Chemtrade Logistics Income Fund

Q2 2024

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10:00 AM

Operator: Good morning, ladies and gentlemen, and welcome to the Chemtrade Logistics Income Fund Q2 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 the star, zero, for the operator. This call is being recorded on Thursday, August 15, 2024.

I would now like to turn the conference over to Rohit Bhardwaj, Chief Financial Officer of Chemtrade. 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 second quarter of 2024. With me on today's call is Scott Rook, President and CEO of Chemtrade.

I will begin this morning's call by providing a brief overview of the second quarter results we published yesterday, as well as the announced increase to our 2024 guidance. I will then hand the call over to Scott, who will provide an update on the outlook for our key products, organic growth and our organic growth projects. Following our prepared remarks, we will open the line for analyst Q&A.

This call has an accompanying slide deck, which is available on our website, chemtradelogistics.com.

Before proceeding, please 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 to in 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 non-cash items such as unrealized foreign exchange gains and losses. While our accompanying presentation refers to Adjusted EBITDA, we will refer to it simply as EBITDA in our remarks.

The second quarter of 2024 was another strong quarter for Chemtrade. The results we reported yesterday exceeded our internal expectations and reflected ardent organization-wide execution with good performance across most business lines. The strategic enhancements we have made across Chemtrade continue to bear fruit and have clearly contributed to a step change in our earnings and cash flow as compared to pre-COVID levels.

When looking at our second quarter results on a year-over-year basis, it is important to take note of a few factors. First, Q2 of 2023 included roughly $12 million of revenue from the P2S5 business that we sold in Q4 of last year. Second, we undertook the biennial maintenance turnaround at our North Vancouver chlor-alkali facility this quarter, which had a negative impact on revenue of roughly $10.5 million and on EBITDA of $17.9 million. And third, Q2 of 2023 was an all-time record quarter for EBITDA, making this a particularly challenging quarter to compare year-over-year.

However, after adjusting for the impact of the P2S5 business and the North Vancouver turnaround, our revenue was similar to Q2 2023. Our EBITDA, excluding the impact of the North Vancouver turnaround decreased by $11.2 million or 7.8% compared to the record quarter last year. Increased corporate costs accounted for a little over half of this decline, and improved margins for several of our products, help mitigate the impact of reduced revenues for other products. We once again delivered a very healthy cash flow that is well above the level of our distributions, and we ended the quarter in a strong financial position.

The positive results we have delivered in the first half of this year, in addition to our outlook for the remainder of this year, supports the increase to our full-year guidance that we announced last night, and I will expand upon shortly.

Looking at the Sulphur and Water Chemicals segment, which I will refer to as SWC moving forward, revenue excluding the contribution from the P2S5 business in the prior year period was similar on a year-over-year basis, while EBITDA increased by $5 million or 7% year-over-year. Water Chemicals remains a particularly strong performer in SWC and was the most significant contributor to the year-over-year increase in EBITDA as higher selling prices have led to improved margins for these products. This ongoing success in water chemicals stems in part from the small but high-return investments we have made in this business in recent years, as well as our team's steadfast focus on commercial excellence.

Higher regen acid volumes were also a positive contributor to SWC EBITDA growth in the quarter, and that business line continues to be a relatively stable and dependable performer for us.

A partial offset to EBITDA growth in SWC, including sodium nitrite, where operations are still being stabilized after the lengthy process improvements made earlier this year. We also had lower realized selling prices for regen acid and merchant acid in the quarter. Recall, however, that the pricing impact on merchant specifically mitigated by our risk-shared contracts with our suppliers, which helped us keep our merchant acid margins fairly stable year-over-year and makes this another resilient product in our portfolio.

Turning now to the electro chemicals or EC segment. Excluding the impact of the North Vancouver maintenance turnaround, EC revenue increased by $2 million or 1% year-over-year, while EC EBITDA decreased by $10.3 million or 11% year-over-year. The primary factor that led to this decline in EBITDA was significantly lower realized caustic soda pricing compared to the prior year. For context, in Q2 2023, our caustic soda pricing was based on an index of roughly $480 per tonne, while in Q2, the index was roughly $365 per tonne. However, about half of this pricing decline in caustic soda was offset by improved pricing for HCL and to a lesser extent, chlorine, with our overall MECU netbacks down about $110 year-over-year.

