

MIDWAY LIMITED (ASX: MWY)

16 May 2022

Investor Conference (12 May 2022) Transcript

Speakers:

Tony McKenna, Managing Director and CEO (**TM**)

Rob Hadler, Investor Relations and Media Adviser (**RH**)

Michael McKenzie, Acting Chief Financial Officer (**MM**)

TM: I'll take you through the presentation quickly and then open it up for questions at the end.

So this morning we've signed contracts for the sale of the 17,000 hectares of Midway plantation assets in southwest Victoria for \$154 million. This is an excellent result for shareholders for a number of reasons. It realises assets that are being undervalued by the market for an amount greater than our book value. It's around 10.9 million before tax over our December 2021 value. It establishes an ongoing revenue stream from asset and carbon management. The \$200 million commitment to investment in greenfield plantation land materially increases the hardwood plantation resources for our Geelong site. It ensures Midway retains access to wood-fibre from the existing plantations post the sale. It removes volatility in our balance sheet that results from the annual biological asset revaluation, and it gives Midway an immediate meaningful presence in the carbon management market.

It's a complex transaction, and the team's done an enormous amount of work to deliver it. It represents an important commitment by Midway that has now been fulfilled. Importantly, the net proceeds of \$86.2 million will enable Midway to remove debt pressure, to allow us to reposition the company for future growth, and to recommence payments to shareholders.

For those of you who don't know our partner, MEAG, MEAG is the asset management arm of the German-based financial services business Munich Re. MEAG currently owns 420 million Euro of forest assets in Oceania, and has 340 billion Euros in assets under management. MEAG has established a special purpose vehicle on behalf of its clients to acquire the existing brownfield and future greenfield plantation assets. The SPV will execute the log offtake and asset and carbon management agreements with Midway. The asset and carbon management agreement is for an initial period of seven years, with provision to negotiate an extension. The log offtake agreement is for two full rotations, or 35 years.

The cash flow impacts for Midway are material. Settlement timing is shown in the table on slide 6 that you can see on the screen, and it will initially be determined by the FIRB

approval, and then determined by the timing for release of titles encumbered under the legacy Strategy tree finance arrangements. The table also shows how the net sale proceeds will be derived after transaction costs, tax payments, and the legacy tree finance buyback arrangements.

As a result, Midway will receive an estimated \$86.2 million over a number of tranches. As the table shows, most of this will be received in FY2023. The bulk of the remaining net amount will be received in FY2025. We're aiming for the settlement of the final tranche in September 2024.

The capital management side of things is very important. The Midway board will work through the optimal capital management outcome, considering the strategic review that's underway, timing of receipt of funds, tax and franking credits, investment opportunities, and all other relevant factors. There is likely to be a mix of debt repayment, future growth initiatives, with a focus on carbon management, and returning funds to shareholders.

The next steps that we need to achieve; we need to obtain FIRB approval for the foreign land ownership for the SPV. The FIRB application will be launched in the coming days, and we are hopeful of clearance within 90 days, but that timing is a bit out of our hands. We need to finalise the calculation of stamp duty on the land sale, which will affect the final sale price received by Midway. An application has been made to the State Revenue Office for a ruling on the duty payable.

We will need to work through unwinding the legacy Strategy financing arrangement, to enable settlement of subsequent tranches by repurchasing the trees. And over the next five years, we need to identify and acquire land to deploy the \$200 million greenfield plantation acquisition program.

And if I just take you through the status on the strategic review, and I'm now 107 days into the role, and a lot has been achieved in that time, largely due to the hard work of the team that we have at Midway. But having determined that the natural ownership of these plantation estates isn't in a small listed company such as Midway, we have executed a number of sales. The Wandong sale has been signed and settled. Kerrisdale is signed and due to settle in June, and now the plantation estate is contracted. The exit from the logistics business has been announced, and is well in train. At Bell Bay, Berth 7 is complete, and Norfolk Street Stage 1 is due for completion in August.

The grain project for Geelong is progressing well, with diligence and negotiations underway. We've made some very substantial progress in establishing Midway in the carbon management market, and particularly through what we're announcing today. The next stage of the strategic review will include assessing the capital management options and business growth opportunities. I can't give a firm timetable for this phase of the review at this stage, as it's evolving. We are gaining good momentum and I appreciate that we need to keep it moving. We will keep you informed.

