FINAL TRANSCRIPT

Cascades Canada ULC

First Quarter 2022 Results

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PRESENTATION

Operator

Mesdames et Messieurs, bienvenue à la téléconférence des résultats financiers du premier trimestre 2022 de Cascades. Je m'appelle Sylvie et je serai votre opératrice aujourd'hui. Notez que toutes les lignes sont présentement en mode écoute seulement. Suite aux commentaires des dirigeants, il y aura une période de questions.

Good morning. My name is Sylvie and I will be your conference operator today. At this time, I would like to welcome everyone to Cascades First Quarter 2022 Financial Results Conference Call. Note that all lines are currently in a listen-only mode. After the speakers' remarks, there will be a question and answer session.

I now will pass the call over to Jennifer Aitken, Director of Investor Relations for Cascades. Ms Aitken, you may begin.

Jennifer Aitken:

Thank you, Operator. Good morning everyone and thank you for joining our First Quarter 2022 Conference Call. We will begin with an overview of our operational and financial results followed by some concluding remarks, after which we will begin the question period.

The speakers on today's call will be Mario Plourde, President and CEO, and Allan Hogg, CFO. Also joining us for the Q&A period at the end of the call are Charles Malo, President and COO of Containerboard Packaging; Luc Langevin, President and COO of Specialty Products; and Jean-David Tardif, President and COO of our Tissue Papers division.

Before I turn the call over to my colleagues, I would like to highlight that certain statements made during this call will discuss historical and forward-looking matters. The accuracy of these statements is subject to risk factors that can have a material impact on actual results. These risks are listed in our public filings.

These statements, the Investor Presentation, and the press release also include data that are not measures of performance under IFRS. Please refer to our Q1 2022 Investor Presentation for details. This presentation, along with our first quarter press release can be found in the Investors section of our website. If you have any questions, please feel free to call us after the session.

I will now turn the call over to our CEO. Mario?

Mario Plourde:

Thank you Jennifer, and good morning everyone. I would like to begin this morning's call with some high level comments before going into details of each of our businesses.

The first quarter was challenging from a cost and execution standpoint. Combined, these factors negatively impacted consolidated first quarter Adjusted OIBD by $36 million sequentially, and nearly $150 million year-over-year. We are operating in a difficult macroeconomic environment which is driving up costs for fuel, logistics and raw material. Notwithstanding this, internal initiatives on low pricing and mix offset these headwinds sequentially, but lag year-over-year. The continued rollout of announced price increases in our business segment will close this gap beginning in Q2.

In our Tissue business, these are being expanded by extensive profitability initiatives currently underway with benefits expected to be weighted to the back half of the year. We highlight some key takeaways on Slide 3 of our deck.

Moving now to our financial results, on a consolidated basis first quarter sales increased 10% year-over-year and were stable compared to the previous quarter, while Adjusted OIBD decreased notably from prior year levels and by 6% sequentially from the reasons I just mentioned.

On the raw materials side, highlighted on Slides 5 and 6, the Q1 average index price for OCC increased 77% year-over-year and decreased by 16% from Q4. Export has been limited by port and container constraints, and the market is generally stable despite persistent transportation challenges, and elevated costs to source our materials within North America.

Average index price for white recycled paper grade increased notably in Q1, up 109% year-over-year and 16% from Q4.

The impact of these cost headwinds can be seen in our Tissue results this quarter as this is the primary raw material for this business.

On the virgin pulp side, the Hardwood Pulp Index increased 27% while Softwood Pulp Index price rose 17% from last year's level. Sequentially, both increased by 4%.

Moving now to the results of each of our business segments, as highlighted on Page 7 through 14 of the presentation, beginning with the sequential performance. Sales in Containerboard increased 6% in Q1. This was largely driven by higher selling price, partially offset by a less favourable sales mix. The 1% volume increase reflects the combination of a decrease of 1% in converted product and a 4% increase in parent roll shipment. Sequentially, converting shipment decreased by 1% in millions of square feet, in line with the 1% decrease in both the Canadian and the U.S. market for the period.