Higher sales volumes and selling prices for sodium chlorate also helped mitigate the declines in EC EBITDA in Q2 as the sodium chlorate business, while not without its demand challenges, continues to be a steady and strong cash flow generator in our product portfolio.

Turning to corporate costs. Our corporate costs in Q2 increased by $5.9 million year-over-year to $28.2 million. This increase reflected higher long-term incentive plan costs, higher short-term incentive compensation costs, realized FX losses in the current quarter compared to realized FX rates in the prior year and to a lesser extent, higher legal and other costs.

Moving to our capital allocation. We remain disciplined in our approach to capital allocation, balancing our excess cash flow across our three key pillars of investing in strategic higher-return growth opportunities, maintaining a strong balance sheet, and returning capital to our unitholders. When the opportunity is available and makes strategic sense, we also believe in taking action to optimize our capital structure. During the second quarter, we acted on each of these fronts.

We ended the quarter with our balance sheet in a strong position. Over the past year, we have reduced our net debt by more than 4%, and we have significant available liquidity between our revolving credit facilities and cash on hand. We exited the quarter with a net debt-to-EBITDA ratio of approximately 2x, and we continue to expect, based on our updated guidance, that our leverage ratio will be close to 2x at the end of 2024.

We also took steps to further optimize our capital structure during the quarter by executing a substantial issuer bid for all of our outstanding 8.5% debentures due September 30, 2025. This SIB expired on July 31st, and we were successful in repurchasing 33% of these debentures. Following this SIB, we have now reduced the principal of convertible debentures on our balance sheet by 23% since the end of 2022.

Chemtrade also approved a normal course issuer bid during the quarter, under which we will be able to repurchase a portion of our units using our excess cash flow. While we're precluded from acting on this NCIB during the period that the SIB was active, we anticipate making use of this NCIB during the remainder of the 12 months that it is available. We have recently seen several industry M&A transactions completed at valuations that further support our view that Chemtrade units are trading at a significant and unwarranted discount to their fair value, making this NCIB an attractive use of our funds.

Meanwhile, we continue to pay a very attractive monthly distribution of $0.055 per unit, which equates to a yield of approximately 7%. Our payout ratio for the last 12 months is only 35%, highlighting the sustainability of this attractive distribution.

Finally, we continue to prudently invest in strategic, high-return growth opportunities, including $17.7 million of growth capital in the second quarter. These investments will help generate additional growth and unitholder value in the years to come. As we have discussed previously, we may also look to supplement our organic growth initiatives with strategic tuck-in acquisitions if these acquisitions are deemed synergistic to Chemtrade's existing business and accretive unitholder value.

Looking at guidance, given Chemtrade's strong financial performance for the first half of the year and the momentum that we have seen carry into the third quarter of 2024, we have raised our expectations for the full-year 2024 EBITDA. We now expect EBITDA this year to be between $430 million and $460 million, which have a midpoint of a 7% increase from the midpoint of our previous guidance.

Notably, achieving this updated guidance would make 2024 the second highest-ever EBITDA year on record for Chemtrade, trailing only our record results in 2023. The latest guidance increase should reinforce to investors and analysts that the earnings and cash flow generation of our business has undertaken a significant step change from pre-COVID levels.

The assumptions underpinning our updated 2024 guidance are available in our disclosure documents. Please refer to these documents for additional information.

I will now hand the call over to Scott to add additional commentary on our outlook. Scott?

Scott Rook: Thank you, Rohit, and thank you to everyone who's on the call. As Rohit just detailed, we have had a strong quarter, and we continue to build on our track record of consistent, solid performance. We hope that it continues to be clear that the underlying improvements in our business are sustainable, and we have a team of dedicated, hard-working employees who are committed to making Chemtrade a company to be proud of.

The step changes undertaken in recent years reflect the combination of various broader macro factors and their impact on our product portfolios, but more importantly, it reflects our commitment to continuous improvement and the significant underlying strategic enhancements made across our business, including safety, productivity, reliability, pricing and margin optimization, customer experience and supply chain resilience. Chemtrade has a diversified and resilient portfolio of products. We have a strong balance sheet that's capable of supporting growth and other strategic priorities. With these two strengths, we believe that the outlook remains bright for Chemtrade as we enter the second half of this year. Given the defensive nature of many of our products and the long-term tailwinds benefiting others, we remain confident about our outlook, regardless of the broader macroeconomic backdrop.