My personal commitment is to continue to deliver on our objectives. And today's announcement is another key objective delivered. So with that, very happy to open to questions that Michael and I might be able to answer for you.

RH: OK, well, thanks, Tony and Michael. I've got two sets of questions from Ian Munro, an analyst at Ord Minnett, and an individual investor, Mr Li Zhang. And I've also got a question from Liam Cummins at Investors Mutual. So I'll take them in order first. The questions from Ian Munro, the first one, a first question for you, Tony, is "What is the future of the business once these assets are sold?"

TM: So Midway will continue to operate its wood chip processing and exporting business in the Tiwis, in Brisbane, Geelong, Tasmania, and these businesses will continue unaffected by that. And we will build our capability around the carbon management space. We're in the ideal industry to be generating ACCUs and revenue from carbon projects. And this is a significant step towards that. We are then still looking at what the business really looks like. And we have some more work to do on that strategic review.

RH: Thanks. The second question from Ian Munro is one for Michael. It's "What's the book value of the assets to be sold? It looks like it's about \$96 million."

MM: Yes, so there's a couple of parts to that. The book value of the land assets is \$93.2 million. The book value of the trees is \$43.8 million. Therefore, that generates the estimated profit on sale of \$10.9 million against the balance sheet at 31 December 2021.

RH: Thanks, Michael. I'll now go to the questions from Mr Li Zhang. And another question for you, Michael; "Can you please explain the neutral impact on EBITDA of the Geelong operations?"

MM: Yes, no problem. So there's a couple of components to this question. One is the cost savings that we're going to make on plantation management expenses. Currently, we have to incur the direct expenses for managing our estate. There are a couple of components to those direct expenses. One is the savings on the direct expenses. We currently manage our plantations and incur those direct expenses. Those expenses will pass on to the SPV. We will also generate revenue from managing the estate, as highlighted in the pack. So therefore, there's a revenue generation component to it. So the revenue generation plus the cost saving will broadly have the neutral impact against the cost of the logs that we need to repurchase. Now that broad impact is EBITDA-S. As highlighted in the pack as well, of course, from a P&L respect, we will miss out on the growth in the trees - the revaluation of biological assets as they grow.

RH: Thanks, Michael. A second question from Mr Zhang is "Why is the tax liability \$19.1 million while the sale price is only \$10 million over book value?"

MM: So the answer to that question is that we've got a big deferred tax liability. The majority of that deferred tax liability is the generation of the capital growth uplift in the value of the land, and that's occurred over a number of years. So the biggest tax component within that \$19 mil is the value uplift on the land over time, that we will need to pay capital gains tax on.

RH: OK, and the final one from Mr Li Zhang; “What is the company’s current FX hedging position?”

MM: So we’re fully hedged at 75 cents for the remainder of this financial year. And we have a fair level of cover out at 75 cents for the first half of FY23.

RH: Thanks, Michael. I’ll now go to a question from Liam Cummins, which is, “Given the ongoing challenges with global supply chain, can management give an update on current trading conditions and the sales outlook?” I think that’s one for you, Tony.

TM: Yes, thanks, Liam. The sales outlook is strong. We’re experiencing very strong demand for all our products from all our markets. On the other hand, on the supply side, we are incurring pressures, again still with contractors availability, tree and log availability, but primarily driven by availability of contractors. We’re also seeing some cost pressures come into the system. Most of our contractors have a quarterly review to reflect fuel costs, that we’ve had to change to match everyone else in the industry. It is now a monthly review with what’s happened with fuel prices, and that is coming out, that’s a straight cost to us. It’s coming out of our margin. We anticipate, with the prices set through to the end of this year, but with the demand that’s in the market at the moment, we would be very surprised if there wasn’t an uplift in the price going into next year.

RH: Thanks, Tony. Sorry Michael, did you want to add to that?

MM: Just to add on to that, those cost pressures and impacts will result in a second half earnings profile to be a little bit less than the first half. So that’s the impact of the business for FY22.

RH: Thanks, Michael. Got several questions from Charlie Kingston now. I think the first one’s for you, Tony. “I appreciate it’s early, but on the carbon opportunity, can you elaborate on this? Do you still have an agreement with Climate Friendly? Mitsui just bought a stake in them, so where does this leave you, noting you already have a JV with Mitsui? What percentage of credits will Midway receive, etc, and when do you think this will generate revenue?”