On a per day basis, converting shipment decreased by 1.6% sequentially, outperforming the decrease of 5.2% in the Canadian market and 5.7% in the U.S. market. I would highlight that shipment levels were impacted as a result of challenges on the transportation side. As you know, roughly 65% of our containerboard business is in Canada where we have seen greater logistics headwinds in terms of availability. These constraints were also felt by some of our customers, preventing them from getting product out the door, which resulted in lower orders. Given the backup, we temporarily limited production at some of our operations, which impacted our shipments level, and therefore top line sales in the quarter. To put it simply, we could have shipped more product had transportation been available.

Q1 Adjusted OIBD of $80 million or 15% on a margin basis was $10 million or 14% above the Q4 levels. While an improvement, it is not where we want it to be, with cost inflation and freight limitation impacting profitability by $17 million, muting the $26 million pricing and mix benefit in the quarter.

Year-over-year, sales were also up by 6%, while Adjusted OIBD decreased 26% due to the significant cost inflation already discussed. Notably, raw material costs add a $31 million negative impact on profitability. This reflects that we are over 80% recycled, well above our Containerboard peers.

Year-over-year converting shipment decreased by 6% in millions of square feet, underperforming the 1% decrease in the Canadian market and the 0.3% decrease in the U.S. market. On a per day basis, converting shipments were down 4.3%, below the 1.2% and1.8% decrease in the Canadian and the U.S. market, respectively.

Lower year-over-year volume reflects labour and transportation constraints at the beginning of 2022, and some customer account erosion related to profitability initiative.

Before moving on to the Specialty Products segment, a quick update on the Bear Island project. The project remains on track from both a cost perspective and a mid-December start-up. We currently have over 490 people on site, increasing to 725 by mid June. And we have received our first delivery of raw material. We are very encouraged that 100% of the volume is secure for 2023, and 75% is secured for the following two years. Our sales team continues to advance discussions to secure additional production offtake for the coming year.

Specialty Products continues to generate solid results sequentially, with Q1 sales up 4% from the prior quarter. The reflected the implementation of price increases in response to cost inflation, the benefit of which offset a less favourable mix in the plastic segment and lower volume in the ag distribution sector from seasonally strong Q4.

Adjusted OIBD increased 1 million sequentially as higher prices offset the impact of higher operating and transportation costs. When compared to the prior year, Q4 sales increased by 35% or 29%, while Adjusted OIBD level increased by 4 million as higher realized spread offset higher production costs.

Moving now to our Tissue business, while expectations were for results to be stable sequentially, sales decreased 7% and our Adjusted OIBD loss grew to $17 million in the quarter. We fell short for two main reasons. As was the case for all of our businesses, cost inflation was a key factor. For our Tissue business, this included not only logistics and energy, but also raw materials, which I touched on earlier. Combined, these elements had a negative $13 million sequential impact on profitability.

The second element was a $6 million impact due to the lower volume. While logistics and production constraints at the beginning of the year certainly contributed to this decrease, it is also the result of tactical and strategic decisions we are implementing to optimize our customer and production portfolio as part of the steps outlined in our profitability plan.

Year-over-year first quarter sales increased 8%, with shipment and average selling price up 7% and 1%, respectively. Significantly higher raw material costs combined with inflationary pressures on production, transportation and energy costs impacted profitability levels by $47 million year-over-year.

These were partially offset by better volume and better pricing and mix, which added $10 million year-over-year.

Moving now to Slide 14 in the presentation, we have successfully implemented the January price increase in our away-from-home segment and expect benefit from the price increases announced in both markets in early 2022 to begin in Q2. Given this, first quarter results in our Tissue business reflect full brunt of our cost inflation without any offsetting benefit from these increases being realized.

I would also that we have just announced an additional price increase for away-from-home effective July 1 to counter the high cost environment. Currently, we anticipated that cost inflation will result in approximately $65 million of additional headwinds from the level outlined in our strategic plan. We expect this to be offset by benefit from revenue management initiatives, announced price increase and other revenue and cost initiatives being rolled out.

Notwithstanding this disappointing Q1 result, I am encouraged by the progress being made with out profitability plan. We are in the midst of executing extensive turnaround in initiatives, making adjustments when and where needed, and are optimistic that these efforts are equipping our tissue business to reach its objective of generating Adjusted OIBD of $60 million to $80 million in 2022.

Allan will now discuss the main highlights of our financial performance, after which I will conclude the presentation.

Allan Hogg:

Thank you, Mario. Good morning.

