FINAL TRANSCRIPT

Cascades Canada ULC

Third Quarter Results

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PRESENTATION

Operator

[Operator Remarks in French]

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 Third 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 will now pass the call to Jennifer Aitken, Director of Investor Relations for Cascades.

Ms. Aitken, you may begin the conference.

Jennifer Aitken — Director, Investor Relations, Cascades Canada ULC

Thank you and good morning, everyone. Thank you for joining our third 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.

Today's speakers will be Mario Plourde, President and CEO; and Allan Hogg, CFO. Also joining us for the question 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 Tissue Papers.

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 outlined 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 Q3 2022 investor presentation for details.

This presentation, along with our third 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 — President and Chief Executive Officer, Cascades Canada ULC

Thank you, Jennifer, and good morning, everyone.

Our Q3 result met expectations, and we are satisfied with our improved sequential performance in light of unprecedented cost inflation and labour constraints we faced during the year. Company wide, the price increases we have put in place mitigated the impact of persistent cost inflation quarter over quarter.

We provide a breakdown of the factors impacting our EBITDA level on Slide 3. As the numbers highlight, however, benefits from these and other initiatives lagged the impact of cost inflation year to date by $67 million, the lion’s share of which are within our Tissue segment.

Moving now to our financial results. On a consolidated basis, third quarter sales increased 14 percent year over year and 5 percent from Q2, while adjusted EBITDA increased 4 percent from last-year levels and 22 percent sequentially, reflecting the sales price increases implemented in all our business segments and improved results in our Tissue Paper business driven by profitability initiatives.

On the raw materials side, highlighted on Slide 5 and 6, the Q3 average index price for OCC decreased 33 percent year over year and 20 percent from Q2.

Reduced demand levels following lower activity at containerboard mills and less export led to an excess of fibre in all North American markets. This resulted in a rapid decrease in pricing for this grade during the quarter, and all of our mills are well supplied.

Average index price for white recycled paper grade continued to increase in Q3, up a substantial 60 percent year over year and 7 percent from Q2. As we have highlighted in the past, these unrelenting cost headwinds have had an important impact on our Tissue results.

The same can be said about virgin pulp. The hardwood pulp index increased 7 percent sequentially, while the softwood pulp index prices rose a more moderate 3 percent. Year over year, these indexes have increased by 23 percent and 17 percent, respectively.

While the market remains challenging for the white fibre grade, with prices remaining high, we have begun to see some easing in recent weeks and our mills are adequately supplied.

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 5 percent in Q3. This was largely driven by higher selling price for both parent rolls and converted product, higher volume levels, and a beneficial exchange rate.

The 3 percent volume increase reflects an 8 percent increase in shipments of parent rolls and a 1 percent decrease in converted product shipments. Sequentially, converting shipment decreased by 1.9 percent in Canada, outperforming the 3.1 percent decrease in the Canadian market. US converting shipment increased 1.1 percent, well above the 3.8 percent US market decrease.

On a per-day basis, our total converted shipments were stable sequentially. This outperformed the decrease of 3.2 percent in the Canadian market and 5.3 percent in the US market.

Q3 adjusted EBITDA of $103 million, or 17.3 percent on a margin basis, was 4 percent above the Q2 levels. This reflects benefits from higher selling price and lower raw material costs, offsetting higher energy costs and less favourable sales mix in the quarter.

Year-over-year sales increased by 17 percent driven by pricing and volume.

Adjusted EBITDA increased by 10 percent for the same reasons I just mentioned.

Year-over-year shipments increased by 4 percent, reflecting a 9 percent increase in external parent roll shipments and a 1 percent decrease in total converting shipments, mainly driven by lower volume in the Canadian market.

On a per-day basis, our global converting shipments were also stable, outperforming the 4.5 percent decrease in both the Canadian and the US market.

Moving now to our Bear Island project, we are continuing to make good progress during the quarter and we are preparing the commissioning of certain key equipment. Despite the progress in the construction over the past three months, the supply chain constraint that delayed certain construction milestones in Q2 continue in the current quarter. As a result, start-up of the machine is now scheduled for Q1 2023.