Looking now specifically at our SWC segment. Our Water Chemicals business remains a standout performer and is on a positive growth trajectory. We believe this is due to the ongoing low-cost, high-return financial investments made in this area. Longer-term macro factors like growing demand due to population growth and increasing regulations around water treatment are also having a positive influence. At the same time, we cannot forget that it's an incredibly defensive business as many of the chemicals are used in essential processes for drinking water.

Our regen acid business also continues to perform very well and is similarly defensive. Regen is used in gasoline alkylate production, and so even in an economic downturn, it typically remains quite strong as driving activity tends to remain stable. As mentioned earlier in the call, our merchant acid business also has processes in place to limit downside risk, namely the risk sharing agreements which mitigate the impact of any potential pricing and input cost movements. This helps us protect margins and smooth out the volatility that we might otherwise see. As you saw in our second quarter results, our risk-sharing agreements are helping to dampen the year-over-year impact on EBITDA. I would reiterate that the merchant acid business had a notably strong year in 2023, and we continue to expect a more normalized performance in the second half of this year.

Finally, we remain very positive about our ultrapure acid business as Chemtrade is the top North American supplier for semiconductor manufacturing. New semiconductor fabs and expansions at existing fabs continue to progress. The US government continues to award new CHIPS Act funding to support those investments, and we are awaiting the results from our applications. This will ultimately lead to significant growth in demand for ultrapure acid in North America over the coming years, and as the market leader supplying this industry, we are positioned at the forefront.

Switching over now to products in our electro chemicals segment. Across EC, we continue to benefit from access to stable, low-cost and renewable hydroelectric power. The majority of the variable production cost for Electrochemicals is energy, so having this access provides us with an advantage versus producers outside of North America. In recent years, we've seen an increasing volatile energy market overseas, while our Canadian hydroelectric power costs have only seen modest increases.

Demand for caustic soda and chlorine remains stable. HCL demand is strong, driven by increased fracking in Western Canada due to increased demand for LNG. Caustic soda pricing in Asia is expected to continue its upward trajectory. Chlorine and hydrochloric prices are projected to remain strong.

In our sodium chlorate business, we have continued to see pulp mill curtailments, particularly in Western Canada. However, we've seen pricing improve on a year-over-year basis, and we expect this to continue through the second half of this year.

Earlier this year, the primary customer of our Prince George chlorate facility announced a production curtailment that will significantly impact the volume of chlorate they require. As a result, we've made the difficult decision to cease sodium chlorate production at our Prince George plant and convert that facility into a sodium chlorate dissolving operation. The change in operation is expected to be completed this September. The remaining chlorate volumes required by our primary customer will be supplied by our Brandon facility. But again, we'll continue to dissolve chlorate at our Prince George facility even though it will be produced in Brandon.

We expect to see costs related to the cessation of sodium chlorate in our third quarter results, with estimated costs reflected in our updated guidance. Given the optimizations that we expect to make, we do not believe the financial impact of this closure will be material to Chemtrade.

I would like to extend my sincere appreciation and gratitude to all of the affected employees. This is not a decision that we made lightly and is no way reflective of the great effort these employees put into their work on a daily basis.

In our chlor-alkali business, the maintenance turnaround at our North Vancouver facility was very well executed. It was conducted without any injuries and was on schedule, on budget, and was quickly returned to normal operations following the completion of the work. Scheduled maintenance helps ensure the reliability of this plant moving forward, which allows us to capitalize on the strong fundamentals that continue to benefit both hydrochloric acid and chlorine.

For the full-year, we now expect our MECU netbacks to be $95 per ton lower than compared to last year. This reflects continued strength in our pricing for chlorine and hydrochloric acid in the second half of this year, helping to mitigate the full-year impact of lower caustic soda pricing.

As you may have seen, we've been engaging with the Vancouver Fraser Port Authority to extend the lease agreements for this facility. To support this conversation, we've been engaging with the community, First Nations, and all levels of government to raise awareness of the critical role our facility plays in supporting safe drinking water for millions of Canadians. It currently produces over 40% of all available liquid chlorine in Canada. On a regional level, our facility produces over 70% of the liquid chlorine used to treat drinking water in British Columbia and Alberta.

Our facility has been operating safely since 1957, and we continue to invest and look for ways to improve reliability, safety, and reduce any potential risk for the surrounding community. We are encouraged by the feedback we have received, which has been overwhelmingly supportive and positive.