On Slide 15 and 16 it illustrates the specific items recorded during the quarter. The main items that impacted our operating income before depreciation were a $7 million unrealized loss on financial instruments, a $6 million gain on asset disposal in our Specialty Products group, and $1 million of restructuring costs recorded in our Tissue segment.

Slides 17 and 18 illustrate the year-over-year and sequential volumes of our Q1 adjusted earnings per share, and the reconciliation with specific items that affected our quarterly results. As reported, loss per share were $0.15 in the first quarter. This compared to earnings per share of $0.22 last year and to $1.04 in Q4 2021. Both periods included specific items.

On an adjusted basis, the loss per share of $0.15 was $0.44 below last year's results and $0.06 lower than last quarter. This mainly reflects our lower operating performance.

As highlighted on Slide 19, the first quarter adjusted cash flow from operations decreased by $58 million year-over-year and adjusted free cash flow levels decreased by $85 million year-over-year. This reflects lowering operating results and higher net Capex paid in the current period, largely associated with our Bear Island project.

Slide 20 provides details about our capital investments. New capital expenditures total $78 million, including $57 million for the Bear Island project. After subtracting asset disposal and adding amounts not paid at the end of the year, net cash outflow amounted to $96 million. For 2022, we continue to expect total investments of $415 million, which includes approximately $275 million for Bear Island.

We expect the project to remain within the range of US$425 million to US$450 million, notwithstanding the current inflationary pressures on cost.

Moving now to our net debt reconciliation on Slide 21, our net debt increased by $198 million in Q1, reflecting the planned elevated capital program, lower profitability and higher working capital requirements in the period.

Our leverage ratio of 4.8x is up notably from 3.5x at the end of 2021, also reflecting higher capital investments and lower Adjusted OIBD levels. When excluding cash investments made to date in the construction of Bear Island, our leverage ratio would stand at 3.9x.

Financial ratios and information about maturities are detailed on Slide 22. Sequential and year-over-year sales and OIBD performance analysis can be found on Slide 25 through 28 of the deck, and historical index pricing on Slide 29 and 30.

Mario will conclude now the call with some brief comments before we begin the question period. Mario?

Mario Plourde:

Thank you, Allan.

We provide details regarding our near-term outlook on Slide 23 of the presentation. I will remind you that this outlook is based on what we are seeing today and may change in the coming months.

Our near-term outlook for Containerboard is for a stronger sequential results, driven by lower average raw material pricing, benefits from the rollout of announced price increases and good seasonal demand. However, these tailwinds are expected to be partially muted by the continued inflationary pressure on operational and (inaudible).

We are expecting continued positive momentum from the Specialty Products segment sequentially, with stable volume and favourable selling price trends expected to offset cost inflation pressure.

As I mentioned during my earlier update on our strategic plans for Tissue, we expect the extensive profitability initiatives underway in this segment to generate growing benefit as they continue to be implemented. At their root, these actions are targeting profitability levels, will help mitigate current cost headwinds, and will generate an improved financial performance sequentially in the second quarter.

Let me finish by saying that cost inflation and constraints in logistics played an important part of our first quarter performance. In our execution, we will need to continue improving within the context of the current business conditions.

We are systematically addressing these factors across our operations and important benefits will be realized over the coming months as our strategic plan continues to be implemented.

We will now be pleased to answer your questions. Operator?

Operator:

Merci. Si vous voulez poser une question, veuillez s'il vous plaît composer l'étoile, suivie du un, sur votre clavier téléphonique et si vous voulez retirer votre question, composez l'étoile suivie du deux.

If you would like to ask a question, simply press star, then number one on your telephone keypad. If you would like to withdraw your question, please press the star then number two. Again, if you have a question, please press star, followed by one on your touch-tone phone. We will pause for just a brief moment to compile the Q&A roster.

Your first question will be from Sean Steuart at TD Securities. Please go ahead.

Sean Steuart:

Thanks. Good morning.

Mario, a question on the Tissue guidance and the commitment to the EBITDA guidance of $60 million to $80 million for this year. It looks like you're guiding to still improved sequential results in Q2 but still negative EBITDA, so the implication is a rapid turnaround in the second half of the year, which is consistent with what you were talking about.

I want to understand, though, these incremental profitability improvement initiatives, some of which are price hikes. These are above and beyond what you would have envisioned at the strategic review that you presented a few months ago. It just feels like an ambitious target through the second half of the year given the struggles you've had of late. Can you go into any further detail beyond price hikes what you're expecting to see flow through to those results in the second half?