A multiyear project of this magnitude is complex at the best of time and was made even more so by cost inflation and supply chain and labour constraints. We are focused on starting up the facility and ramping up production. Given this slightly modified timeline, 2023 production is expected to total $265,000 short ton and adjusted EBITDA is forecast to be US$20 million to US$30 million.

Under current market condition, total expected returns for the project remain within our target and despite the higher project cost level.

Continuing with our packaging business, Q3 sales levels in our Specialty Products segment were stable sequentially. This reflected the implementation of price increases in response to cost inflation and a favourable exchange rate, the benefit of which upset lower volume.

Adjusted EBITDA was also stable sequentially as higher selling prices mitigated the impact related to volume and sales mix, as well as higher production and energy costs.

When compared to the prior year, Q3 sales increased by $24 million or 17 percent, and adjusted EBITDA levels increased by $8 million or 47 percent, as the higher realized spread more than counterbalance a slightly less favourable volume and sales mix and higher operating costs.

We are pleased with the performance trends of the Specialty Products business this year, which reinforced the progress being made toward meeting a targeted margin range of 17 percent to 19 percent by 2024.

Moving on to our Tissue business, sales increased 12 percent sequentially in Q3, while adjusted EBITDA level improved $12 million to $4 million. Top-line growth was driven by pricing and sales mix initiative, higher volume, and favourable exchange rate.

Sequentially, improvement was largely driven by benefit generated by improved selling prices offsetting higher costs for energy and raw material.

Year over year, sales level rose 11 percent, with pricing and sales mix initiative offsetting the impact from lower volume.

Adjusted EBITDA decreased $8 million year over year, mainly due to higher raw material costs offsetting benefit from our profit initiatives.

We have provided an update on our Tissue profitability plan initiative on Slide 14.

The impact of rapid escalating costs in this business has been unrelenting and pronounced in 2022, and the financial performance of this business year to date clearly demonstrate the immediate effect that this has had on result ahead of benefit being realized from corrective measures.

Pricing and other cost-saving initiatives continue to be implemented to offset these headwinds, and we are expected to generate additional positive upside in the fourth quarter throughout 2023.

To this end, we are focusing adjusted EBITDA of $8 million to $12 million for the segment for the fourth quarter. This outlook, however, implies that the Tissue segment will not achieve the objective of $25 million to $40 million of the adjusted EBITDA for the calendar year 2022.

Notwithstanding this, we continue to expect that these initiatives will allow the Tissue segment to deliver on its long-term 2024 target.

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

Allan Hogg — Vice-President and Chief Financial Officer, Cascades Canada ULC

Yes. Thank you, Mario, and good morning.

Slides 15 and 16 illustrate the specific items recorded during the quarter. The main items that impacted operating income before depreciation were $14 million of impairment charges in our Tissue segment related to the decision to permanently close the Memphis tissue mill that ceased operation in 2020.

It also includes a $10 million foreign exchange loss on long-term debt and financial instruments; a $3 million unrealized loss on financial instruments; and a $2 million of impairment charges in our Containerboard segment related to asset optimization initiatives in Ontario.

Slides 17 and 18 illustrate the year-over-year sequential variance of our Q3 adjusted earnings per share and a reconciliation with the specific items that affected our quarterly results.

As reported, Q3 net loss per share was $0.02. This compared to net earnings per share of $0.32 last year and $0.10 in Q2.

On an adjusted basis, net earnings per share were $0.20 in the current quarter. This compared to a net loss per share of $0.01 in last year's results and net earnings per share of $0.10 in Q2. This variance mainly reflects improved adjusted EBITDA and a reversal of tax assets in Canada in the third quarter of last year.

As highlighted on Slide 19, third quarter adjusted cash flow from operations decreased by $8 million year over year to $62 million and adjusted free cash flow levels decreased by $123 million year over year. This reflects stable operating results and significantly higher net CapEx paid in the current period, largely associated with our Bear Island conversion project.

Slide 20 provides detail about our capital investments.

Paid capital expenditures, net of disposals, totalled $121 million in Q3 and $333 million for the first nine months. Of this amount, $83 million was invested in the Bear Island project in the third quarter and $228 million so far this year.