TM: Yes, sure. So thanks, Charlie. We see carbon as a really important part of our business and business strategy going forward. As I said before, this is a really meaningful step in that direction, with basically securing a \$200 million plus to invest in projects that will generate carbon, and we’ll be paid for registering and managing those projects. And that will help us build out our existing in-house expertise in carbon, so that we can be providing those services to others. And it’s our aim to then be looking to roll that out into other markets.

Yes, we still have our arrangement with Climate Friendly. But we’re looking in Tasmania at other projects outside that. I think Mitsui’s interest in investing in the carbon management space is not at all surprising, given they will be seeing what we see, and be very familiar with what – I mean I’m sure you all see, and that I see, that our business of identifying land, acquiring land, planting trees, managing plantations, and making a commercial return from those, sits immediately adjacent to the carbon world, and with our expertise in that, plus our expertise now that’s developing in carbon,

makes us a very attractive business I would have thought, or makes a business model very attractive and puts us into that space very, very squarely.

RH: Thanks, Tony. Next question from Charlie is “Can you provide a rough indication for a capital management split between debt reduction, growth and dividends? And also be a bit more specific as to when you may be able to return some funds?”

TM: So not at this stage, I can’t give a more definitive split. There’s more work to be done on the strategic plan. But there’s also work to be done just considering the other elements that need to be gone over for capital management. And what was the second part of the question, sorry, Rob?

RH: More specific about the timing.

TM: Yes. So we will be certainly aiming to be in a position to announcing that around the time of the settlement of the first tranche, which we expect in around 90 days. So we will probably coincide with that as we get a better read on everything, and we’ve had a chance to have a look at all the factors that need to be considered.

RH: Third question from Charlie; “Are you up for any of the \$200 million for future planting, noting the comment that Midway has participatory rights for 3,800 hectares?”

TM: I assume that if you’re referring to do we have any ownership of ACCUs generated from those plantings –

RH: No, I think the question is – I’ll rephrase it. “Will Midway have to contribute to any of the \$200 million in greenfield land acquisition, given that we’ll have a participatory right for some of the hectares?”

TM: OK, thanks. So, no, all that investment comes from MEAG and MEAG’s clients. Our participation in the carbon from those 3,800 hectares refers to existing plantations that we’ve sold, that have been identified as having alternate higher and best uses. And if they go back into plantations, then we’d be running an application for carbon ACCUs out of that.

RH: Thanks Tony. A supplementary from Charlie; “Can you comment on how quickly you’ll deploy the \$200 million, considering it’s competitive in forest land right now?”

TM: Yes, so the plan is to roll that out over five years. And with an even spread, and we’ve had people warming up on that for the last couple of months.

RH: And another one from Charlie, before we move on to others; “How significant do you think the stamp duty is, and does the \$86 million net expected proceeds already provide for that?”

TM: Yes, it does. There may be some movement. But the \$86 million is our best estimate, including the impact of the stamp duty.

RH: Thanks. Got a question from Mr Yanti Zhou – sorry, if I’m not pronouncing your name correctly – “What is the nature of the participatory rights?”

TM: Yes, again, assuming that’s referring to the carbon ACCU that I was just touching on. So again, there are some areas of our plantation that would naturally go to another

use. And so therefore, are likely to be eligible under the Schedule 3 exemption under the Carbon Farming Initiative, that we could claim ACCUs if we replant them into forestry, and that's, again, a process that we need to work through with MEAG to see how they want to manage it. If they do choose to go that way, we will have a share of the ACCUs that are generated from that land.

RH: Thanks, Tony. A question for Michael from Anthony Bak; "The strategy liability was circa \$40 million on the balance sheet on 31 December. Why is the repayment in slide 6, \$47 million?"

MM: Yes, there's an interest component to that liability. So it's non-cash interest, but it unwinds over time. By paying out the liability as early as we can in the contractual window, we're actually minimising the cash payments that go out over the next couple of years. At face value, the liability would have gone out to 2027, and we would have been paying more cash had we not paid it as early as we can in the piece. So it's actually a benefit in paying it in this kind of arrangement.

RH: Thanks. Another question from Anthony; "How much land will Midway continue to own after this transaction?"

TM: So Midway will have a small, very small, piece of plantation land, which is not meaningful, but we will also own the freehold title at Geelong, at the Geelong port, where we've got the waterside land, where we have the mill and our head office, and where we're working to develop the grain project on that freehold land.

