FINAL TRANSCRIPT

Cascades Canada ULC

Fourth Quarter 2021 Financial Results Conference Call

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PRESENTATION

Operator

Mesdames et Messieurs, bienvenue à la téléconférence des résultats financiers du quatrième trimestre 2021 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 Fourth Quarter 2021 Financial Results Conference Call.

All lines are currently in listen-only mode. After the speakers' remarks, there will be a question-and-answer session.

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

Jennifer Aitken:

Thank you, Sylvie. Good morning, everyone, and thank you for joining our Fourth Quarter 2021 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 question-and-answer 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 those 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 Q4 2021 Investor Presentation for details. This presentation, along with our fourth quarter press release, can also be found in the Investor 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. Good morning, everyone.

Before going into details for each of our businesses, let me begin by saying that the fourth quarter was a challenging end to the year, and let me be clear, we are very disappointed with this performance.

A powerful mix of wide-ranging inflationary pressure on costs, labor challenge and constraint in logistics, and the supply chain led to our initial fourth quarter warning on December 22. However, their impact continued to escalate as the quarter progressed, and were subsequently made worse by lapping secondary effect of the flooding in the rail disruption in Western Canada and the steep rise of Omicron cases in December.

The first of these factors significantly impacted the cost and availability of transportation in Canada, the second led to staffing shortage in several of our operations, and both impacted production levels in several of our facilities. As a result, we issued a second fourth quarter warning at the end of January.

Moving now to our financial results, on a consolidated basis, fourth quarter sales were stable year-over-year and compared to the previous quarter, while Adjusted EBITDA decreased, notably, in both cases. Slides 4 and 5 provide quarterly information for each of our business segments.

On the raw materials side, highlighted on Slide 6, the Q4 average index price for OCC increased 183% year-over-year, and while slightly higher than Q3, as has been the case throughout the year, these higher prices reflect elevated domestic demand, driven by strong containerboard industry production levels. Average index prices for white recycled paper grade also rose in Q4, increasing 103% year-over-year and 12% from Q3. On the virgin pulp side, the hardwood pulp index increased 45%, while the softwood pulp index price rose 29% from last year's level. Subsequently, both decreased by approximately 5%.

Moving now to the results of each our business segments, as highlighted on Pages 7 through 9 of the presentation.

Beginning with the sequential performance, sales in Containerboard decreased marginally in Q4. This reflects lower volume, partially offset by a more favourable sales mix and benefits from price increases during the year. The 2% volume decrease reflects a decrease of 4% in parent roll and 1% in converted product. I would highlight that shipment levels were impacted by approximately 20,000 short tons in Q4, as rail disruption in Western Canada made an already challenging transportation situation worse. This transportation shortage, combined with limited availability of labour as the Omicron variant escalated in December, impacted production levels at several of our facilities.

Converting shipment decreased by 1% in millions of square feet, in line with the 1.2% decrease in the Canadian market and the 0.3% decrease registered in the U.S. market for the period. On per day (phon) basis, converting shipment increased by 4%, slightly below both the Canadian and the U.S. market average, which were in the range of 5%.

Q4 Adjusted EBITDA of $70 million, or 13.9% on a margin basis, was $24 million, or 26% below Q3 levels. This reflected higher raw material costs, which also included inbound freight costs, as well as lower volume and higher logistics and operational costs, due to the reasons just discussed. These impacts were partially offset by the continued rollout of price increases.

Year-over-year, sales were stable, while Adjusted EBITDA decreased 36%, due to many of the elements discussed.

It was a difficult quarter for our Tissue business, for the reasons laid out earlier. Sales were largely stable sequentially, as a 2% increase in average selling price was offset by a 3% decrease in volume. Specifically, parent roll shipments decreased by 16%, while shipment of converted product increased by 1%. This resulted in a 5% improvement in the integration rate. Shipments of away-from-home product were flat sequentially, while those of retail converted product grew 3%

Adjusted EBITDA decreased $18 million sequentially, as sales mix benefits were offset by lower volume and higher raw material, production, supply, logistics and energy costs. Year-over-year sales and Adjusted EBITDA both decreased, reflecting many of the factors we have highlighted.

Specialty Products grew, continued to generate solid results sequentially. Q4 sales increased 5% from the prior quarter, as the implementation of price increases in response to cost inflation offset lower volume. Adjusted EBITDA increased $4 million sequentially, as higher price offset the impact of volume decrease and higher operating and SG&A costs. When compared to the prior year, Q4 sales increased by $28 million, or 23%, while Adjusted EBITDA level increased by $6 million, as the higher realized spread offset higher production costs.