In recent months, we've seen the Northeast Asia caustic soda index pricing begin an upward trajectory. Both Taiwan contract pricing and commentary from industry consultants suggest that pricing has moved through past trough levels and could see further improvements over the remainder of this year and into 2025. As a result, we are optimistic that the earnings contribution from caustic soda could increase in future quarters.

Our updated guidance assumes a realized caustic soda price in 2024 based on an average Northeast Asia index price of $385 per ton compared to $455 per ton this year.

We should also note that we now have moved past the most difficult year-over-year comparable period for caustic soda pricing. This means that realized caustic soda pricing could transition from being a headwind in the first half of this year to potentially contributing to a year-over-year growth in the second half of 2024.

Switching over to our growth projects. To drive additional incremental growth in our business in 2025 and beyond, we continue to prudently invest in strategic opportunities. We believe that these investments will further strengthen our existing market position while also generating attractive returns on investment. To support these projects, we expect to spend between $70 million and $100 million of growth CapEx this year. This estimate includes over $37 million spent in the first half of this year.

The largest of our current organic growth projects, the expansion of our ultrapure acid facility at our Cairo, Ohio plant. This project is approaching completion. Once completed, the production from this facility will increase by approximately 60%. The upgraded product quality will be capable to supply the next-generation semiconductors, further supporting Chemtrade's position as the leading North America acid supplier.

We expect to provide samples of the new product to our customers for product validation shortly. Similarly, the continuous quality upgrades at our other ultrapure acid facilities continues to progress well.

As we have previously shared, we are also completing a number of small projects in our water chemicals business. This includes additional capacity expansions in PAC and ACH, similar to those that we completed in 2022 and 2023. It also includes a new specialty water chemical line at our Augusta, Georgia plant. As already mentioned, this is an area in which we continue to see good sustainable growth with high-returns on investment. While the investments we're making in water chemicals are not individually material, they're having a very positive combined impact on our business. As we continue to progress on these and other growth opportunities, we'll continue to provide more updates.

To conclude, I would like to again thank you for your interest and support for Chemtrade. We hope that we continue to successfully execute quarter after quarter. We are further bolstering your confidence in the quality of our business, its long-term sustainable cash flow generation and its underlying value. Our diversified product portfolio is different than many other North American companies, offering an attractive combination of defensiveness and growth.

We continue to look for ways to meet and exceed our stakeholder expectations, which we know includes delivering on our ESG goals and commitments. We are in a strong financial position. I can tell you that our team is built differently. We have an unwavering commitment to excellence, a relentless dedication to quality and customer service, an acute focus on making Chemtrade better every single day.

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

Q&A

Operator: Thank you. And ladies and gentlemen, we will now begin the question and answer session. To ask a question, you may press star followed by the number one on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing any keys. To withdraw your question, please press star followed by the number two. One moment please for your first question. Your first question comes from the line of Ben Isaacson with Scotiabank. Please go ahead.

Viktor Sayek, Scotia Bank: Good morning. This is actually, Viktor jumping on for Ben. Congrats on another beat and raise on your end. I guess our question is, we've seen the water business post solid margins. Can you perhaps expand a little bit on the drivers? Have you seen a decrease in raw material prices? Is it to do with the timing of the contracts? And do you expect a headwind if energy prices moderate in Europe? Thank you.

Scott Rook: So let me address that. So the drivers for our growth in water business, I'll start and say from an operational standpoint, we have focused on reliably running our assets better. And so we have seen continued improvements in the underlying performance of those assets for the last two to three years, and so that continues to pay benefit for us.

We have also focused on pricing optimization and aggressively pushing prices in the marketplace, and so that has had an impact on us. We have also added capacity at some of our more specialty materials. We've been adding capacity since 2022 and so the capacity expansions are having an impact as well. So, when you put all of that together, better operations, better pricing support. I will say this year, we are seeing a little moderation in raw materials, and so that is having an impact as well. But all those factors together, I think, are what's behind our improved results in water.

Rohit Bhardwaj: And on the question on the energy cost in Europe, I'm assuming that you didn't mean that in the context of water because that's not a factor. But in terms of electro chemicals segment, we think the pricing in North America never fully priced in the very high energy costs that we experienced in Europe. And so I think right now, we are already, the pricing is now, pricing in the moderation that's already occurred, keeping in mind that even though energy costs in Europe have moderated from their peaks in 2022, they still remain elevated compared to prewar levels, and so that's already priced into our assumptions here.