For 2022, our total capital investment forecast remains in a range of $450 million to $470 million Canadian dollars, which includes $310 million to $330 million for the Bear Island project.

Moving now to our net debt reconciliation as detailed on Slide 21.

Our net debt increased by $299 million in Q3. This is a reflection of the combined effect of our current investment in Bear Island, higher working capital requirements, and an unfavourable FX impact in the period.

Our leverage ratio of 6.2 times is up from 5.4 at the end of Q2. As we have mentioned in the past, we expect this leverage trend to reverse with improved operational performance and results and the start-up of the operation at the Bear Island facility.

When excluding cash investments made to date in the construction of Bear Island and its negative contribution to operating results, our leverage ratio would stand at approximately 4.9 times.

I would highlight that our bank agreements do not include a leverage ratio covenant. This remains the case following the recent amendments to our existing credit facility that we announced on October 19.

Specifically, we increased our term loan by US$100 million to US$260 million and extended the maturity by two years to December 2027. Concurrently, we extended the revolving facility by one year to July 2026. These amendments reinforce our financial flexibility as we complete the Bear Island project.

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

Mario will conclude 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 and would remind you that this is based on what we are seeing today and may change in the coming weeks.

Our near-term outlook for Containerboard is for stable sequential results, with lower raw material costs expected to offset softer volume and continued upward pressure on operational costs driven by inflation.

We have scheduled additional downtime totalling approximately 13,000 short-ton on our Machine 2 at our Niagara Falls facility to manage inventory level for corrugated medium. This planned downtime follows the 18,000 short-ton of downtime already taken in Q3.

We also announced that we will be permanently shutting down the corrugator at our Belleville, Ontario facility in December. This decision is part of the continuing optimization initiative of our Ontario asset base and strategically reposition the Belleville facility as a high-volume graphic sheet plant by redeploying its corrugated product to our other units.

We are expecting a stable performance in our Specialty Products segment sequentially, with steady volume and selling price trend expected to offset cost inflation pressure.

Our outlook for Tissue is slightly improved sequential results and a stronger performance year-over-year. The strategic initiatives we are putting in place are meeting our expectations. The exception of this is our productivity volume target, which continue to be hindered by labour availability and training.

That said, we continue to put in place additional action plans to correct this and help drive meaningful financial and operational benefits going forward. To this end, our long-term ‘24 target for this business remains unchanged.

With that, we can now open the call to questions, Operator.

Q&A

Operator

[Operator Remarks in French]

Thank you. If you would like to ask a question, simply press *, then number 1 on your telephone keypad, and if you would like to withdraw your question, please press *, then number 2.

Again, if you have a question, please press *, 1 on your telephone keypad.

And your first question will be from Hamir Patel at CIBC. Please go ahead.

Hamir Patel — CIBC

Hi. Good morning.

Mario Plourde

Good morning.

Hamir Patel

First question I had was for Charles. Could you comment on, in terms of the reduction in the Bear Island EBITDA contribution in 2023, how much of that reflected the lower production assumptions and how much was maybe adjustments you might have made to your price forecast?

Mario Plourde

Go ahead, Charles. Go ahead.

Charles Malo — President and Chief Operating officer, Cascades Containerboard Packaging, Cascades Canada ULC

The new assumption that we made is based on the start-up and the ramp-up mainly. These are the assumptions. Because for the rest, when we look at the long term, the premises that we have announced on the project stays still the same for the long term.

Mario Plourde

So, Hamir, you will understand that we will not provide details of the assumption used in that. But as Charles mentioned, the important point is it doesn't change the long-term outlook on this.

Hamir Patel

Okay. Fair enough. And, Charles, there's been some commentary in the trade press about recycled prices declining. Has that been your experience so far in your open market sales?

And then can you just remind us, are your box prices tied to the kraftliner benchmark? Or are some of them tied to some recycled pricing?

Charles Malo

Okay. So you understand I'm not going to comment on specific pricing, especially forward-looking and things like that. I can talk about what we're experiencing right now.

So the grades that we're selling today, whether it's going to be Bear Island or Greenpac, are high-grade, high-performance, so we don't follow new indexes. So, as you see in our results, as we speak right now, our pricing has been maintaining as we know today.

