

Q4 2017 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.

2017 was a busy and eventful year for Chemtrade. The most important achievement of the year was the acquisition of Canexus. The addition of the Canexus businesses to our portfolio increased our size, scale and diversity of earnings. The resulting Electrochemicals (or "EC") segment is reflective of the strong and significant positions we now have in sodium chlorate and chlor-alkali markets in North America and Brazil.

The integration went well and we achieved the cost synergies we had expected. As we will discuss further, the new businesses have performed well, and are continuing to do so.

Chemtrade had a good 2017 but it could have been much better. In short, our newly acquired businesses performed well but we encountered some issues in our legacy businesses, primarily due to a failure to execute to the standard we expect of ourselves. As indicated in our January 12 update news release, demand for all our core products was firm throughout most of 2017, and particularly strong for the newly-acquired chlor-alkali business. A number of operational issues, some of our doing and some outside our control (like Hurricane Harvey) meant that our financial results failed to reflect the true potential of our expanded business. Note that these "operational issues" are not solely plant issues, but also include our supply chain and logistics costs.

We discussed these issues at some length in prior calls. In summary, our Sulphur Products and Performance Chemicals (or "SPPC") segment suffered from a shortage of merchant sulphuric acid supply and the resultant costs to supply our customers from alternative purchased supply.

In our Water Solutions and Specialty Chemicals (or "WSSC") segment, the main issues involved production at a couple of key sites and, again, increased costs as we sourced

product elsewhere to supply our customer base. We are extremely focused on addressing these issues and I will have more to say on that after Rohit reviews the numbers.

There was one other issue that affected our fourth quarter financial performance. Early in the fourth quarter we announced an unexpected shutdown at our North Vancouver chlor-alkali plant. As you know, this plant had been performing very strongly in 2017, driven by high demand and prices for caustic and increasing demand and pricing for hydrochloric acid. At the time we acquired the plant from Canexus, we knew of an operating issue that was temporarily fixed in November 2016 and was expected to remain operational until the permanent fix could be implemented during the scheduled turn around in April 2018. Unfortunately, in late November a recurrence of the operating issue forced us to take the plant offline for a little over two weeks for another temporary fix. Since then it has been operating well, but the interruption cost us approximately \$8 million in EBITDA in the fourth quarter. The permanent fix is still scheduled to be made in April as expected.

Despite the array of issues we faced in the second half of 2017, Chemtrade is generating significant earnings and cash. For the full year, excluding Canexus acquisition and related costs of \$18.6 million, EBITDA was \$301.7 million. Also, recall we didn't acquire Canexus until March. Distributable cash for the year, excluding the acquisition and related costs and the related \$18.3 million foreign exchange loss, was \$1.79 per unit vs. distributions of \$1.20 per unit.

As I said at the outset, we are very pleased with our new EC segment and how smoothly the new operations have been integrated. We have definitive action plans in place to address the operational issues incurred by our businesses in 2017. Finally, demand for our key products remains firm. We look forward to 2018. I will have more to say about that in my concluding remarks.

Rohit will now provide you with some more details on the fourth quarter results.

Rohit Bhardwaj

Thank you, Mark and good morning everyone.

As Mark indicated, our fourth quarter results fell short of the original guidance we gave on our Q3 call but are consistent with the news release we issued on January 12 this year. One reason was the unplanned interruption of production at our North Vancouver chlor-alkali plant, which affected results for our EC segment. Additionally, SPPC results were down year over year, and WSSC was steady with Q4 2016, but less than our expectations. I will provide more details on these shortly.

Revenue from continuing operations for the fourth quarter of 2017 was \$386.7 million, an increase of \$134.9 million from 2016. This increase was primarily due to revenues of \$150.3 million generated by the newly acquired businesses, partially offset by lower revenues in the SPPC segment.

Aggregate EBITDA from continuing operations for the fourth quarter of 2017 before acquisition related costs, was \$70.0 million compared with \$40.1 million in the fourth quarter of 2016. The major acquisition cost excluded was a provision for the Canexus head office lease of Calgary office space which we have vacated. The increase in EBITDA is mainly

attributable to the contribution of approximately \$40.5 million from the new businesses in the EC segment, partially offset by lower EBITDA in SPPC.

