

Cascades Inc.

Second Quarter 2024 Financial Results Conference Call

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Matthew McKellar

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PRESENTATION

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 the Cascades Second Quarter 2024 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 will now pass the call to Jennifer Aitken, Director of Investor Relations for Cascades.

Ms. Aitken, you may begin.

Jennifer Aitken — Director, Investor Relations, Cascades Inc.

Thank you, Sylvie. Good morning, everyone, and thank you for joining our second quarter 2024 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 Hugues Simon, 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; Jérôme Porlier, President and COO of Specialty Product Segment; and Jean-David Tardif, President and COO of Tissue Papers; and Luc Langevin, Senior VP of Corporate Services.

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 Q2 2024 investor presentation for details.

This presentation, along with our second quarter press release, can be found in the Investor section of our website. If you have any questions, please feel free to contact us after the session.

I will now turn the call over to our CEO, Hugues Simon, who will begin with a review of our performance.

Hugues?

Hugues Simon — President and Chief Executive Officer, Cascades Inc.

Thank you, Jennifer. Good morning, everyone. I'm pleased to be here today and look forward to having the opportunity to meet you in person in the near future.

Beginning with a quick overview of our consolidated results.

Our second quarter sales levels increased by 6 percent from Q1 and were essentially stable year over year. This performance was in line with our expectations. Volume, pricing, and exchange rates drove the sequential improvement. Year-over-year sales mix and exchange rates were both tailwinds, while volume and pricing were headwinds.

Consolidated EBITDA of \$112 million increased 9 percent from Q1, reflecting stronger pricing and favourable volume and mix, freight, and energy costs.

These were offset by higher raw material and production costs. Year-over-year consolidated EBITDA decreased 20 percent, mostly due to higher raw material costs and decrease in average selling prices.

Our second quarter results also includes a \$5 million one-time compensation expense related to CEO transition.

On the raw material side, highlighted on Slide 5 and 6, the second quarter average index price for OCC increased 9 percent from Q1 and 134 percent year over year.

The market for these materials are consistent demand domestically, including growing amounts needed for new recycled containerboard mills.

We have no problems supplying our operations with good inventory management and in our internal supply networks. We expect a relatively stable market in the coming months.

Average Q2 index prices for white recycled paper grades decreased 6 percent versus Q1 and 27 percent from last year. The market was balanced, with readily available volumes and fibres translating into a small decrease in pricing in the quarter.

While prices were higher sequentially, up 18 percent in the case of softwood and 17 percent for hardwood, year-over-year prices were also higher, up 12 percent and 13 percent respectively.

Our mills were adequately supplied throughout the period.

Moving now to the results of each of our business segments, as highlighted on Page 7 through 12 of the presentation.

Beginning with Containerboard, Q2 sales increased by 5 percent sequentially, reflecting higher selling prices and volume and better sales mix and exchange rate.

Shipments increased 1 percent from Q1, driven by converted products.

Sequentially, converting shipments increased 5.9 percent in Canada, slightly below the 6.2 percent increase in the Canadian market.

US converting shipments decreased 2.1 percent below the 3.3 percent US market increase, reflecting the sale of our Newtown facility during the quarter.

Excluding that sale, US converting shipments increased 0.3 percent from Q1.

EBITDA in Q2 was \$60 million, or 10 percent on a margin basis. This represents a 20 percent increase from Q1.

The results benefitted from recent market price increases, offset by continued higher material costs.

We also recorded a \$4 million R&D credit during the quarter.

This was in line with the range we provided with our Q1 results, but nonetheless impacted by a prolongation of planned maintenance downtime at our Greenpac and Bear Island Mills.

In total, the additional downtime reduced our production capacity by a further 8,000 short tons in the quarter.

Year-over-year sales increased by 4 percent with benefit from higher volumes and more favourable sales mix and exchange rate offsetting the impact from lower selling prices.

EBITDA levels decreased by 38 percent, a reflection of the combined impact from lower pricing and higher raw materials.

Year-over-year shipments increased by 4 percent in Q2, mostly driven by the new Bear Island volume.

