

MIDWAY LIMITED (ASX: MWY)

27 August 2021

Investor Conference Call 26 August 2021 - Transcript

Midway Limited (Midway) has previously advised ASX that a recording of Midway's Investor Conference Call on 26 August 2021 would be made available on Midway's website.

Unfortunately, the conference was not recorded due to an oversight by the conference provider. As an alternative, the presenter's talking points, and a summary of the issues raised by investors and Midway's responses, follows.

TALKING POINTS - Managing Director and Chief Executive Officer, Tony Price

- Thank you for joining us for the Midway FY21 financial results.
- While it has been another challenging year, I am pleased to report there are some positive signs of recovery in the FY21 Midway results.
- The highlights of the Midway FY21 results include:
 - Sales revenue up 8.7% to \$280.2 million as China and Japan recover from the first wave of COVID-19;
 - Underlying EBITDA up 5.8% to \$14.6 million driven by increased sales volumes and cost reduction;
 - A doubling of operating cashflow to \$22.3 million on the back of higher sales and lower inventories;
 - Excellent cash conversion allowing us to reduce net debt to \$31.5 million and internally fund capex projects;
 - A lower debt-to-equity ratio of 26.4% and interest cover now over 7 times; and
 - A healthy balance sheet with the unencumbered value of our plantation land now at \$113 million.
- However, there were several factors largely outside our control that slowed the Midway recovery in FY21, including:
 - Market and COVID-19 related production shutdowns that adversely affected sales volumes by PMP, SWF and Bio Growth Partners (BGP);
 - While Midway signed contracts at higher prices in late FY21, woodfibre export prices lagged the recovery in global pulp prices during FY21;
 - Export returns in FY21 were adversely impacted by a lower bone-dry content of woodfibre due to La Nina weather patterns; and
 - The value of our US dollar export earnings was also adversely affected by Australian dollar appreciation during FY21.
- Several significant items also resulted in a net loss after tax of \$0.6 million, these included:
 - A \$1.6 million devaluation of our biological assets primarily due to lower export prices and the higher Australia dollar;
 - A \$1.8 million non-cash interest expense from the impact of AASB15 on off-balance sheet plantation assets; and
 - A \$1.8 million impairment of BGP due to COVID-19 production constraints in WA.
- Given our desire to progress new capital projects that will generate future earnings, the Board has decided that the Company will not pay a final dividend for FY21.

- However, I remain optimistic about the future of Midway and I am confident that measures we have put in place this year will contribute to more sustainable shareholder returns in future.

Business Improvement

- I am very pleased to report that management have implemented a range of cost reduction initiatives across the business in FY21.
- PMP has also recently signed acacia export contracts with a major new Chinese customer that will underpin a resumption of exports from the Tiwi Islands in FY22.
- While COVID-19 has so-far prevented PMP from actively marketing a second rotation of hardwood on the Tiwi Islands to global investors, domestic partners have committed \$4.6 million to eucalypt trials commencing in FY22.
- Midway has also acquired the remaining 60% interest in BGP for a nominal amount and we have now fully integrated this business into Midway Logistics to provide us with total control over production and sales in WA.
- Midway has already secured a number of WA supply contracts in H1 FY22 and has entered contracts with key domestic biomass customers.
- Midway is also examining future options for hardwood and softwood exports through the Port of Esperance in WA and Kwinana.

Trading Conditions and Outlook

- Improved global economic conditions and the prospect of increased pulp production in the next few years is driving an improved trading outlook.
- We are seeing renewed interest by Japanese pulp producers in hardwood woodfibre and are confident that Japan will return to pre-COVID-19 supply levels.
- Japanese woodfibre demand is already up 2% and Australia imports are displacing higher priced competition from Brazil and Chile.
- Chinese pulp stocks are also starting to normalise after the trade and COVID-19 related stock build-up in FY19 and FY20.
- Lower pulp stocks are underpinning a rebound in Chinese pulp prices that will be reflected in higher woodfibre prices in FY22.
- Global paper and pulp analyst, Hawkins Wright is also forecasting a significant increase in Chinese production from new mills in the next few years.
- We believe that this will drive increased demand for hardwood and softwood exports from Australia over the next few years.
- In this environment, gaining access to additional fibre resources will be important to Midway growth in the next few years.

Timber Resource

- With this opportunity in mind, Midway is selling plantation land north of Melbourne that is better suited to urban development.
- We recently sold one block of land north of Melbourne for \$3.2 million, which was well over book value.
- We will use funds generated from these land sales to invest in infrastructure in Tasmania to support our expansion.
- We are also very close to issuing an Information Memorandum to domestic and global investors for a new plantation vehicle in south-west Victoria.
- Under this proposal, Midway would vend some of its existing plantation estate into a plantation fund and global investors would invest to expand the estate in future years.