RH: OK. One further one from Anthony, one for you, Michael; "What's the estimated net debt of Midway post FY23?"

MM: Yes, I mean, that's a challenging one to answer, because it largely depends on the capital management strategy. However, if we look through the financial years, we've got \$86 million coming in. So it just depends on what we pay out in terms of the long term debt. But obviously, it'll be a net debt positive figure at that point in time.

TM: It's our expectation that the business going forward on completion of the sale of these assets, doesn't naturally – given the cyclical nature of the business – doesn't naturally carry any core debt, but we would still be funding working capital with debt, and some plant and equipment.

RH: Thanks, Tony. A question from Liam Cummins at Investors Mutual; "How definite is the tree acquisition profile? Could the profile be accelerated, or is it a risk if it is delayed?"

TM: We're talking the buyback of the logs, I assume, so I'll answer that, and pop up another question if I'm not right. So the purchase of the logs has minimum volume of 140,000 tonne a year for the first 10 years, which is about what we're taking at the moment. And then there's provision for movement in that. And then as the new rotations come on from the planting in the future, then we'll see greater volumes come through then.

RH: I think Liam was referring to the tree acquisition program from Strategy, which is over a four-year timeframe, and whether that could be accelerated?

TM: Yes. Sorry. OK. That we have brought through to the earliest points, and we'll make those payments at the earliest possible point, as Michael referred to before, so September '24 is the earliest that we can pay or reacquire those trees, those final set of trees that allows us to settle that final tranche.

RH: Thanks, Tony. One more from Liam Cummins; "Is management still comfortable with Bell Bay and Geelong capex forecasts, given materials and labour inflation?"

TM: So basically, yes. We don't see any major changes for that at the moment. Bell Bay, most of our costs are committed. So we're not subject to those movements. Michael, did you want to add anything to that?

MM: No, that's exactly right. I mean, the capex profile, there's only a few more months to go on Bell Bay. So we're largely committed, and likely to come in within the forecast. And same with Geelong. I don't expect any adverse impacts.

RH: OK, I've got a couple of questions now from Simon Conn. The first one for you, Tony; "Given the share price trades at NTA, c. NTA, the operating business is not ascribed much value but by the market. Can you explain the strategic position of this business? What is its competitive advantage? And how do we assess the mid cycle EBITDA for the business?:

TM: Sorry, can we take that in parts? So, what business are we in? We are in, after today's announcement, focusing ourselves in forestry asset management, carbon management, and wood chip processing and export. Now, where we go from here, as I said before, I'm 107 days in, and we've knocked over quite a few things. We're still working through what the long term strategy for the business looks like. But the core of the business activities that we undertake, and the core of the things that we do well, is becoming clearer to me, and I think creates some interesting potential. Sorry, the second part of that?

RH: Was the strategic positioning of the business, its competitive advantage, I think it partly answered it in your second part.

TM: So competitive advantage is our presence in the Port of Brisbane where we're the only exporter there. Our portside land in Geelong is a meaningful asset and gives us an advantage there. Again, we've secured port access directly in Tasmania now, our access and relationship with clients and customers are amongst some of our key assets in that way.

RH: And the last part of that was the mid-cycle EBITDA expectation.

TM: Michael, do you want to talk to that?

MM: Yes. I mean, the EBITDA expectation over time is, we're looking to at least get back to the last year's EBITDA, and growing the business beyond that. But a lot of it will come down to how we position ourselves, and at the regional strategic review, we'll be able to hopefully provide a more firm answer to that question.

RH: Thanks, Michael. Second one from Simon Conn for you, Tony. "The company is looking for two new non-executive directors. What skills are you looking for, and how many directors do you see Midway having going forward?"

TM: So that's all currently being reviewed. And just in the last week, we have done the skills matrix for the board working with a search firm who were refining that process. So that's in play. The numbers on the board certainly won't be more directors, and the board's costs certainly won't be higher, following the review.

RH: Thanks Tony. Going back to a couple of final questions now from Charlie Kingston. I think, Tony, but you might want to flick to Michael; "Is the Geelong terminal likely to be minimal capex spend, where you don't contribute to the build? And are you also considering now you've sold the plantation land, would you also look to sell the Geelong property?"