For the three months ended December 31, 2017, Distributable cash after maintenance capital expenditures from continuing operations and before the acquisition related costs was \$15.3 million, or 16-cents per unit compared with \$19.7 million, or 28-cents per unit in 2016. As usual we spent a disproportionately high amount of capex in this quarter. The per unit amounts are based on a weighted average number of units outstanding of 92.6 million units in the fourth quarter this year, versus 69.2 million units outstanding last year.

For the full year 2017, Distributable cash from continuing operations after maintenance capital expenditures and before the foreign exchange loss and the acquisition related costs, was \$157.7 million, or \$1.79 per unit, compared with \$128.3 million, or \$1.86 per unit in 2016, also excluding the foreign exchange loss and acquisition costs incurred in 2016. The per unit amounts are based on a weighted average number of units outstanding of 88.2 million units in 2017, versus 69.1 million units outstanding last year. Consolidated revenue from continuing operations for 2017 was \$1.5 billion, which was \$401.9 million higher than 2016. The increase was due primarily to contributions from the acquired businesses of approximately \$500.7 million, offset by lower revenues in SPPC. Aggregate EBITDA from continuing operations for 2017 before the acquisition related costs was \$301.7 million compared with \$209.0 million in the previous year, again, before 2016 acquisition costs.

Turning to segmented results for the quarter, SPPC generated revenue of \$126.6 million compared to \$141.9 million in 2016. EBITDA for the quarter was \$22.9 million, which was \$8.1 million lower than 2016. While the majority of SPPC earnings is driven by sulphuric acid, there are a few other products within this segment. During the fourth quarter, three such products experienced weakness. First was sodium bisulphite, or SBS, a by-product of our acid production process. We made a strategic decision to self-market this product, rather than going through a third party, and in the short-run this is hurting our results. This segment also includes our sulphur resale business and this had a weaker quarter due to turnarounds at suppliers and the loss of a key customer. Finally, sodium hydrosulphite, or SHS, had lower sales volume during the fourth quarter of 2017 when compared with Q4, 2016.

Our WSSC segment reported fourth quarter revenue of \$97.6 million compared with \$96.5 million in 2016. EBITDA was \$16.4 million which was similar to the \$16.7 million generated in 2016. As Mark mentioned, we had expected strength in some of our WSSC products to offset some weakness in SPPC, but that didn't happen. Partly that was because some issues at our new ACH plant earlier in the year persisted, and the higher demand we expected for potassium chloride and phosphorus pentasulfide did not materialize. The slight decrease in EBITDA was primarily a result of higher input costs for some products.

Our EC segment reported revenue of \$162.5 million, most of which is attributable to the newly acquired businesses. EBITDA was \$46.8 million. This would have been higher but, as already noted, the two-week production interruption at our North Vancouver chlor-alkali plant had a negative impact on EBITDA of approximately \$8 million.

Excluding unrealized foreign exchange gains, Corporate costs during the fourth quarter of 2017 were \$24.6 million, compared with \$19.6 million in the fourth quarter of 2016. The higher costs in Q4 2017 include the accrual of \$8.6 million related to the Calgary Canexus office lease.

Maintenance capital expenditures in the fourth quarter were \$34.7 million, bringing the total maintenance capex for 2017 to \$66.7 million, which was in the range of our estimate. We expect maintenance capex in 2018 to be roughly \$100 million and this includes approximately \$10 -15 million we had previously said that we would incur at the newly acquired sites.

Our balance sheet remains sound, with our bank covenants well below required levels and we maintain ample liquidity. We have roughly US\$378 million room on our US\$525 million revolving facility.

Finally, some comments on the recently announced US tax reform. There was a non-cash gain of \$38.0 million reflected in our income tax line during the fourth quarter of 2017. This was due to a reduction in our aggregate US deferred tax liabilities, as they were revalued to reflect the lower US Federal tax rate. More importantly, the ability to claim an immediate deduction for capital expenditures should allow us to essentially pay no US Federal tax for at least the next three years, while extending the life of our tax losses. Thereafter, while the ability to deduct interest will be diminished, a combination of expensing of capital investments and the lower Federal tax rate will result in considerably lower US cash taxes than we had previously estimated.

I'll now hand the call back to Mark.

Mark Davis

Thank you, Rohit.

As I mentioned earlier, demand for most of our products was steady to robust throughout the year. We expect this to continue in 2018.

Here's a quick rundown on how we see the 2018 markets for our products.

