant acid sourcing issues in SPPC that Mark mentioned.

Revenue for the first quarter of 2016 was $336.1 million, an increase of $10.1 million over 2015. The primary reason for the increase was the positive impact of the stronger US dollar on US dollar denominated revenues. Higher volumes of water products also contributed to the increase, partially offset by lower selling prices and lower sales volumes of sulphur, not to be confused with sulphuric acid, in the SPPC and International segments.

For the three months ended March 31, 2016, Distributable cash after maintenance capital expenditures was $37.5 million, or 54-cents per unit compared with $41.7 million or 61-cents per unit in 2015.

Aggregate EBITDA for the first quarter of 2016 was $54.0 million compared with $58.1 million in the first quarter of 2015.

Turning to segmented results for the quarter, SPPC generated revenue of $159.5 million and EBITDA of $35.7 million compared with $160.8 million and $40.4 million, respectively, in 2015. While this segment's primary product is sulphuric acid, it also sells sulphur. The main reason for the decreased revenue, year over year, was lower selling prices for sulphur, which more than offset the positive impact of the stronger U.S. dollar. The decrease in EBITDA was however due to lower margins for sulphuric acid, offset partially by the positive impact of the stronger US dollar of approximately $2.7 million.

WSSC reported first quarter revenue of $120.8 million compared with $108.3 million in 2015. EBITDA was $30.7 million, up slightly from the $29.2 million generated in 2015. The higher revenue and EBITDA generated in this segment is primarily due to higher volumes of water products and the positive impact of the stronger US dollar of approximately $2.3 million.

International reported revenue of $55.8 million for the first quarter, compared with $57.0 million in the first quarter of last year. The lower revenue was due to lower volumes of sulphur. EBITDA for the quarter was $2.6 million, compared with $4.8 million last year, when we enjoyed an exceptionally strong quarter. The lower EBITDA reflects lower margins for sulphuric acid in international markets, partially offset by the impact of the stronger US dollar.

Maintenance capital expenditures in the first quarter were $4.9 million. We expect maintenance capex for 2016 will be approximately $50 million, so spending in the first quarter was well below the run rate. However, as in recent years, this is mostly a timing issue, and we believe we will reach our expected spending level as the year progresses.

Excluding unrealized foreign exchange gains and losses, Corporate costs during the first quarter of 2016 were $15.1 million, which was $1.2 million lower than the first quarter of 2015. The primary reasons for the decline are LTIP expenses that were $2.4 million lower than the first quarter of 2015. This was partially offset by the negative impact of foreign exchange of approximately $0.8 million.

Our balance sheet at March 31, 2016 was in sound shape. We had drawn down about US$458.3 million on our senior credit facility. Our term loan is fully drawn but we maintain about US$456 million of undrawn capacity, which provides us with ample liquidity. The credit facility matures in October 2020.

I'll now hand the call back to Mark.

Mark Davis

Thank you, Rohit.

While the first quarter presented some challenges for our acid business, the positive takeaway is that we were able to meet all our obligations to our customers and suppliers, and still generate distributable cash that was comfortably ahead of our distributions to unitholders. As mentioned, while these events caused us some first quarter pain, long term they will be beneficial as it is clear evidence to our customers of the long term value Chemtrade can provide.

Our ability to do this is the result of a clear strategy we have followed since our IPO in 2001, and I will have a little more to say about that at our AGM that takes place here in Toronto later this morning.

One last point. As some of you know, we have a small facility located on the Syncrude property in Fort McMurray. We normally have about 22 employees working at our site. All of these employees are safe and are among those evacuated from Fort McMurray. Our facility has been safely shut down and we don't know when it will be restarted. From a financial perspective Fort McMurray is one of our diverse sources of earnings. While its contribution is beneficial to our portfolio, on an aggregate basis, it's not material, meaning it contributes less than 5% of our EBITDA. We do maintain property damage and business interruption insurance, and we have not yet determined whether the losses, if any, may be contractually covered.

Our thoughts and best wishes go out to our employees and their families and to the Fort McMurray community.

So, in summary, our businesses continue to operate well. Our organic growth strategies are moving ahead according to our plans. We remain confident that our business model and strong balance sheet will allow us to sustain our distributions to unitholders and enact the initiatives necessary for strengthening our business.

Thank you for your attention. Rohit and I would now be pleased to answer questions.

Operator (Joanna): Thank you. Ladies and gentlemen, we will now begin the question and answer session. Should you have a question, please press * followed by 1 on your touchtone phone. If you are using a speakerphone, please lift the handset before pressing any keys. One moment please for your first question. Your first question comes from Nelson Ng from RBC. Please go ahead

Nelson: Great, thanks. Just a quick follow up on your comment on the Fort Mac facility. Has there been any physical damage on the facility?