Scott Rook: Yeah. On that, I think that if you look at, let's say, our competition with caustic soda, particularly with our plant in Vancouver, our competition there is caustic soda that comes over from Asia. And so the underlying, let's say, the floor of material, the floor for pricing for that material is going to be tied to energy. And I think the energy costs in Asia are higher because energy costs around the world have typically been higher over the past couple of years, and I think that's going to continue to be the case.

Viktor Sayek: Makes sense on both water and EC. Thanks, guys.

Rohit Bhardwaj: Welcome.

Operator: And your next question comes from the line of Joel Jackson with BMO Capital Markets. Please go ahead.

Anthony Taglieri, BMO: Good morning, everyone. This is Anthony Taglieri on for Joel. Maybe I'll just start with a question on your guidance. Obviously, Canadian rail strike is out of Chemtrade's hands, but how might your guidance change with a strike that goes on for maybe a week, two weeks, a month?

Rohit Bhardwaj: OK. So the high point of our guidance definitely does not assume any rail strike. I'd say the midpoint of our guidance assumes disruptions leading--so even if there's no strike, there tends to be some disruptions leading up to a potential strike. So, our midpoint contemplates those disruptions because we'll start putting embargoes on shipments. And I think our bottom end of the range would absorb some strike levels, but it's really hard to see the full impact until we know if there's going to be a strike, and secondly, how long that strike is going to be.

Anthony Taglieri: Great. Yeah, that makes sense. And I guess just a second question, maybe comment on your decision to buy back the September 2025 converts. Obviously, at a one-third uptake despite the large premium offered, and maybe talk about what this might imply to you for how convert owners value Chemtrade units.

Rohit Bhardwaj: That's a good point there, a good question there, I should say. So yeah, the reason we want to buy it is because they're getting close to their hard call time, which is October 1st, and they will have one year to maturity. They are 8.5% coupon so they're a fairly expensive piece of paper. And of course, their conversion price was 7.35, so they could be potentially dilutive, so we thought it made sense.

So if you think about it, the 1.30 premium we offered represents a parity value of about 9.55 on the units which we're somewhat trading at that right now, and we're in the market buying back units at those levels. So it just really was a way of trying to reduce the amount of debentures that might get converted and might potentially convert into units and be dilutive.

Now, the feedback we got from certain debenture holders is that they actually like the Chemtrade story, and it's a convenient way for them to convert and hold equity as opposed to tendering to our price, which is a very fair price. So we think this was a good outcome for us. We think we took out some of the people who wanted to exit, and the remaining ones will convert and be good long-term equity holders for Chemtrade.

Anthony Taglieri: Great. Thanks so much.

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

Jacob Bout, CIBC: Good morning.

Rohit Bhardwaj: Good morning.

Jacob Bout: A question on the cessation of this sodium chlorate production at Prince George. Maybe just walk us through, so you said not a meaningful for charge associated with this change. But interested in, does this reduce your overall base cost for producing chlorate, because would presume that Brandon is lower cost? And is there any impact on 2025 chlorate volumes, because it sounds like it will be lower year-on-year?

Scott Rook: Yeah. So first, let me say that, yeah. As we were producing chlorate at our Prince George facility, also producing chlorate at our Brandon facility, Brandon, as a reminder, it's the largest chlorate facility in the world and so we had capacity there. So we had room to move chlorate production from Prince George over to Brandon. And so that was the decision that we made. And so there are lower costs associated with moving chlorate production from Prince George into Brandon.

However, our primary customer at our Prince George facility takes chlorate not in a--well, let's say, takes chlorate that's dissolved in water. So we made the decision to do is move that production to Brandon. There's cost savings associated. We'll move chlorate from there, back to Prince George. We'll dissolve it and then supply our customer in a way that will be the exact same way that they've continued to get material from us.

That customer, though, had made a curtailment for part of their pulp mill production. And so yes, we have continued to see pulp mill curtailments across Canada. We hope we're getting to the end of that, not sure about that. But yeah, we'll have somewhat less volume, I would expect next year, but also lower total production costs as we consolidate production into Brandon.