Converting shipments increased by 8 percent in Canada, outperforming the 6 percent increase in the Canadian market.

US converting shipments increased 0.6 percent, slightly below the 1.1 percent US market increase. Excluding Newtown, US converting shipments increased 3.2 percent from the year-ago period.

Continuing with our Packaging business, our Specialty Product division continued to deliver strong results. Q2 sales were up 4 percent from Q1 on improved selling price, sales mix, exchange rate, and higher volume in plastic food packaging.

EBITDA was up 4 percent or \$2 million from Q1 and the margin of 15.6 percent remains solid and unchanged from Q1.

Year-over-year sales increased 2 percent in Q2, with exchange rate and higher selling prices in certain products driving this growth. EBITDA improved by \$2 million to \$26 million, as lower operating costs offset lower realized spreads due to higher raw material.

Moving now to our Tissue business. Second quarter sales increased 8 percent sequentially, largely due to volume increases of 16 percent in the away-from-home market and 3 percent in the retail market, both of which reflect seasonality, new business gains, and promotional activities.

EBITDA of \$54 million increased 8 percent from Q1, driven by higher volume and lower transportation costs. These benefits were partially offset by higher raw material costs.

Q2 margin of 13.6 percent remains stable with Q1 levels.

Sales decreased 5 percent year over year, reflecting lower shipment levels. This was driven by a decrease in parent roll shipments following mill closures and higher internal consumption. As a result, the integration rate increasing to 94 percent from 83 percent in the year-ago period.

On the converting side, shipments increased by 3 percent the result of a 4 percent decrease in away-from-home following plant closures, offset by a 9 percent increase in retail.

The average selling price increased by 4 percent, driven by lower proportion of parent rolls in the sales mix and the beneficial exchange rate.

Year over year, EBITDA increased by \$10 million, or 23 percent. This is the outcome of favourable product mix and lower production costs, the latter of which reflects the beneficial impact from recent plant closures.

I will now pass the call to Allan, who will briefly discuss some of the financial highlights. Allan?

Allan Hogg — Chief Financial Officer, Cascades Inc.

Yes. Thank you, Hugues, and good morning, everyone.

Slide 13 and 14 illustrate specific items recorded during the quarter.

The main item that impacted EBITDA were \$10 million of restructuring costs related to the closure of plants, mainly in Containerboard and Tissue, that occurred over the last 12 months.

Slide 15 and 16 illustrate the year-over-year and sequential variance of our Q2 adjusted earnings per share and the reconciliation with the specific items that affected our quarterly results.

As reported, Q2 net earnings per share was \$0.01. This compared to net earnings per share of \$0.22 last year and a net loss per share of \$0.20 in Q1.

On an adjusted basis, net earnings per share were \$0.08 in the current quarter. This compared to net earnings per share of \$0.27 in last year's results and zero in the first quarter.

Year over year, this variance mainly reflects lower EBITDA and higher financing and depreciation expenses, while sequential variance reflects higher EBITDA levels.

As highlighted on Slide 17, second quarter adjusted cash flow from operations was \$95 million, down from \$122 million in the year-ago period, but up \$49 million sequentially.

Adjusted cash flow used in the second quarter improved year over year, largely reflecting the higher levels of capital investments associated with Bear Island in the year-ago period.

Sequentially, adjusted cash flow from operations also improved due to lower net financing expenses paid.

Slide 18 provides detail about our capital investments. New investments in the second quarter totalled \$62 million.

For 2024, our planned capital investments will be below our initial forecast of \$175 million.

Moving now to our net debt reconciliation, as detailed on Slide 19.

Sequentially, our net debt increased by \$73 million in the second quarter. Despite higher cash flow from operations in Q2, net debt increased due to the exchange rate, our paid capital investments, leases renewal, and a negative working capital variance.

We also disposed of some assets for \$17 million, largely related to the Newtown, Connecticut converting facility in the second quarter.

Higher levels of net debt and lower EBITDA levels on a LTM basis increased leverage to 4.2 times at the end of Q2 from 3.8 times at the end of Q1.