Mario Plourde:

Hello Sean, yes. Certainly I can.

The inflationary pressure we get on many of our different raw materials and costs throughout the operation and the speed of them are quite of a surprise for us, so that's why we initiated another price increase to compensate for those inflationary costs. We basically have no choice to pass on those increased costs to our customers to protect our margins.

It was not on the plan when we launched our plan in February, but with actual results of these inflationary, we have no choice to increase pricing.

But at the same time, we're looking at many different options. Network optimization between where we're producing, where it will be shipping, the numbers of SKUs we'll be producing, and the numbers of customers we'll be shipping, all of these are being addressed in our action items as we speak today.

We're quite confident because as it doesn't show in Q1, we have those benefits in our plans and we are quite confident to deliver on them for the second half of the year, and we'll see results of that in Q2.

Allan Hogg:

In addition, I may add to this also additional production output, volume output increase …

Mario Plourde:

In the coming months, yes.

Sean Steuart:

Okay. Thanks for that detail.

My second question is on OCC. We've seen gradual declines in recent months. I would have thought maybe even a bit faster given lockdowns in China. Can you speak to the tension in the market? Is there just that much incremental competition for supply domestically within capacity starting up that it's tempering the pace of decline, and what are your expectations for those costs into the summer?

Luc Langevin:

Good morning, Sean. This is Luc Langevin. I will take your questions.

To be frank and honest with you, we would have expected a more significant decline based on the reading we have of the market. Since the beginning of the year, typically the first quarter is a low-generation season for OCC, and despite the low-generation season we have seen most of the mills have been high (inaudible).

I think what potentially has slowed down the decrease is probably more the logistics challenges we had at the beginning of year. That seems to be coming back to more normal now. That put a little bit more pressure and stress. I think this is probably what could have limited the decrease of OCC, and we would believe that with the normalization of the logistics, slow normalization of the logistics over the next few months, that we will see further maybe a more favourable market conditions for buyers.

With regards to the start-up of new mills, I think everybody already is active and it doesn't put significant pressure on the market. We don't have any—I will speak for our own start-up. We have no challenge to meet the targets that we have planned for the build-up of inventory in provision of the start-up of Bear Island.

Sean Steuart:

Okay. Thanks for that detail, Luc. That's all I have for now. Thank you.

Mario Plourde:

Thank you.

Operator:

Thank you. Your next question will be from Hamir Patel at CIBC. Please go ahead.

Hamir Patel:

Hi. Good morning.

The first question I have is for Charles. Are you able to comment on how your box shipments have fared in Q2 to date, and what you might be seeing in the ecommerce side of the business given tougher comps there?

Charles Malo:

Hamir, the volume in Q2 from what we've seen the start of Q2, was we see the seasonal uptake, which is more normal than the COVID in Q1 last year, which is a good sign right now.

On the ecommerce, the exposure that we have with the ecommerce, the Q1 is good, as we see, but mind you that Q4 was extremely busy, so it's more stabilized right now on the ecommerce side.

Hamir Patel:

Great. Thanks, Charles.

Charles Malo:

But our Q2 overall volume, we are benefitting from seasonal trend right now.

Hamir Patel:

Okay, fair enough. Charles, I was wondering, are you having any trouble getting starch and are you seeing any further cost pressure there?

Charles Malo:

The availability is still good, so we have a good agreement with suppliers. But there is cost pressure, especially with what's going on in the world right now. But on the availability side we are comfortable with being able to supply our customers and respond to our needs.

Hamir Patel:

Okay, great. Thanks, that's helpful. Just a last question I had for Allan.

As the company wants to grow its integration rates in Containerboard in coming years, just given the high leverage at the moment, how do we think about the timing of when Cascades might look to construct additional box plants and what kind of capital cost would that be?

Allan Hogg:

Well, as we stated in our plan, it's something we would like to put forward before 2024, and you know to start something, depending on how we do it, it takes 12 to 24 months. It's something that we believe that at that time with the Bear Island project being started and everything we're doing right now to improve profitability, we believe that our leverage will gradually come back to where we want it to be so we don't feel this is a problem right now.

The level of investment, if we refer to Piscataway or something to $80 million or a bit now right now with all the costs going up, and again, depending what the size would be and how we do it, so it has to be finalized. That's what I can say right now.