Rohit Bhardwaj: Yeah, Jacob, if you look at our assumptions in the guidance, we have said that our sodium chlorate volume assumption for 2024 is roughly 257,000 tons. Last year, we did 283,000. And first half of this year, we did about 140,000. So when you do the math there, you will see that half (inaudible) will be baked in lower volume. And so we think that we will be somewhat off the 257,000 that we'll achieve this year. But as Scott said, some of the curtailment is already in the first half so it will be somewhat lower but not significantly lower than what we have for the full-year.

Scott Rook: Yeah. And then somewhat offset by the consolidation of production.

Jacob Bout: OK. That's helpful. And then maybe just going back to the question on the strong margins in the SWC segment. There was basically, what, a 317 basis point improvement in margins year-on-year in the quarter. Maybe just kind of walk us through what the buckets would be. Would water products be the majority of that?

Rohit Bhardwaj: Yes. Water would be the majority because within the asset, there's some puts and takes but water is the primary contributor.

Jacob Bout: OK. OK. And then maybe if I can just sneak in another one here. Just on the rail, have you made any preparations for a rail strike? And how long can they be out before you meet it, you feel an impact? And then I'm assuming North Van is probably the biggest immediate impact, but how long before you start feeling the impact of Brandon and some of the other plants?

Scott Rook: So look, the market, our customers, the entire industry has been talking about a potential strike for at least 60 to 90 days. This was not a new surprise. So even in the second quarter, I think across Canada, we were seeing customers raise inventory levels and stockpiling some material in anticipation of this. So I think that has definitely been happening.

But look, we won't speculate on--there's no reason for us to speculate on how long this strike is going to last, even if it's going to go into effect. Based on what we've seen, the strike could start on August 22nd. And so we'll see if that's going to happen, but we won't speculate on how long that's going to last. We're beginning to see an impact even as of today that TIH materials are not moving, but that is being discussed at, let's say, take chlorine for drinking water, that was being discussed yesterday. We can share at the highest levels of US and Canadian government yesterday and, say, highest levels at the office of the Prime Minister in Canada and at US, because chlorine goes into drinking water. And so we think, and I think it's fair, obviously, that if there's any essential material, that chlorine for drinking water would be considered essential.

Rohit Bhardwaj: And so, Jacob, if you look at our guidance, initially, we had said that the back half of the year is going to be stronger than the first half. Then if you look at our revised guidance now, you will see all the update. Our first half was very strong. Some of it was this extra inventory buildup in Q2 for our customers. So we'd already assumed regardless of a strike, that some of that would get unwound as inventories go back to normal, either because the strike happens or because a strike doesn't happen, and customers don't need that level of inventory. Some of that is baked into our numbers. But again, for us, we don't recall ever having both rail companies go on strike at the same time. So this would bring the Canadian economy to a grinding halt, and so we are hopeful that this will not be a long disruption.

Jacob Bout: OK. That's helpful. Thank you very much.

Operator: And your next question comes from the line of Steve Hansen with Raymond James. Please go ahead.

Steve Hansen, Raymond James: Yes, good morning, guys. Thanks for this time. I echo your comments, the strike is short-lived, if at all, but we'll see. On the Cairo expansion completion, it's coming up here quickly. I think the bulk of the contribution will really start in 2025, but can you just remind us what kind of incremental contribution you are expecting there, relative to the capital spend. And how the pricing dynamics might have changed or have been changing in recent periods here as that market continues being pretty tight?

Rohit Bhardwaj: So I think initially, we had said we are targeting a 25% return. Then I think when we gave some revised estimates earlier this year, we said that we'd like to hold off on giving kind of the expected margins until the project is complete. We are having commercial talks and other talks. We'd rather wait for maybe until the next quarter to give you a little bit more color as to what we expect the margin contribution to be. But you're right, it will start ramping up in 2025, so we will expect margins to ramp up during 2025. So 2025 may not hit a full-year return but it will start ramping up.

Scott Rook: We will be producing acid in the second half of this year and so we're very excited about that. We're going to plan a ribbon-cutting ceremony, a very successful project. Again, we'll start acid production second half of this year, and we'll begin the process of sampling and approving this for the high-end new chips that are there. But what will come, I think significantly faster, will be approval for existing chip production. And then the new small nano chips, that approval process will be happening in 2025.

Steve Hansen: OK. Just to clarify then, it sounds like this isn't the type of facility you just move from 0% to 95% rates over a couple of weeks. You're going to slowly and gradually step production as demand.