Financial ratios and information about maturities are detailed on Slide 20, and other information and analysis can be found on Slides 23 through 30 of the deck.

I will now pass the call back to Hugues, who will conclude with some brief comments and our near-term outlook before we begin the question period. Hugues?

Hugues Simon

Thank you, Allan. We've outlined our near-term outlook on Slide 21 of the presentation.

As a reminder, actual results may differ from this outlook in the event of movement in index pricing, both in terms of raw material cost and selling prices.

Beginning with our Packaging businesses, we expect Q3 results to be stronger sequentially in Containerboard.

Two main factors are driving this outlook. The first is the benefit being realized as price increases continue to be implemented. The second is improved operational efficiency following the important shutdowns in Q2 and good volumes given stronger seasonality.

We expect raw material costs to continue to be a headwind for the business.

We're planning approximately 11,000 short tons of maintenance scheduled on time in the quarter.

Results in the Specialty Product segment are expected to be stable sequentially. This reflects higher selling prices in certain product categories and gains from efficiency improvements.

These tailwinds are expected to offset any impact from higher production costs.

Finally, we expect third quarter results to be softer sequentially for our Tissue business. While we anticipate stable volumes, this will be outweighed by higher raw material costs and less favourable sales mix.

Looking further ahead, our outlook is positive as we have announced a price increase of up to 8.5 percent for Canadian retail tissue products and some US customers at the end of Q3.

We also secured additional US retail business volume that will be starting in Q4.

More broadly, we're focused on four main work streams. The first is the ongoing ramp up of the Bear Island facility. Second is solidifying efficiency improvements across all of our production facilities. Third is on further improving customer satisfaction levels with our partners and remaining the supplier of choice. And last, but certainly not least, is the diligent implementation of already announced price increases.

We remain cautious, given the economy and persistent inflation and are committed to continuous operational improvement throughout our business, while remaining rigorous when it comes to capital allocation.

Let me finish by saying that, in my eight weeks with Cascades, I've been very impressed with the passion and the commitment of every employee. People are dedicated and proud and doing everything they can to meet customers' expectations.

To me, clearly, the saying a company is its people rings very true for Cascades, and I'm looking forward for the next step as we continue to grow our company.

And before I pass it to the Operator, I want to thank the people around the table with me here. They made my life easy on this first call.

Back to the Operator. Thank you.

Q&A

Operator

[Remarks in French]

Thank you. If you would like to ask a question, simply press *, then the 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 *, then 1 on your telephone keypad.

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

And your first question will be from Jonathan Goldman at Scotiabank. Please go ahead.

Jonathan Goldman — Scotiabank

Hi. Good morning, and thanks for taking my questions. Maybe just one on the industry generally. Could you discuss how containerboard end-user demand trends have evolved since May?

Hugues Simon

Yes. I'll let Charles take this question.

Charles Malo — President and Chief Operating Officer of Containerboard Packaging, Cascades Inc.

Yeah. So we see a general uptake due to the seasonal demand. But overall, the demand is pretty good in our—sorry. Third quarter demand right now is pretty solid.

Jonathan Goldman

Solid relative to Q2? Or as solid as Q2?

Charles Malo

Yes. Relative to Q2. Yeah.

Jonathan Goldman

And it looks like another quarter where containerboard shipments outperformed the industry. Actually, it looks in my model like the eighth quarter in a row. What do you think is driving that outperformance?

Charles Malo

So basically, like we mentioned, we made some significant investment, strategic investment in our group starting with Bear Island, but also on the converting we made a major investment in Piscataway; investment also in Central Canada and Ontario, so this also gave us some competitive advantage on the market and growth potential.

Jonathan Goldman

Okay. That makes sense. And then I guess maybe switching to Bear Island. Can you give us a status update on the ramp of the facility?

And maybe specifically how the transition to using more mixed paper is going?

Charles Malo

So the Bear Island ramp-up continues. We are now able to supply all the grades that we were supposed to do and that they've been qualified to the customer, which is a very good news.