- Chlor-alkali will remain strong, for this year and for the foreseeable future. We can sell as much caustic as we can produce and this business will continue to be a strong contributor to EC earnings. Recent industry publications support our view that these market dynamics should persist for several years.
- Regen acid should also remain strong as refineries are running at high utilization rates. Alkylate continues to be a key component of the refining process.
- Ultra-pure acid is another product where we can sell as much as we can produce. As well as generating solid revenue and earnings, this business has opportunities for expansion. We continue seeking to produce more product from our plants and meet the stringent quality requirements.
- The market for merchant acid is adjusting to reduced supply and prices are firming. Our key by-product supplier has reduced its 2018 rates by about 50% from historical rates. This is a reduction of about 350 thousand metric tonnes for Chemtrade to sell

and about 3% less supply for the industrial market. This reduction in North American supply is supporting the price increases that are starting to work their way through the market.

- The sodium chlorate industry is producing at high utilization rates. Our Brandon plant is one of North America's lowest cost producers, so we stand to benefit from this tight market. Recently, one of our competitors announced the shutdown of one of its plants in Quebec, reducing North America capacity by about 3%. We believe that the entire North American sodium chlorate industry is operating at about 94% of capacity. Our planned capital spend at Brandon will enhance this plant's reliability and efficiency.
- Our water solutions businesses are also seeing stable demand. We expect to see additional benefits as our investments in certain alum plants and our PACI and ACH plants take hold. We expect to improve these production rates as the year progresses.

All of these market conditions provide a favourable base for 2018. There are, however, certain other factors that will influence our 2018 performance. First, in the SPPC segment, we have a large number of turnarounds for our acid plants this year – 13 versus 8 last year. And, as you know, there are changes taking place with the closing of one of Vale's furnaces. In 2018, as I noted, we expect supply of acid from Vale will be half the historical rate, although it's expected to increase slightly in 2019. This supply change has been anticipated for some time, but the magnitude has been less certain. In the past we have said that a reduction in supply of 25% would be essentially EBITDA neutral for us. The larger reduction we now anticipate should eventually be offset by price increases, but that will take time to take effect.

The outlook for our Electrochemicals segment is excellent. We do have the important turnaround at our North Vancouver plant in April as I mentioned, but apart from that downtime, we will be able to sell as much caustic as the plant can produce and the railways can move. As a general statement, service levels being provided by the major rail carriers has been erratic for many shippers and this could be a headwind in the future. The sodium chlorate business is also expected to operate at high utilization rates, and as we have noted, a long-term capex spend to improve our Brandon plant is now underway.

In our Water Solutions business we need to optimize the returns from the investments we made in new PACI and ACH plants. Our assessment of the market was correct – there is definitely opportunity, and we are focused realizing on the capital spending we made on these new plants. Some products are facing tighter margins as raw material costs increase – such as sulphuric acid – and unlike some of the contracts we have in SPPC, many of the annual contracts in WSSC do not allow cost pass-throughs.

As market conditions for our products continue to improve, we will be putting added focus on our core businesses, sulphuric acid, electrochemicals, water solutions and certain specialty chemicals – to ensure we are allocating the proper time, resources and capital to maximize returns from these businesses.

Overall, the outlook for 2018 is solid, and we expect a strong EBITDA performance and continued reliable distributions for our unitholders. We expect that the second half of 2018 will deliver stronger financial results than the first half, as the first half has more maintenance turnarounds, reduced supply of byproduct acid and weaker WSSC performance.

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 star followed by one on your touch-tone phone. If you are using a speaker phone, please lift the handset before pressing any keys. One moment please for your first question. Your first question comes from Jacob Bout from CIBC. Jacob, please go ahead

Jacob: Good Morning

Mark: Hey Jacob

Rohit: Good Morning

Jacob: Question here on the SPPC business in the increased reduction from 25% to 50% of volumes. What is the expected EBITDA impact in 2018 and then how long for the offset of increase in sulphuric acid prices and in your mind, what it would take to kind of breakeven?

Mark: I think we'll recover completely on EBITDA, but it's probably a 2019 issue; it's probably \$2 million difference.

Jacob: And then the shutdown of the AkzoNobel plant, are you seeing an impact on the chlorate pricing right now? And how long does it take before you actually start to realize any improvement in chlorate pricing?

Mark: Chlorate by and large is not a spot business, it's generally an annual contract business. So, we expect price increases to really be evident in 2019 not in 2018.