Scott Rook: So in terms of acid production, look, without getting into, we can run that facility full of acid pretty much from when we start out. And then there are different applications that will move that, that have different quality requirements.

Rohit Bhardwaj: Yeah. So I mean, not all acid is equal, so we will be producing acid but for the real high-end margin stuff, that's what Scott was talking about, that it takes a bit more time qualifying for that. So that will start ramping up in 2025.

Steve Hansen: OK. I appreciate that. I guess we'll get an update again here later this year. Just switching gears quickly back to the water side and some of the pricing dynamics there. I mean, how far and how aggressively have you pushed price? Just trying to get a sense of whether the margins are relatively sustainable into next year, excluding any puts and takes around raw material costs, etc. I'm just thinking pricing specifically. Is that something you continue to expect pricing dynamics will hold and perhaps even increase next year? How do you feel about that?

Scott Rook: So look, I think the thing with water, we are seeing, I think the market is seeing more mature price in the market. However, that being said, a significant portion of our business goes to city bids and those city bids are annual prices and where we have raw material concerns, or we take the raw material risk, so that's always there. However--yeah.

Rohit Bhardwaj: Let me just add one thing. I mean, our pricing team has definitely got a long-term view of the market, so they would not be too opportunistic in pushing something that would reverse shortly. So, I think they do take a holistic long-term view to the market and price where they think that it is sustainable.

Scott Rook: I think as we look at that, yeah, I mean, we feel good. We feel very good about the direction of the water business. We're not going to give any specific numbers for 2025, but we feel very good about the direction of the business as we look out certainly for the next several years.

Steve Hansen: That's helpful. And then I'll squeeze one last one. Just Rohit, I think you mentioned some M&A transactions, or might have been Scott, I apologize, on the buyback and how you think about the undervalued nature of the stock relative to some of these transactions. I mean, where do you ultimately see that fair value? Can you give us some sort of directional sense for how undervalued you think you are and how you think buyback will roll out here through balance of this year and into next year?

Rohit Bhardwaj: So I think what I'll give you is that we are trading at about 5x EBITDA. Historically, we have been in the 6x to 8x EBITDA. If you look at some of the transactions that are taking place in the market, like there's one big water competitor, and that, we've been told, is 10-plus times. We've also seen a transaction in the sulphuric acid space that was in the 7s kind of directionally.

So you can kind of triangulate that and see where you think our valuation should be, but we think there is a significant undervalue. So we are in the market on the NCIB. We were not allowed to do it during the SIB. So as soon as the SIB was lifted, we had an automated share purchase plan that kicked in on August 1st, and so we've been buying every day since then. And we fully intend to continue doing that because when we do our own DCFs, I mean, this is a project and an initiative that probably delivers us return better than almost anything else we can do.

Steve Hansen: Right. Appreciate it. Thanks.

Operator: And your next question comes from the line of Gary Ho with Desjardins Capital Markets. Please go ahead.

Gary Ho, Desjardins: Thanks. Good morning. Just want a quick update on the Arizona ultrapure acid kind of project. How things are progressing there. And also, any comment on the progress on getting funding from the CHIPS Act? Any visibility on that, that would be great.

Scott Rook: Sure, Gary. I'll say, so we have not heard back a final answer from the US government on the CHIPS Act. Our partner and I, and Chemtrade, we've done a lot of work in putting together that application. There's been a lot of back and forth with the government and we're kind of waiting to hear that. As I shared last quarter, the key for that facility in Arizona would be a clear vision of how that facility could ramp up to the volumes that we have projected, which would be 100,000 tons of acid.

The fabs have delayed many of their expansion plans. And so even as we look at it, we no longer see the need for that much volume in, let's say--we don't think the market is going to need that much material in the next two to three years. But we're very closely looking at that and then talking with the fabs and trying to understand the rate that they're going to bring on their expansions and the acid that's going to go along with that. And then we're trying to match supply so that would come together. We wouldn't build a 100,000 ton and then that could take seven or eight years to fill that out.

Gary Ho: Got it. OK. And then my next question, just on the North Van lease extension discussion. It sounds like you've been pretty proactive in some public government relationship building. Can you elaborate on any early feedback? And when can we hear something kind of more definitive on the lease extension?