So now we can provide to the customers on a regular basis 21 pound and over. And so we're working with our customers and potential future customers also to deploy that on the market.

And on the ramp-up and the use of the mixed waste, we're going gradually increasing the mix percentage, but we're doing so and making sure that the quality of the product is there. So we're balancing more mix, but at the same time monitoring the quality of our product to our customers.

Jonathan Goldman

No, that's good to hear. Thanks for taking my questions. I'll turn over the line. Thank you.

Operator

Thank you. Next question will be from Hamir Patel at CIBC World Markets. Please go ahead.

Hamir Patel — CIBC World Markets

Hi. Good morning. I realize it's only been eight weeks, but can you maybe speak to some of the potential areas that you expect to look to make changes to, just given your operating background?

Hugues Simon

Yes. Thank you. Yeah. As you said, it's been eight weeks. Clearly, as I said in the outlook, the Bear Island ramp-up is going to be a focus to make sure that we go as fast as we can to get to capacity.

Very satisfied with what we've seen so far. The next coming quarter is going to be really important as we have a good order file, and we need this production to be coming as planned.

The second one is on operational efficiencies to make sure that we capture all the potential efficiencies that we have with our current assets.

Hamir Patel

Okay. Fair enough. Thanks. Then just the last question for Allan.

Just given the lower CapEx you're pointing to, how should we think about CapEx for 2025?

And when you think about larger strategic projects for the business, what's kind of left other than maybe some more box plants over time?

Hugues Simon

Yeah. So, Hamir, I'll take that question.

And as Allan mentioned, we will be spending less than \$175 million in CapEx this year. We're currently doing a diligent work on how to allocate cash. So that will be coming in the coming months, but we'll be really focused on capital allocation to make sure that what we do with cash will add long-term and sustainable value.

Allan Hogg

So priority will remain debt reduction in the coming quarters for sure.

Hamir Patel

Okay. Fair enough. Thanks. That's all I had. I'll turn it over.

Operator

Thank you. Next question will be from Kasia Kopytek at TD Cowen. Please go ahead.

Kasia Kopytek — TD Cowen

Hi. Good morning, everyone. It's Kasia on the line. Maybe I'll just take that capital allocation thread a little more. You mentioned CapEx and that reduction.

Just curious around the deleveraging front. Any preliminary thoughts on reducing that not just by higher EBITDA, but actually reducing debt levels?

Allan Hogg

Well, yes, there's some initiative ongoing work with some working capital items looking at everything on that. And there are some assets that we're looking to dispose of following some closure in the recent quarters, but that's—just as we did with Newtown in the second quarter. So that may be (phon) other items to further reduce debt in nominal dollars.

Kasia Kopytek

So the—

Allan Hogg

But the objective remain to be under 3 times. So it's just delayed, but as Hugues mentioned, rigorous capital allocation will get us there.

Kasia Kopytek

I'm glad you mentioned that target. That was going to be my follow-up. But, Allan, any sense of the order of magnitude on the working cap reduction and/or asset disposals?

Allan Hogg

Well, asset disposal, you know it can change rapidly. It's maybe too early to give you amounts. But it's—and working cap, I think we are under 10 percent of sales. It's a slight improvement here and there, but we are pretty in good shape, but there's always opportunities. So a couple of millions, but we don't have any amount to state at this time.

Kasia Kopytek

Okay. Gotcha. The June containerboard price hikes, how are those progressing? Do you expect to get the full hike?

Any pushback from customers?

Allan Hogg

I'm not going to be too specific on the price increase, but what I can tell you is we are still implementing the price increase. So there's some benefits in the Q2, but continue in Q3.

So yes, we are diligently working with our customers to work with them in passing on the price increase.

Kasia Kopytek

And just beyond the price hikes themselves, any prospects—or other prospects, rather, for recouping margins in containerboard beyond price hikes and OCC relief?

And if you can give us a sense maybe of how much Bear Island has undermined margins to this point, that would be helpful.

Hugues Simon

So as far as improvement, as Allan and Charles mentioned, some of it will come from working cap. We have work streams on margin improvement and cost reduction in all of our businesses, and we're doing diligent work to track these changes with milestones that we have regularly.