- This has the potential to secure a long-term timber resource for Midway in south-west Victoria and free up capital to invest in expansion projects

Business Development

- Midway is also looking at a range of business development opportunities that will generate additional earnings in future years.
- Two of these key projects include:
 - expansion of our woodfibre processing and export capability at Bell Bay in Tasmania; and
 - development of a grain trading terminal at our Geelong woodfibre export facility in Victoria.

Bell Bay

- Phase one of our Bell Bay expansion is well underway. The project is expected to go live in September 2021, with exports starting in December 2021.
- Phase two – expansion of wood fibre processing at Bell Bay - is expected to see a significant increase in export capacity in future years.
- We expect to fund the Bell Bay expansion through a combination of internal cash flow, asset finance and corporate debt.

Grain Trading

- Phase one of our grain trading terminal at Geelong is also progressing quickly with commercial agreements expected to be signed with key parties shortly.
- Phase two, construction of a 35,000 tonnes storage and export terminal is planned for FY22.
- Once again, Midway plans to fund this expansion through a combination of internal cash flow, asset finance and corporate debt.
- This project will offset the projected short-term reduction in woodfibre exports through Geelong because of supply constraints.
- The grain terminal will also generate incremental earnings from management rights on an ongoing basis.
- Finally, we are examining a range of options to leverage new technologies including activated carbon and biomass to diversify business earnings

Key Points

- To summarise, my key points today are:
 - FY21 represents the start of the Midway recovery from the market and COVID-19 trade disruption of FY20;
 - The FY21 financial results show green shoots of the recovery which is expected to gain pace with secure contracts at higher prices in FY22;
 - We have put measures in place to turn around the business performance at PMP and Midway Logistics in FY22;
 - We are well progressed on our expansion projects at Bell Bay and at Geelong that will generate better returns in future years; and
 - We are starting an asset optimisation program that facilitate plantation development in south-west Victoria.

MD Succession

- Given these exciting initiatives at Midway, it is with a tinge of regret that I will not be here next year to see the recovery continue.
- However, as recently announced, in January 2022 I will be retiring from full-time employment after a forty-year executive career to commence a new non-executive career.
- I believe that the new Managing Director and CEO of Midway, Tony McKenna has the right combination of skills and experience to successfully take the company on the next phase of growth.

Questions & Answers

- Midway's CFO, Ashley Merrett is with me on the call today and we would now be pleased to answer any questions you may have about the FY21 results.

ISSUES RAISED BY INVESTORS AND MIDWAY'S RESPONSES

Sales Volumes and Pricing in FY22

- Midway MD and CEO, Tony Price said pricing negotiations with major Chinese and Japanese customers had been concluded for 1H22 and Midway is hopeful that higher prices can be sustained in 2H22.
- A table showing projected export and domestic sales volumes for FY22 and FY23 is included in the Midway FY21 results investor presentation lodged with the ASX. This table shows an increase in forecast sales volumes across the Company in FY22 but with some ups and downs within the overall number. For example, a slight increase is forecast for e-globulus exports from Geelong in FY22 but a decrease in FY23 as timber resource is constrained in the local catchment.
- If the grain storage facility at North Shore proceeds as planned, grain sales through the Port of Geelong loader will partially offset the forecast drop in woodfibre sales at Geelong. The biggest increase in sales volumes in FY22 and FY23 are forecast from Midway Tasmania with the establishment of the new processing and export facility at Bell Bay.
- There are some factors outside the control of Midway that may affect sales volumes and prices in FY22 and FY23 including the level of bone-dry content and foreign currency movements.
- Rising global shipping freight costs and bottlenecks at Chinese ports following the first wave of the COVID-19 pandemic may also affect export volumes and pricing in FY22. About two thirds of Midway sales to China are on a Cost, Insurance and Freight (CIF) basis and about one third on a Free-On-Board (FOB) basis.

FX hedging in FY22

- Midway CFO, Ashley Merrett advised that before the start of the FY22 financial year, the Company had hedged 80% of its forward sales contracts at a mid-70 cents level against the US dollar but could, depending on future foreign exchange rate movements, negotiate to average down the cost of cover as export shipments are confirmed.

Cashflow and capex in FY22 and FY23

- Mr Price noted there had been a significant improvement in cashflow in FY21 on the back of higher sales and lower inventories.

- He said there was a high level of cash conversion into EBITDA and this had allowed Midway to reduce net debt and fund future capex.
- Stage 1 of the Bell Bay project could cost approximately \$9 million. This will be funded via asset finance, corporate debt and internal cash flow in FY22 and FY23.
- Midway's share of the proposed grain terminal at Geelong would also cost up to \$15 million and is expected to be primarily funded from internal cash flow resulting from land sales in FY22 and FY23.
- The target date for completion of the grain project and go live was October 2022. This would enable Midway to work with grain traders during the 2023 summer grain harvest.