Scott Rook: So yes, we've had an effort that's been ongoing for more than a year, and we have targeted our communications and our interactions with the local community, with First Nations there, and then municipal and federal officials than there have been a wide number of meetings over a year. Feedback has been very positive from a great majority of those meetings, and so we're very optimistic based on that feedback.

And so although I can't give you--I'm not going to say here's a date, can't do that. I will say that the feedback has been positive. And so the feedback has been positive and the goal we're hoping that we could come back at some point in time and say that here's a lease extension. But we can't give a date on that, but we'll just say that that's work in progress right now.

Gary Ho: OK. Perfect. And then just one last question. Maybe higher level, can you just refresh us on your capital allocation ranking? We've seen you kind of announce a convertible kind of SIB, execute on NCIB, the Dividend increase. I think also in kind of recent quarters, you've talked about strategic acquisitions and also you have the Kanto JV in the background. Maybe just help us think through each one of those and what's the pecking order? And also, maybe just on the last question on the NCIB. Is your thinking that you repurchase stock to the tune of how much the force converts will come back, so essentially no dilution on your side?

Rohit Bhardwaj: OK. So I'll take part of it and then maybe Scott will step in for some of it. So our allocation strategy is, as we said, the dividend is very important. Maintaining a healthy balance sheet is important. Returning capital in other ways, like the NCIB, so yes, we don't want to give you an exact number we want to buy. But our thinking was that, one, it was undervalued. Two, if there is a conversion event, which we would definitely sop up those units. So you can expect us to continue to be buying.

In terms of leverage, we have said in the past, we think our long-term target is about 2.5x. For strategic opportunities we could lever up a little bit higher. We have a lot of liquidity. Right now, we've got over $400 million undrawn on our revolver. So, we have capacity to do things. So those are kind of the priorities, and I'll let Scott add anything if he wants to.

Scott Rook: Yeah, sure. So just, Gary, I guess, with how the prioritization and roughly the general direction for returns, I think that we feel that some of the best use of the capital that we're generating would be the NCIB and buying back units, as well as the SIB and the NCIB. And so returning that capital to shareholders, I would say we feel that's going to be a very high-return.

Next for us would be organic growth projects and that's across ultrapure, across water. We continue to look at other projects and so high-returns. And so we look at that.

And we are open and looking and thinking about moderate acquisitions. Typically, I think we would exhaust the majority of our organic growth. And then if we still have capital left over, we would consider that in terms of moderate acquisitions, and there's always other ways that we look at in terms of returning capital to our shareholders.

Rohit Bhardwaj: And any moderate acquisition would definitely be synergistic and strategic fit to our business. So we would be, think of it very cautiously.

Scott Rook: Exactly.

Gary Ho: OK. Perfect. Thanks for the detailed answers.

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

Zachary Evershed, National Bank: Good morning, everyone. Congrats on the quarter.

Rohit Bhardwaj: Thank you.

Scott Rook: Thanks, Zach.

Zachary Evershed: So you did mention the customer stockpiling inventory ahead of the rail strike and that the unwinding or the destocking thereafter is baked into your numbers. Can you give us an idea of how much of a pull forward that might have created in Q2 results?

Rohit Bhardwaj: Yeah. You know what, we don't want to go too far down that path. You can look at some of our volumes that we've disclosed and triangulate from there. But we don't want to get too specific on quarterly stuff. But I wouldn't say it's overly material but it's a meaningful number.

Zachary Evershed: Gotcha. Thanks. And then how much of the current and expected strength in electro chemicals can you attribute to disruptions of competitor supply versus strategic actions to keep supply fairly restricted?

Scott Rook: Yeah. I would say very little would be--I think our view, very little of the benefit that we've seen in EC would have anything to do with competitive supply. The disruptions, let's say, from some of our competitors are in the US Gulf Coast, and so we don't see that much, let's say, interaction between the US Gulf Coast because our market segment where we primarily sell to, is Northwest Canada. And so our competition there tends to come over by ship from Asia. So really not that much of an impact by the supply disruptions from the recent weather events.

Zachary Evershed: Thank you very much. I will turn it over.

Operator: Thank you. And there are no further questions at this time. I would like to turn it back to Scott Rook, President and CEO, for closing remarks.

Scott Rook: So thank you, everyone. Thanks, everyone, for joining the call. We're proud of the second quarter and look forward to delivering continued strong results for the second half of this year. Thank you and have a great day.