Jacob: Maybe just last set of questions here just on the WSSC business. So, I guess a couple of issues there. You did have some staffing issues and then the issue with the specialty chemical demand. So, maybe first on the specialty chemical demand; is that just a loss of business that you didn't see the sales, or can we expect to see some of that? Is it more of a timing issue and then we'll see some of the impact in the first quarter.

Mark: We think it's primarily a timing issue, and we ought to pick it up this year.

Jacob: Ok. And then the staffing issues? How long does that persist for?

Mark: It's different plants and different timing. The easiest way to think about it frankly, is by the second half of the year, we think we will be able to actually run or produce as we want to.

Jacob: Alright. Thank you very much

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

Joel: Hi. Good morning Mark. I appreciate you going through all the puts and takes on '18 versus '17. As you think about SPPC, maybe a \$30-35 million EBITDA hit in '17, how much of that do you think you can recover in '18? Maybe just go through some of the larger buckets of what you think you can recover in '18: maybe just go through some of the larger buckets of what you think you may recover versus what still may not come back.

Mark: Sorry, we're actually looking at each other trying to figure out where you got this size of the EBIT let's ignore the quantum and actually say that in 2017 we got hit in that segment by two different buckets of things. The first bucket was a bunch of merchant acid issues. As we've said, we started taking fruition in the third quarter when we were short and then the knock on effects of various supply chain purchases etc. right? Again, couple that in 2018 with Vale's reduction in supply and the number of turnarounds etc. we have in 2018 and 2018 probably looks pretty similar to 2017 despite the fact that we're eating a bunch more costs and shutdowns and having less Vale product. So, you'll probably see an uptick in that segment in 2019 but 2018 in aggregate to look like '17.

Rohit: I think to your point, there are a few structural changes in the SPPC segment and some we won't recover from like Fibrant plant and some of the other smaller businesses we talked about like the SO₂ we exited, and SHS. So, some of them won't recover but in '19 as Mark said, once we get the first additional turnaround spending in '18; so '18 should be similar to '17 but after the extra costs. And '19 we should see some recovery but unlikely it's going to go back to the \$145 million that we made in 2016.

Joel: Ok, and I'm just using your adjusted EBITDA report numbers. So, the same question for WSSC, you report a \$20 million reduction EBITDA in '17 versus '16. How much of that can you recover in '18? What are the puts and takes?

Rohit: So, I think the first thing to be clear on WSSC, we show a reduction of about \$10 million. One thing to be clear is that if you go back to our 2016 reports, the WSSC segment included our sodium chlorate business. I would not refer to that in terms of getting your EBITDA comparative. I would look at it as current MD&A which shows that we're down about \$11 million from 2016 on an apples to apples basis. So, we do expect to recover that in 2018 so we should expect 2018 to be stronger than 2017.

Joel: Ok, and my final question is on the synergies and Canexus. I think you talked about it could be done within 6 months; could be another 5 or so. Can you give an update on what you realized in Canexus now? I think we're about a year in or 11 months in.

Rohit: We did achieve the synergies we had expected that were mentioned in the timeline. And I think on a cost basis, we probably are in that \$15 million run rate for 2018. So, we have achieved those.

Joel: Thank you very much

Mark: Thanks Joel

Operator (Joanna): Thank you. Your next question is from Benoit Laprade from Scotia Bank. Benoit, please go ahead

Benoit: Thank you, good morning gentlemen. Rohit, just to clarify; you mentioned \$100 million of maintenance CAPEX for '18. How much should we model for growth CAPEX or non-maintenance CAPEX?

Rohit: So, that \$100 includes the stuff we had said was relating to Brandon and North Vancouver as well. But in terms of non-maintenance CAPEX, we've said in the past \$10-15 million. This year we spent about \$8 million. So, I would say around \$10 million is not a bad number to have in mind for the next couple of years

Benoit: Ok, thank you for that. And just curious, is there anything you can share with us at this point with respect to the MEG lawsuit?

Mark: There's really no status report other than... I guess I can say that discoveries have been planned, I forget frankly whether it's April or May but sometime in the first half of this year is the parties going through examination for discovery and it's just winding its way through the courts.

Benoit: Great, thank you

Operator (Joanna): Thank you. Ladies and gentlemen as a reminder, should you have any additional questions please press *1. At this time, I'm showing no further questions

Mark: We thank you all for your time and attention and look forward to talking to you next quarter.

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