The impact of logistics and Omicron variant also impacted the performance of this segment. However, strategic investment, production innovation and commercial strategy implemented in recent years supported the segment 23% year-over-year increase in Adjusted EBITDA in 2021.

Allan will now discuss the main highlights of our financial performance. Allan?

Allan Hogg:

Thank you, Mario, and good morning, everyone.

As a quick reminder, once again, the results of the European Boxboard segment have been presented as discontinued as of the second quarter of 2021, following the sale of our equity position in Reno de Medici. We provide relevant details regarding the changes to financial consolidated results on Slide 10.

Looking at sales, as detailed on Slides 11 and 12, year-over-year Q4 sales decreased by $2 million. This reflects favorable pricing and sales mix in our Packaging businesses. The benefits of these elements were offset by lower volumes in Containerboard and Tissue, due to the factors that Mario discussed earlier, and unfavorable exchange rate, which also impacted sales levels for all of our business segments.

On a sequential basis, fourth quarter sales also decreased by $2 million, as the impact from constraints in labor and transportation, that were discussed earlier, on volumes offset improved pricing and mix in our all our business segments.

Moving now to operating income and Adjusted EBITDA, as highlighted on Slide 13, Q4 Adjusted EBITDA of $62 million decreased $77 million from the prior year level. The decrease was due to lower volumes and higher raw material and operational costs, as already discussed. These were partially offset by stronger results in Specialty Products.

Sequentially, Q4 Adjusted EBITDA decreased by $45 million, as shown on Slide 14. This decrease reflects all the elements we have highlighted throughout the call so far.

Slides 15 and 16 illustrate the specific items recorded during the quarter. The main item that impacted operating income before depreciation, that is worth mentioning, is a total of $92 million of impairment charges and restructuring costs that were recorded in Tissue, reflecting the current challenging results. Other items also impacted our net results. These include a $20 million loss on the repurchase of senior notes debt in November and a $204 million net gain on the sale of our equity stake in Reno de Medici.

Slides 17 and 18 illustrate the year-over-year sequential values of our Q4 adjusted earnings per share and the reconciliation with the specific items that affected our results. As reported, earnings per share were $1.04 in the fourth quarter. This compared to earnings per share of $0.72 last year. Both periods included specific items. On an adjusted basis, the loss per share of $0.09 was $0.51 below last year's results. This mainly reflects our lower operating performance. On an adjusted basis, sequential fourth quarter EPS decreased $0.08 per share from Q3 2021 levels, which included a negative adjustment of tax assets totaling $0.19.

As highlighted on Slide 19, fourth quarter adjusted cash flow from operations decreased by $86 million year-over-year to $51 million, and adjusted free cash flow levels also decreased significantly year-over-year. This reflects lower operating results, costs related to the repurchase of senior notes and higher net Capex paid in the current period.

Moving now to our net debt reconciliation, on Slide 20, our net debt decreased by $409 million in Q4, reflecting the $450 million of net proceeds from the sale of our European segment. Our leverage ratio of 3.5 times is down from 3.8 at the end of the third quarter, despite lower Adjusted EBITDA levels. Our leverage ratio includes the impact of the construction of the Bear Island containerboard mill. When excluding the project cash investment to date, our leverage ratio would stand at 3 times. Financial ratios and information about maturities are detailed on Slide 22.

Slide 23 provides detail of our capital investments. Gross capital expenditures totaled $330 million, including US$150 million for the Bear Island Project. After subtracting asset disposal and amounts not paid at year end, net cash outflow amounted to $233 million. In 2022, we are now expecting total investment of $450 million, which includes approximately CAD$275 million of investment associated with our Bear Island conversion project.

Inflation is also impacting project costs and, in this regard, Bear Island is no different. After being increased from US$380 million to US$400 million, the project investment is now expected to be in a range of US$425 million to US$450 million. We continue to secure contractors, installation contracts, and payment terms agreement with suppliers, which has also resulted in cash outflow moving from 2022 to 2023. This situation does not impact the expected startup date of December 2022.

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

Mario Plourde:

Thank you, Allan.

Many of the factors discussed have continued to impact our performance at the start of 2022. However, we have begun to see positive signs of improvement in labour availability in the recent weeks.