Mark: Not to ours, no

Nelson: Ok, got it. And then on the Sulphuric acid side you mentioned the supply issues where I think you said the customer in the east produced too much and the customer in the west produced too little. I think in the press release you mentioned that you see things improving as the year progresses so, are you effectively saying the supplier in the west will produce more and the producer in the west will produce less going forward? Have you seen that pattern so far?

Mark: Yes in the west and not yet in the east. A little bit more on the west — the supplier had a production issue that's now been solved. In the east, our by-product supplier is producing at a historically high rate helped in part, we believe, by the late spring and the smelters run harder when there are cooler temperatures. We believe that they will revert to the norm and our norm for them is actually a multiyear basis. So, I don't think they've slowed down yet but we expect them to revert to the norm in the near term.

Nelson: Ok, got it. And then in the water treatment business, I think last year you mentioned that the spring runoff is one of the demand drivers for some of your products. Given the warm winter, do you expect the spring runoff to be pretty weak in Q2?

Mark: I think we're going to have to wait, only because there was a lot of snow out west; it was a warm winter here. There's a variety of factors including the amount of snow and how quickly it warms and, I'll say, the "violence" of the runoff. We usually plan for 5 year average amounts of chemical consumption and to the extent that it's better or worse than that is generally what we comment on but we don't know that answer yet.

Nelson: Ok and then just one last question. I'm not going to mention any names, but what's your interest level in growing your sodium chlorate business and do you think that's an effective business? I'm just wondering whether you've begun discussions on potential asset acquisitions on that front.

Mark: We'll give the answer that we always give which is that we're always interested in acquiring assets that fit our core competencies and our business model and obtainable at valuations that we deem appropriate.   We actually never really comment on specific opportunities and won't be doing so today either.

Nelson: Ok, great thanks. Those are all my questions

Mark & Rohit: Thank you

Operator (Joanna): Thank you. Your next question is from Jacob Bout from CIBC. Please go ahead

Jacob: Good morning. I had a question on the water treatment segment. Their EBITDA margins were down. Can you talk a little bit about other specific products that you're still having issues with on the pricing side?

Rohit: No, there's really no pricing issues in that segment. As you know, in our business it's very hard to actually look at EBITDA margins as a percentage of revenue. Our comment is more around the major products; EBITDA being very similar to last year, and so, that's where the stability is from. But we don't particularly target any kind of a percentage. EBITDA is actually based more on maximizing the dollars that we can get.

Mark: For example, there's a product in there; we don't talk a lot about P_2S_5 (Phosphorus Pentasulfide). Two main materials there Phosphate and Sulphur and we adjust our sales price in movements of both of those products. Again, it's a hard segment to actually look at the percentage of sales margin.

Jacob: You have noted in the past though there was some competitive pressure. You're saying that that is now eased basically across all product lines?

Mark: In the water business

Rohit: It was mainly alum we had talked about and we had said, actually, in a few markets we had proactively reduced pricing and we think now the pricing is at appropriate levels. So, that's how it's stable.

Jacob: And the PACl platform expansion that you've talked about in the past, how many facilities have been added and what's the cost associated with those?

Mark: So, we've added one that's running. There's a second one that's being built and it will start by the end of this year. And there's another product called ACH which we're starting construction on that too which I think in 2017, right. As we said at last year's AGM, no one of these things is a step change to either our EBITDA nor is it a huge CAPEX drag. So, we've said we're going to accomplish all these things at about $15-20 million a year of growth CAPEX. So, that's for all these things.

Rohit: And these are all being built on existing sites so we aren't doing any kind of 'green fields' building here.

Jacob: And then on the SPPC side with the supply issues, can you talk about if any of this is tied to Copper Cliff? Should we be looking at that smelter any differently? I think we talked about a shut down there. Was it at beginning of 2017?

Mark: Yes, a bunch of the excess supply in the east is associated with that and it frankly ties to actually what we've said before. In 2017 as you remember, we've said that they're going to go down from 2 furnaces to 1 furnace which will have a significant reduction in acid. We've said that we don't think the reduction in acid will actually have a material effect on us since we don't make that much money on the last tons. If you take that thesis and actually say they're producing at particularly high levels in the first part of this year, the last tons we sell are not desirable. That's why aside from the fact that this year we think it's unlikely that they're going to keep producing at historically high volumes, as we know for sure next year they won't.

Jacob: Great! And then last question here just on the International side, can you just talk a bit about EBITDA. It was about half of what it was a year before; can you talk about some of the pressures there? Is this primarily an FX thing?