Hamir Patel

Okay. Yes. Fair enough. Then just a final question I have for Allan. Just given the elevated leverage here, are there any covenants that may be of concern that you might be looking to renegotiate?

Allan Hogg

No, there's no concern on—as I mentioned, there's no leverage ratio in our covenant package, so there's nothing to worry about.

Hamir Patel

Great. Thanks. That's all I had. I'll get back in the queue.

Mario Plourde

Thank you.

Operator

Thank you. Next question will be from Sean Steuart at TD Securities. Please go ahead.

Sean Steuart — TD Securities

Thank you. Good morning. With respect to Q4 guidance, a little surprise that it's tempered, and I appreciate there's extra downtime plans and other cost inflation factors. But with OCC collapsing to the extent that it has, I guess how much of that decline in OCC do you expect to see in Q4? Should we think of that as more of a first half of 2023 benefit for your margins?

Charles Malo

So I just want to mention, on the overall guidance for our results, we are being cautious also considering the market condition today. So we are not seeing the uptake that we usually see this time of the year for seasonal pickup. So part of this is, yes, we're being cautious about the result. And when you look at the impact of the OCC or the fibre, it's about $40 million.

Sean Steuart

Sorry, for the next year? Or what's the time frame you're referencing there, Charles?

Charles Malo

Sequentially, I mean.

Sean Steuart

Oh, sequentially.

Charles Malo

Yes.

Sean Steuart

Okay.

Charles Malo

So there’s positive impact of OCC, obviously, but inflation continues on chemicals and stuff like that. But we are cautious on the volume side of things.

Sean Steuart

Okay. That makes sense. Allan, any initial views on the 2023 CapEx budget with the Bear Island complete? Any initial thoughts you can give us there?

Allan Hogg

Well, CapEx will be limited for next year as the focus will be to complete the Bear Island project. So there’s nothing big next year, so it will be very limited.

So we are in the process of evaluating everything, and with the business environment, we’ll be very cautious on this next year.

Sean Steuart

Got it. Okay. That’s all I have for now. Thank you.

Operator

Thank you. Next question will be from Paul Quinn at RBC Capital Markets. Please go ahead.

Paul Quinn — RBC Capital Markets

Yeah. Thanks. Thanks. Just a follow-up question on Bear Island. That reduced volume is about 20 percent on the original guide. Just wondering if the expected start-up is at the end of Q1 as a result of that? Or when do you expect to start up the machine?

Charles Malo

You know, we mentioned in our last call that we were still working towards the end of the year. And we know today that it's going to be in Q1. So we're not going to say is it going to be in January or February or provide the date, but we're aligned to do a good start-up, and it's going to be in Q1.

One thing I can say is we're at the peak of the amount of people that we have on-site. The work is progressing very well. We have fibre on-site. The mechanical installation is going very well. And we're focusing right now—we already started, by the way, to do some commissioning as we speak for certain area in the facility. So we're confident now that we can formalize a bit more the date in Q1.

One thing that I want to say also is that there's less of unknown today than we had three or four months ago. The risks are lower since we're getting closer to the date. Main components are being or are installed as we speak.

So that's why we're saying that now we're confirming that it's going to start in Q1, but we don't want to provide any fixed date on that.

Paul Quinn

Okay. Thanks very much on that. And then maybe just on a recovered paper, I think you guys have commented in the past the sustainability of OCC prices down at this level is really not there. Just what your expectation through Q4 is for OCC as well as SOP?

Charles Malo

We don't see any significant change on the OCC side for sure until the end of the year. However, we are in the period of high generations now and the demand remains stable and not very strong. So there's an abundance of fibres in the market.

For SOP, we've seen, as Mario said earlier, some easing in the market conditions recently. Hard to predict what's going to happen. We are looking also closely at what's going to happen on the virgin pulp, which indirectly will impact the cost of recycle-like rates. So I cannot really comment that. There are too many variables now with regards to virgin pulp.

But definitely, everybody sees additional volumes coming to the market, especially in the hardwood by mid next year. So, definitely, the fundamentals which should favour, promote some easing conditions on the virgin pulp next year.