Details regarding our near-term outlook can be found on Slide 24 of the presentation. Given the dynamic nature of the current business circumstances, I would 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 stronger sequential results. Despite a slow start in January, demand remains good in both the manufacturing and the converting side, but our ability to ship continues to be challenging. However, our expected result will benefit from lower raw material costs. This is expected to help offset the combined inflationary pressure on operation and production costs.

Our Bear Island project is progressing as planned and sales commitments continue to be put in place. As we mentioned in our Q3 call, 100% of production of year one has been secured, and we have now confirmed that we have commitments for approximately 75% of the total plant capacity for the first three years.

Results for the Tissue segment will continue to be under pressure and are expected to remain flat sequentially. This reflects persistent cost inflation for raw materials and transportation, and continued operational constraints in logistics and labour. As it is the case with many industrial companies, labour availability and recruitment remain a challenge. This situation is limiting our ability to optimize our recent investment, which lowers our production efficiency, as we continue to produce below optimal capacity. This factor will be partially offset by benefit from announced price increases. We have also announced additional price increase up to 12% in the retail and away-from-home product, effective April and May, respectively, across North America.

Lastly, we are expecting continued positive momentum from the Specialty Products segment.

Moving now to raw materials, OCC was readily available throughout Q4, and we built a solid inventory level at all of our operating sites before year end. Inventory levels are on target and we are prepared for the current lower generation season.

Transportation continued to require a higher level of our attention. Market conditions for SOP and high grades have not improved since the last quarter. Generation remains impacted by limited office building activity and an overall market that is showing a slow structural decrease. More recently, we have seen increased purchasing activity from Southern mills and higher export activity to South America. This dynamic has led to sequential increase in SOP index price in the last few months.

Until late December, virgin pulp conditions continued to be favourable. However, the situation has reversed in the last few weeks. The global pulp market has been impacted on the supply side by multiple events, pulp mill strikes, unplanned maintenance downtime and the forced idling of mills due to the major transportation challenge. Tonnage in-transit is very high and transportation continues to disrupt the supply chain, especially in Canada. Several major producers have recently announced price increases for the months of February and March.

Let me finish by saying that, without question, business conditions have been very challenging in recent quarters. This was due to a variety of factors, many of which we discussed during this call, and many of which remain today. To this end, we have announced cost inflation-driven price increases in most of our subsegments.

We look forward to sharing the path forward we have outlined in our new strategic plan for 2022 to 2024 on our call with you later this morning.

We will now be pleased to answer your questions and ask that they be limited to our Q4 results and full year results 2021. 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.

We'll pause for just a moment to compile the Q&A roster.

Your first question comes from Hamir Patel at CIBC Capital Markets.

Hamir Patel:

Hi, good morning. The first question I had was for Charles, on the Containerboard side. I know Cascade had announced some larger medium-price hikes than some of your peers ended up following with. Are you realizing the full levels that you've announced so far this year?

Charles Malo:

We have announced, as you know, the dates are starting in March, so we're still working on getting both of our announced price increases. Basically, $40 on medium, additional to our $70 announced. So, we have one on medium and $70 on liner. The reason why we went with this is because of the profitability level that we see in our facility between medium and liner. So, at this point, we're still working on getting these amounts. It's probably going to be a challenge to get 100% of it, but we're working with our customers towards that amount.

Hamir Patel:

Great, thanks, Charles, that's helpful, and I realize we'll kind of delve into some of the outlook stuff on the subsequent call, but I was just wondering, in terms of the spring containerboard hike, just given the cost inflation in recent months, at least based on the sort of current cost profile, how much of that price hike would you kind of expect to kind of drop down to the bottom line versus just being eroded by the cost inflation that you've seen?

Charles Malo:

Okay. So, I'm going to give you—you can make a calculation at, let's say, $70 on 1.5 million tons, so that's going to give you the price increase announced. With the way that the increase works on a year impact, it's probably about 50% of that amount, so that's on the plus side, and you can apply the impact on transportation and other costs, like we made in our presentation. We do have $3 million to $5 million per month of transportation and other cost inflation.

Hamir Patel:

Okay, thanks, Charles, that's helpful, and just a final question I had on the Tissue side. Jean-David, I'm just wondering if you could perhaps just clarify—I know Mario mentioned them in his prepared remarks, but the price hikes that you have underway in both consumer and away-from-home, if you could just maybe run through what is in the market today, the level of the increases, and the timing that you would expect that to flow through your results.