And on the specific mill with Bear Island, I'm not going to go specific on one mill, but Bear Island is part of the process that I've just mentioned.

Kasia Kopytek

Any numbers you can share around targets for how much margins can improve based on those efficiency and other streamlining measures you referred to?

Hugues Simon

Yeah. We're not going to put any number at this point but let me tell you that we're really working diligently to make sure that we cover back enough margin so that we can further reduce our debt level.

Kasia Kopytek

Gotcha. Okay. Thanks a lot, everyone. Appreciate it.

Operator

Thank you. Next question will be from Matthew McKellar at RBC. Please go ahead.

Matthew McKellar — RBC

Hi. Good morning. Thanks for taking my questions. I think in your prepared remarks you mentioned securing some additional US retail tissue volumes beginning in Q4. Can you maybe just provide a bit of colour around how material the volumes associated with that new business should be?

Hugues Simon

Yes. I'll let Jean-David respond to that.

Jean-David Tardif — President and Chief Operating Officer of Tissue Papers, Cascades Inc.

Yeah. Good morning, Matthew. It's a nice business, honestly. It's slightly above 4 million cases for a major retailer in the US. So we're really pleased of those negotiations and discussion and the outcome.

Matthew McKellar

Okay. Thanks for that. Are you able to provide any more additional colour around the mechanical break at Bear Island in the quarter?

Hugues Simon

Yep. So basically, as you know, it's a ramp-up paper mill. So the items, there was a breakdown on the paper machine and the team worked diligently to ramp this up. But this is behind us right now, and it's not anything that will affect the future of the mill.

Matthew McKellar

Okay. Thanks. That's helpful. And then maybe last for me, I think earlier this year you talked about relocating some tissue-converting equipment from your operations in Oregon that are now closed elsewhere in your network. Can you maybe speak to how that's progressing and maybe where you are in that process?

Jean-David Tardif

Yeah. Those four lines are already running in our other facilities. So the 4 million cases I was just talking about is going to fill about 50 percent of the capacity that we're adding. The remaining two are in ramp-up and those two are for away-from-home market.

So we still have some open capacity short term in the away-from-home. But overall, I will say that those line relocation went pretty well and are according to the plan.

Matthew McKellar

Okay. Thanks very much. That's all for me. I'll turn it back.

Operator

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

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

Thomas Bolland — National Bank Financial

Good morning. It's actually Thomas calling in for Zach. Can you give us a little bit more colour regarding the tissue mix? Is this a consumer trade-down?

Jean-David Tardif

Yeah. We see still private label going up. So if you look at Nielsen data for the last quarter, private label is gaining share again.

In terms of trading down into the category we see some, I will say, moderate trading, I will say. But I think the biggest uplift that we see is retail price going down at some retailers, some important retailer in US that adjusted their share.

So we see good uplift in volume for our own business and retail US mainly.

Thomas Bolland

That's helpful. Thank you. And I'm sorry if I missed this, but given the mechanical issues at Bear Island, are we expecting to see a catch-up in shipments in the third quarter?

Allan Hogg

Yup. So yeah, the third quarter outlook is positive compared to the Q2. And this is a combination of market and also more availability on our production.

Jean-David Tardif

At Bear Island, but also all the shutdown we took—

Allan Hogg

Yup.

Jean-David Tardif

—in Q2 are much larger than what we expect in Q3. So yes, we should see pickup in shipments.

Thomas Bolland

Perfect. That's helpful. Thank you, guys.

Operator

Thank you. There are no further questions at this time.

Mr. Simon, please continue.

Hugues Simon

All right. Well, in conclusion, thanks, everyone, for taking the time to attend our quarterly call. And we're looking forward to meeting some of you in person in the near future.

Allan Hogg

Thank you, everyone.

Hugues Simon

Thank you.

Charles Malo

Thank you.

Operator

[Remarks in French]

Thank you, ladies and gentlemen. This does conclude today's conference call. You may now disconnect your lines.