Rohit: No, it's not FX and if you recall, we've been very particular in the last few years talking about what the expected run rate in this business is; closer to $10 million, so we weren't far off that pace. Last year was exceptionally strong at the $4.5 we made last year; that was unusually strong. The acid market in the international markets has not been that strong but our earnings are still kind of in line with what we consider normal in that business.

Jacob: That's helpful, thanks guys

Mark: Thank you

Operator (Joanna): Thank you. Your next questions is from Joel Jackson, BMO Capital Markets. Please go ahead

Joel: Thanks. Are you able to delineate what the earnings impact is fpr Q1 from the sulphuric acid issue? And then, can you gauge kind of Q2, what it would look like if Copper Cliff continued to run at these rates through May and June?

Mark: I'll give you 2 rough data points. If you look at SPPC this year versus last year, that aggregate missing EBITDA is probably reflective of the supply issues we faced. I will also say that even if they keep producing at the rates they are, the aggregate hurt in Q3 and forward should be a much smaller magnitude than it was in Q1 for a bunch of interconnected but hard to explain reasons but we think that the main hurt was in Q1 and even if they keep producing at this rate it will be less going forward.

Joel: And is there some max from Copper Cliff of acid that you have to take or do you have to take whatever they produce within your contract?

Mark: There's a max but having said that, we're going to be just fine handling what they produce and as part of our long term partnership value proposition. Even if contractually we don't have to take it, we're going to take it and find good homes for it.

Joel: And can you speak on your inventory situation a bit now and I guess it may vary in regions but do you have too much acid now in the east or have you balanced? What are you looking at right now?

Rohit: We're keeping a very close eye on our inventory and there are physical limitations on how much inventory we can carry anyways so, we are right in the zone that we need to be. As Mark mentioned, we actually turned down some of our own production in Q1 to make room for this extra acid so that's how we managed the situation.

Joel: And my final question on the International business, I think you guys talk about $10 million EBITDA rate is sort of where you are in Q1; you had higher performances in the past few years. But is the Q1 run rate indicative of what we can expect the rest of the year?

Rohit: It looks like unless there's some dramatic turnaround, this is what we think is reasonable for this year

Joel: Thanks

Mark: Thank you

Operator (Joanna): Thank you. Your next question is from Steve Hansen from Raymond James. Please go ahead

Steve: Sorry, I just wanted to clarify the one issue, I believe you also related to the south. That issue is also rectified at this point?

Mark: Not yet. As some of you know is we have an (inaudible) of sulphuric acid plant that's tied to a guy who makes Caprolactum, another chemical. The Caprolactum market has been actually suffering. Having said that, if you look in the news the Caprolactum industry has just nominated a price increase which ought to be good for go-forward volumes. So, we don't know if that issue is resolved or not but I will tell you of the 3 issues mentioned, that is the smallest contributor to the miss in the first quarter.

Steve: Understood. In your comment earlier you already described the shrinking delta of the acid this quarter so I think that's probably captured. Just on the broader economic front, GDP issues or GDP rates have been compressed to some degree in recent quarters in the U.S. but just what are you seeing from your customers in the downstream end markets as it relates to the outlook for the year. Just trying to get a sense for the cadence here just as it relates to U.S broader GDP growth.

Mark: As we tried to say and I'll say it again actually, with the exception of the Caprolactam guy, demand from our customer base — I'm not going to say it's robust but it's certainly firm, and as we would have expected. It's as expected when we did our plan which was 6 months ago. Again, I'm not going to say it's robust. But for the Caprolactam guy, it's plenty firm and in certain areas like the refineries it's been robust.

Steve: Ok, great! And just this last if I may, it's just on the acquisition front. Excluding the sodium chlorate issue that's mentioned earlier, what does the pipeline look like these days in the broader context of lots of churn going on in the T-markets and lower debt rates. Have you guys seen more opportunities today versus 6 months ago or would you suggest that they're fading?

Mark: No, I'd say we're seeing at least as many as we saw 6 months ago. Having said that — and all this is anecdotal — there seems to be more failed sales processes than successful sales processes. We've talked about this before. It seems to me that there has been a mismatch between sellers' expectations and buyers' willingness to pay. It's a target rich environment. Whether or not it's a target rich environment at valuations that we find attractive, we'll have to wait and see.

Steve: Ok, that's for me guys

Operator (Joanna): Thank you. Ladies and gentlemen as a reminder, should you have any questions please press * followed by the number 1. There are no further questions at this time, you may proceed

Mark: As usual we thank you all for you attention and hope to see some of you in our AGM in about an hour. Thanks very much

Operator (Joanna): Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and we ask that you please disconnect your lines.