Jean-David Tardif:

Good morning. We announced 12% on both markets, March 1—sorry, May 1 for away-from-home, April 11 for retail. Right now, we have strong justification to support those increases. I won't comment on the value, on the bottom line of those increases, since we're negotiating with customers as we speak, but we saw letters from competitors in the last two weeks that are also announcing similar price increases for the same date, as well. So, again, we are firmly convinced that these can move forward.

Hamir Patel:

Great, and, Jean-David, is there also some element of perhaps de-sheeting underway across your retail business this year, or is any price gains—or any improvement coming from these sort of overall price increases?

Jean-David Tardif:

Yes, there's many initiatives going on. We are working a lot to improve portfolios, so we're continuing SKU rationalization, as we started at the beginning of the pandemic, so we've never stopped those initiatives. Same thing with the customer portfolio, as well. There's also de-sheeting project, or a basics white project adjustment with specific customers, as well. So, there's many initiatives going on right now to improve margins.

Hamir Patel:

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

Operator:

Thank you. The next question will be from Sean Steuart at TD Securities.

Sean Steuart:

Thank you. Good morning. A question on the tissue impairment charge. Can you give us some context on any specific assets that were affected by this, or is it a general provision across the segment, and are there read-throughs for your perspective on the long-term earnings potential for that segment?

Allan Hogg:

Sean, the impairment, there's two categories of impairment that we took. The first one is on intangible assets and goodwill, so that's for the Tissue group as a whole, or one of the business segments, and there's a smaller amount on specific fixed assets, I won't mention which ones. But, again, it's the rules of impairment are different than maybe some that you see on U.S. GAAP. Under IFRS, it's much more restrictive. But, it doesn't change the outlook, long-term outlook on these assets. We continue to deploy our margin initiatives there. It's more accounting-based than the long-term outlook there.

Sean Steuart:

Okay. Well, that's relatively encouraging. The second question I have is—I appreciate the general inflationary cost environment you're in. My specific question on costs, are you seeing any easing in the shipping constraints that you faced in the fourth quarter, especially in Western Canada, and the labour availability issues associated with the Omicron variant, any easing at this stage on that front? I'm just trying to get a perspective on how that feeds into your near- to mid-term outlook.

Mario Plourde:

Sean, I'll start—it's Mario—with the labour recruitment and availability of the people. Honestly, December was very important and impacting the way we were operating, so we had to find ways to do overtime, even ask our retirees to come back to our plants to help us operate. So, it was a difficult period. It last a little bit, I would say, in January. Now, we see the pandemic, the Omicron behind us, we see people coming back. Recruitment, even in the U.S., is much easier now. So, hopefully, within a quarter from now, the labour activity, or labour availability will be behind us.

I will leave Charles for the transportation, because Charles is the most impacted with transportation, so I will leave him with the answer.

Charles Malo:

The situation with transportation out West is getting better, though we still have some impact, mainly on the rail side—and it's all across Canada, by the way—still some railcars that are stuck at ports and on boards. We figure that this situation will improve in Q1, but still have some impact till the end of Q1, at least. But, the transportation, the rail is also being impacted in the U.S. We have two of our main, I would say, shipping points that are affected by transportation, and rail mainly, one in our major facility in Niagara Falls, where we have repacking (inaudible) paper machines, and one also in East Canada, that are still impacted by the ripple effect of out West.

I know it's a long answer. It is improving in Q1, but there's still some ripple effect to us, and mainly there's some limitation on our capacity to ship. We're trying to compensate every day, but we have to ship. What we can't ship by rail, we're trying to find some trucks to do it, so the cost is going up, and that's the impact. There's going to be less impact on the quantities shipped, but there is still going to be a lot pressure on costs for the quarter in Q1.

Sean Steuart:

That's excellent detail, thank you, Charles. That's all I had.

Operator:

Thank you. The next question will be from Mark Wilde at BMO.

Mark Wilde:

Good morning, Mario. Good morning, Allan.

Mario Plourde:

Good morning.

Mark Wilde:

Allan, I wondered if you could help us, just in general terms, think about your expectations around price/cost in '22, and then, also, to just confirm, it sounded like in Containerboard it might be a wash this year, if you get about 50% of the price hike benefit, but you're seeing kind of $3 million to $5 million in costs, and can you confirm that?