Profits in FY22 and in future years

- Mr Price said Midway expects a much better result in FY22 on the back of higher sales volumes and prices.
- However, he said it may take some time before the Company can return to the levels of profitability seen in FY19.

A resumption of dividends in FY22

- Mr Price said the Board had decided not to pay a dividend in respect of FY21 and to use available cash to fund projects such as Bell Bay and Geelong Grain to generate earnings in future years.
- He said future dividend payments is a matter for Board consideration but the Company is hopeful that it will be in a position to resume dividend payments in FY22.

Balance sheet assets and returns to shareholders

- Mr Price noted that the net tangible asset backing of the Company was 149.2 cents per share, well above its current market capitalisation.
- He said returns to shareholders is a matter for the Board but Midway was looking to optimise its asset base to fund future growth, including land sales north of Melbourne and reinvest those funds in earnings accretive projects.
- Midway had recently sold one property north of Melbourne for \$3.2 million, well above acquisition cost and has been advised that three additional properties in the same region could be sold for \$21-\$23 million after the trees on the land have been harvested.
- The mortgage on the land on these properties is held by a third party and is released when the trees on the land are harvested. The mortgage right may be renegotiated to expedite the sale process.

Plantation Fund

- Mr Price said the Company was close to finalising a proposal to establish a new plantation estate vehicle with global investor backing.
- The plantation fund has the potential to free up significant capital on the Midway balance sheet to fund future growth and develop a long-term timber supply pipeline in the Geelong catchment.
- Mr Price said Midway had engaged Azure Capital, a leading advisory company based in Perth, to progress the plantation fund proposal with global investors.
- He said Azure Capital had made significant progress in the last 12 months and Midway is close to issuing an Information Memorandum to investors that have expressed interest in the proposal.

- Under one option, Midway could sell a large proportion of its current plantation estate into the vehicle. This was attractive to some global investors who want early income from brown-field projects.
- Global investors could also invest in additional green-field plantations of at least 10,000 hectares that could generate a potential earnings stream from plantation management and harvest rights of up to \$2 million in EBITDA per annum.
- Mr Price said the final form of the plantation fund and its detailed mechanics would be determined by the Board and the global investors that formally agree to participate in the project.
- Mr Price said the Information Memorandum could be issued as early as mid-September 2021 and agreements finalised by the end of the 2021 calendar year subject to final Board approval.

Carbon credits and activated carbon opportunities

- Mr Price said carbon credits were attractive to private plantation managers and global investors.
- He said Midway had recently joined in partnership with Climate Friendly, a carbon advisory firm, to encourage private landowners in Tasmania to establish plantations.
- Under the partnership, Climate Friendly would advise land holders on carbon credit incentives and Midway would advise land holders on plantation management and secure offtake agreements to the timber.
- Mr Price said that Midway was examining a range of opportunities offered by emerging technology to enter the activated carbon market.
- He said Midway was negotiating with Bygen Pty Limited re the possibility of building a pilot plant at North Shore in Geelong to use woodfibre to produce activated carbon.
- The Bygen pilot project at Geelong would confirm whether it was commercially feasible to produce activated carbon at scale at other Midway sites.
- Mr Price said there are significant import replacement markets for activated carbon in mining, gas refining, food manufacturing, water industry and contaminated soil remediation.
- He said biochar used in organic fertiliser was currently selling at \$2,000 per tonne compared with pulp paper prices of around \$800 per tonne.
- This represents a significant commercial opportunity to diversify the Midway business and generate significant new earnings streams for shareholders.

Midway Share Register

- Mr Price noted that there had been some turnover on the Company share register but as far as he knew no major institutional shareholders had left the register entirely.
- He said that there were several new institutional holders and many new retail shareholders on the Midway share register.
- Midway is pleased that most shareholders had remained loyal to the Company despite the market turbulence over the last 18 months.

This announcement has been approved by Midway's Company Secretary.

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About Midway Limited

Midway Limited is a leading Australian forestry company with headquarters in Geelong, with 100% shareholdings in Plantation Management Partners (PMP) based on Melville Island and Midway Logistics (MWL) based in Bunbury, Western Australia, and majority shareholdings in South West Fibre Pty Ltd (SWF) based in the Green Triangle and Queensland Commodity Exports Pty Ltd (QCE) based in Brisbane. Founded in 1980, Midway is primarily involved in the production, processing and export of high quality wood fibre to producers of pulp, paper and associated products in the Asian region. For further information, visit www.midwaylimited.com.au.