TM: So the grain capex, as I've said previously, it's my preference to do that through a lease arrangement where we don't incur large capital expenses, and where we don't take operating risk on it. It's important enough to the business that if we had to, we would, but at this stage, the most likely outcome is that it doesn't involve significant capex from us, that it's in line with the sort of figures that we spoke about in March. The second question, sorry?

RH: So would you look to sell the Geelong property at any stage?

TM: It's not on our radar, and it still has work that we can do to significantly add value to it. I think the plantation estates, the point in the cycle, the maturity of the assets, there wasn't a lot we could do as a company to improve the value of those. Whereas I think for Geelong, there's a lot we can do, and a lot we can do reasonably quickly to improve the value of those assets, then we're the natural owner of those assets or not, remains to be seen. But it doesn't hurt our balance sheet and our ability to borrow for the working capital finance, to have a physical property asset on the balance sheet.

RH: Thanks, Tony. Second question from Charlie Kingston for you, Michael. "How much revenue do you expect the plantation fund management to generate, excluding anything from carbon?"

TM: If I could just – so the plantation management and carbon management are bundled into one. We're not really in a position to talk about that publicly. It's confidential between the parties. But over the course of the development of the assets, it becomes a meaningful continuing revenue stream, and one that we can earn with minimal addition to our team. So it has some real attraction.

RH: Thanks, Tony. Final question for the moment from Ian Munro. And Tony, you might want to have a go at this one first; "How do we think about the volume of woodchips that can go through Geelong based on the existing supply in the region? Are the supply demand dynamics changing or staying the same on a three to five year view?"

TM: Yes, so the supply of logs available to go through the Geelong mill is one of our biggest challenges, and one that we've spent a lot of time working on. We have a number of initiatives to increase that, there's a number of factors that are outside of our control, and ultimately, to have a tree ready for harvesting today, you needed to have planted it 10 to 12 years ago. So we can't do much about the total number of trees available. What we can do is try and position ourselves as well as possible to access more of them, than otherwise. So the volume through the mill will be

constrained by the supply that's available. And as I say, it's our priority to get as many of the trees in the catchment through our Geelong site. But we're also working on the Geelong grain project, so that we've got additional volume utilising the site, and utilising our ship loader there.

RH: Tony, thank you very much. Charlie Kingston slipped another one in. And one for you, Tony; "Can you provide an update on Chinese demand, please? Is substitution to cheaper alternatives still occurring?"

TM: No. So what we're seeing at the moment, there's some interesting dynamics. Vietnam has not increased its production in the way it has in the past years. So it's still at the same level as last year, whereas each year in the past couple of years, we've seen very significant increases year on year. Vietnam have put their prices up by between \$20 and \$30 US a ton. And we are seeing very strong demand from both China and Japan for Australian wood chips, all the way from the acacia that we're growing on the Tiwi Islands, where we could this year sell more than we can produce, in probably next year as well, through the nitens and the globulus and the native hardwood that we've got through our other sites. So the demand from both China and Japan, as we sit today, is very strong.

RH: Thanks, Tony. "How does that Vietnam price compare to your product?"

TM: So Vietnam is still cheaper, particularly on a delivered basis. And the dynamic where Vietnam will sell everything that they can produce before the rest of the world gets a look in, other than the quality element where they'll always take some of the Australian higher standard globulus and nitens, but it's still significantly cheaper on a delivered basis, but the gap is less. And it's indicative that there's that stronger demand pushing that up, which is right across the board.

RH: And final question from Charlie, Tony; "Do you expect to breakeven this year?"

TM: On an EBITDA basis, it will be around break even, probably.

RH: OK, well, I think that unless there's any final questions on the Q&A chat, we'll just give people another opportunity to insert some questions ...

No, it looks like we've exhausted the participants today. So Tony and Michael, thank you very much. Thank you to everyone who's participated in today's call. We will be putting a copy of this video on YouTube, and we'll also be putting a transcript on the ASX website. So if you need anything else, please don't hesitate to give me a call directly. Thank you. And we'll now end today's proceedings.

TM: And if I may just end by thanking you all again for your interest in the company, for your questions, and for your support.

The conference can be viewed at:

<https://www.youtube.com/watch?v=Afb6F2Q3k1c&t=42s>

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

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About Midway Limited

Midway Limited is a leading Australian forestry management and woodfibre export company with headquarters in Geelong, with 100% shareholdings in Plantation Management Partners (PMP) based on Melville Island, processing operations in Tasmania 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 Limited 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.