Charles Malo:

This is Charles. There's probably a plus. I'm being cautiously—I wanted to give some numbers. There's probably a positive at the end of the year, but I want to be cautiously optimistic on this.

Mark Wilde:

Okay. For the overall Company?

Charles Malo:

For the Containerboard, yes. On the $70, the question was asked on $70, and then times $1.5 million—that's U.S., by the way—and then when you look at the $3 million to $5 million, these costs are in Canadian. So, there's a small potential they're positive, or potential positive on a year basis.

Allan Hogg:

In Tissue market, there's continued increases on the raw material side, so that would be more of a headwind in Tissue than in Containerboard and in Specialty, but everyone is impacted by transportation costs. As Charles mentioned, the railway availability, it's more on the Containerboard side than the others.

Mark Wilde:

Okay. Then, in Tissue, can you just help us. I know a lot of times there's a variance between sort of announced Tissue price hikes and realized Tissue price hikes, and can you just give us any historical perspective on what you've typically been able to realize as a percent of the announced increases?

Jean-David Tardif:

I don't think the past will guide the future with this market. We've not been able to materialize most of those price increases in the past, but today the situation is different, and with the inflation that we're facing and the market conditions, I'm sure we're going to realize much more than what we realized in the past. We used to realize half to three-quarters of the announced pricing, but now we're firmly working on 100% of it, and, in fact, we are increasing even more than 12% on many categories.

There's many categories right now that are under allocation. There's really strong demand, especially on the away-from-home side. So, overall, we're really working hard for the full 12% on both markets.

Mark Wilde:

Okay, that's encouraging. Then, finally, is it possible to get a little bit of colour on the increase in costs at the Bear Island Project, and whether at this point you think there's any more risk of upward kind of cost creep?

Jean-David Tardif:

Yes, I can give you maybe a bit of where we stand. In our range that we provided, $425 million to $450 million, we built in known increases from now till the end of the year. A big portion of the increases were the steel, concrete, labour, and all other costs that we plan from now till the end of the project. The other thing is we have about 80% of our contracts that are now signed, secured or agreed, so this is reducing the risk from now till the end. So, we feel pretty comfortable with the number that we've announced, and the range. Right now, we're on the low end with the contingency, so we feel comfortable it's going to be $425 million to $450 million.

Mark Wilde:

Okay, all right, that's helpful. I'll turn it over.

Operator:

Your next question will be from Zachary Evershed, National Bank.

Zachary Evershed:

Good morning, everyone.

Mario Plourde:

Good morning.

Zachary Evershed:

I was hoping you could give us a bit more colour on the pace of Bear Island investments in 2022 and 2023, and speak to your confidence on the December start-up date?

Jean-David Tardif:

Okay. So, on 2022, I'm going to answer on the starting, and the second part of your question, I'm going to have to ask you again, but just on the starting date, right now, with all the—the team is working on making the date stick our schedule. We have to make a lot of adjustments, but it's still working. We're hiring more people right now than our original curve. We're making changes based on the challenges that we're seeing. But, as we speak, the date is still holding for the end of December. We made some commitments, also, to customers, so we're really focusing on meeting that date with the teams.

Allan Hogg:

Zachary, on your other question, the layout of the investment, you have a slide on the next at eleven o’clock, but it’s about US$210 million in 2022, and US$50 million in 2023.

Zachary Evershed:

That’s very helpful, thanks, and then one last one for me. The Tissue industry in North America is still pretty highly fragmented and some of your competitors have indicated they’re working on consolidation there. Are you active on that front, as well, or is your plate pretty full with Bear Island?

Mario Plourde:

Zachary, thank you for your question, but if I may, I would like to defer it for our call at 11:00, we’ll answer that question.

Zachary Evershed:

Makes sense. Thank you very much. I’ll turn it over.

Mario Plourde:

Thank you.

Operator:

Thank you. There are no further questions at this time, Monsieur Plourde. Please continue.

Mario Plourde:

Thank you, everyone, for being on the call this morning and we are looking forward for presenting our Strat Plan ’22, ’24 at 11:00, so meet you at 11:00. Thank you.

Operator:

Merci. Mesdames et Messieurs. Cela met fin à la conférence d’aujourd’hui. Vous pouvez maintenant raccrocher.

Thank you, ladies and gentlemen. This concludes today’s conference and you may now disconnect.