Paul Quinn

Okay. And then just over on Tissue, can you remind me what the 2024 target is?

And then I was expecting on the guide, a higher Q4 estimate. Just wondering, do we need additional tissue price hikes to be able to get to your 2024 target?

Allan Hogg

Well, Paul, I will answer the first part of your question. The target for tissue was $150 million of EBITDA in 2024. So I will let Jean-David talk about what needs to happen, but that’s the target of 2024.

Jean-David Tardif — President and Chief Operating Officer, Cascades Tissue Group, Cascades Canada ULC

Yeah, the main driver for us is the productivity, Paul. So we’re working really hard to increase productivity on the newer assets that we installed over the last two years and also the Orchids facilities that we’re ramping up. It was certainly more difficult than expected with all the challenges on labours and the support that we were able to provide and with parts and other technical support.

But the goal is to get back to the 2022 target, which was 68 million cases or so. And as you can see, we’re going to finish the year about 60 million cases. So we should be able to go back to the 2022 target next year.

Paul Quinn

All right. That’s all I have. Thanks very much.

Operator

Thank you. Again, if you would like to ask a question, please press *, followed by 1 on your telephone keypad.

And your next question is from Zachary Evershed at National Bank Financial. Please go ahead.

Nathan Po — National Bank Financial

Good morning. This is actually Nathan calling in for Zach. Thanks for taking my question.

So, first of all, other than the challenging macro environment, can you share some details on the tissue profitability progress and maybe some things that should or could be done and that are not being properly executed?

Jean-David Tardif

Yeah, there's a lot of initiatives going on in tissue for sure. Pricing, we made a lot this year. There's still a lot of initiatives on the table with product spec, price increases, et cetera. Again, productivity is the main driver, is really making more cases. That's going to be the driver for the coming months. And by having productivity higher, it will help the cost and the efficiency of the costs throughout system. So that's a double attack.

Nathan Po

Okay. And now switching over to Containerboard. Some contacts are saying that the retailer destocking has continued up until now. So, on your end, what's the inventory situation looking like at your retail customers?

Charles Malo

So I'd say that when I mentioned that we don't see necessarily the seasonal pickup that we usually see, I would even say that we're more in the normal of the pre-COVID or 2019. So yes, we are seeing that some of our customers right now are readjusting.

Supply chain is now picking up, meaning that it's becoming a bit more normalised. We see that trucking is a bit more available. So we know that some of our customers are adjusting. And this is one of the reasons we believe that the volumes are being adjusted. And we don't see the same pickup for this time of the year.

So overall, there are some customers that are still busy. And one thing, depending on which sector, like the food and beverage is still very good. The industrial seems to be a bit more in adjusting inventory at this point. But when we look also at the e-comm, the growth is still good for us at this point.

Maybe one thing that I can add also is when you look at the performance of our growth, our commercial initiative that we've put in place since this year has been paying off. Also the investment that we made in certain regions over the last two years are also benefitting Cascade as we speak.

Nathan Po

All right. Thanks for the colour. And just one last quick one. In your presentation, it says that there is additional planned downtime, excluding the 18K in Q3. Is there a certain way we should be thinking about how the rest of that is spread out?

Charles Malo

Mainly, we've announced that it's mainly focused on one grade, which is right now medium, and one of our sites, which is in Niagara Falls, one machine.

I mentioned in the past that we are taking actions to balance and watch our inventory level to service our customers. So, at this point, this is what we're planning to do to take additional downtime mainly in one of our machines.

And we'll take the right decision in the future, but always keeping in mind that we also took the downtime at the less, I would say, performing or contributing machine to maximize the profitability of the Company.

Nathan Po

Okay. Thanks. I'll turn it over. Thank you.

Operator

Thank you. And at this time, there are no further questions. I would like to turn the call to Mr. Plourde.

Mario Plourde

Thank you, everyone, for being with us this morning. And we're looking forward to talk to you for the next quarter. So have a good weekend, everyone. Thank you.

Operator

Thank you. Merci.

Ladies and gentlemen, this does indeed conclude your conference call for today. Once again, thank you for attending. And at this time, we do ask that you please disconnect your lines.