Hamir Patel:

Great. Thanks, Allan. That's all I had. I'll turn it over.

Operator:

Thank you. Your next question will be from Zachary Evershed at National Bank Financial.

Zachary Evershed:

Good morning everyone. Thanks for taking my questions.

Mario Plourde:

Good morning.

Zachary Evershed:

With inflation running hot and interest rates rising, how do you feel right now about future containerboard demand against a likely pressured consumer?

Charles Malo:

Well, there is I would say a more normal demand as we see right now than the, I would say Q1 and Q2 of 2021. But the need to move goods are still there. Again, in our case, in Cascades, we are seeing right now the uptake from the seasonality, so we kind of see the trends of pre-COVID. At this point, unless the macro economy changes drastically, we're still confident that there is going to be a good demand in 2022.

Zachary Evershed:

That's helpful, thanks. Then we know that closure announcements have a much shorter lead time than capacity addition, so we may not have the full picture for the end of 2022 and 2023, but if there is to be capacity rationalization in the industry, given how Cascades is positioned with the quality of its asset base, would you see yourselves participating in that as well?

Charles Malo:

Well, as we said earlier, the investment that we've made has been to improve our asset base. We've proven that with the recent investments like Greenpac and Piscataway. The same thing also with our Bear Island. It's hard to predict the moves that we are going to be making in '23/24, but one thing I can say is Cascades is going to be better equipped to compete with the type of product that we are offering, recycled high-performance, but if the market conditions change drastically, like we've done in the past we are going to take the proper decision to maximize the profitability and create value for Cascades.

Zachary Evershed:

That's good colour. Thank you.

One last one for me. Allan, you were saying that you do see a path down on the leverage ratio naturally, but at what point does your net debt-to-EBITDA ratio become a concern?

Allan Hogg:

Well, now the increase in leverage is mainly driven by EBITDA, so that's our focus right now towards the end of the year and for next year. We feel that working on profitability initiatives in Tissue and having all these price increases being implemented, we'll revert back rapidly to where we could be and we'll have sufficient leeway to complete that Bear Island project.

For now, the last two quarters were not great, we know that, but we expect that we're going to get back on track. In the near future.

Zachary Evershed:

Any commentary on covenants?

Allan Hogg:

No. There is no debt to deduct in our bank covenant. It's only as we disclosed and interest coverage ratio and a debit-to-capital, so we have plenty of leeway right now on the bank covenants.

Zachary Evershed:

Thank you very much. I'll turn it over.

Allan Hogg:

Thank you, Zachary.

Operator:

Thank you. The next question will be from Paul Quinn at RBC.

Paul Quinn:

Thanks very much. Just a question on the Tissue guidance at 60 to 80 by the end of the year. You've guided for Q2 to be up over Q1 here, but I still suspect it will be negative. You probably, the first half of the year you'll be down sort of negative 20, negative 25. Does that imply that you're going to be 80, 85 in the back half to get to this 60 to 80?

Allan Hogg:

Well, I would say if you do the math as you did, yes, but remember that we have just announced price increases yesterday for—another price increase yesterday for July 1. And as we illustrated in our deck, these are part of the initiatives that have to be implemented, so it includes that.

Jean-David Tardif:

And if I can add, we're also considering about the price increases, I think the market is able to absorb those increases. We've been happy with the increases that we've implemented so far for May 1, and we believe that the other will go on as well. So, your math is correct.

Paul Quinn:

Okay. Then just on a leverage question, given these (inaudible) headwinds and also the Bear Island spend, where do you expect that leverage to peak out at?

Allan Hogg:

At the end of the year?

Paul Quinn:

Sure.

Allan Hogg:

For now we're within a range of 3 to 3.5. We stated 2.5 to 3 in our plan, but maybe higher than that due to the slower first quarter.

Paul Quinn:

Great. That's all I had. Thanks guys. Thanks a lot.

Mario Plourde:

Thank you.

Operator:

Thank you. At this time we have no further questions. M. Plourde, please continue.

Mario Plourde:

Thank you everyone for being on the call this morning. Looking forward to see you on the next call. Have a good day.

Allan Hogg:

Thank you.

Operator:

Thank you. Merci. Ladies and gentlemen, this does indeed conclude your conference call for today. Once again, thank you for attending. At this time we ask that you please disconnect your line.