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MIDWAY LIMITED (ASX: **MWY**)

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Investor Conference (29 August 2022) Transcript

Speakers:

Tony McKenna, Managing Director and CEO (**TM**)
Michael McKenzie, Acting Chief Financial Officer (**MM**)
Rob Hadler, Investor Relations and Media Adviser (**RH**)

TM: Good afternoon. Welcome and thank you for attending today's Midway Analyst and Investor call on our FY22 financial results. I'm Tony McKenna, CEO and MD of Midway Limited. And I'm joined today by Michael McKenzie, who was appointed Chief Financial Officer on the 1st of July. We are recording today's session, so we can put the transcript on the website. Despite the disappointing financial result, there's an inspiring challenge before us to restore profitability, establish Midway as a leader in the emerging carbon offset industry, and to maximize shareholder value. We are taking positive action to manage the adverse factors affecting our performance due to a difficult global environment and unexpected domestic industry issues. We've announced a strategic review and, on determining that Midway is not the natural owner of large forestry assets, executed contracts for the sale of our Victorian plantation estate.

I will now take you through the key takeouts from the analyst and investor presentation lodged with the ASX this morning. Michael and I will then be pleased to answer any questions at the end of the presentation. In summary, the year was a tale of two halves, each with its own challenges. In the first half, the ongoing COVID-19 pandemic and power cuts in China adversely affected customer demand and export volumes. Wet weather and COVID-19 disruption to harvest and haul activities constrained the Australian industry's ability to capitalize on better trading conditions in the second half. Surging import prices, particularly fuel and labour and a long-dated FX hedging position have squeezed profit margins. Partly as a result of these factors, the WA Logistics, Plantations, and the Woodfibre segments made losses in FY22. We've taken decisive steps to structurally address the persistent NPAT losses in WA Logistics and Plantations. We've exited the Logistics business. And with Plantations, we have contracted to sell the plantation assets, refinance the expectancy of supply arrangements, and restructured the operations.

As these initiatives are finalized, they'll permanently remove the drag on earnings from these segments. The decision to sell our Victorian plantation estate to MEAG for $154 million, will have a major positive impact for the company and investors. On completion, it will secure expansion of the plantation estate for future log supplier and establish the Company as a manager of carbon and plantations. We are optimistic that this project will receive FIRB approval shortly, and that it will reposition the company for future growth. Midway has also taken a number of steps to improve the earnings of the Woodfibre segment. New customers have been secured for the Tiwi project. The

Company has exported the first cargo from our new port facility at Bell Bay in July. And we expect Midway Tasmania to make a significant contribution, after the Norfolk Street mill is fully operational in October this year.

We also continue to progress design, and planning activities for a grain storage and export terminal on our North Shore site in Geelong. We are taking a range of other initiatives to ensure that when supply chain constraints ease, Midway will be well placed to capitalize on strong regional woodfibre markets. The rapidly emerging demand for carbon emissions offsets presents a huge opportunity for Midway. The activities that generate plantation-based carbon credits are core to our business, and we are striving to establish Midway as a carbon manager in a way that has the potential to transform the company.

Now to the FY22 key results. The industry's faced a very difficult operating environment and the FY22 results reflect this and are clearly unsatisfactory.

We have revenue down 29%, underlying EBITDA loss of $1.8 million, slightly worse than anticipated in an underlying net loss after tax before significant items of $8.6 million. Significant items pre-tax cost the business $1.2 million, excluding biological asset revaluation of $6.5 million up.

Operating cash flow was down $6.5 million and net debt has risen to $42 million as at 30 June. It was not an option to pay a dividend to shareholders based on these results. However, the sale of the Victorian plantation land and trees gives directors the ability to use the first tranches of the proceeds to reduce debt, repay the Strategy finance liability, and pay a fully franked dividend of up to 19.5 cents per share in the first half of 2023, subject to final completion and other conditions. Directors will consider future special dividends when the subsequent tranches of the sale proceeds are received.

The financial results FY22. Again, the numbers tell a story of a difficult year. Operating costs were down because of lower sales volumes. However, underlying costs actually went up in the second half of FY22 as a result of rising inflation and fuel costs. The net fair value of our biological assets increased by $6.5 million on the back of higher woodfibre prices. But the higher woodfibre prices and higher interest rates meant our Strategy financial liability also increased. As a result, we recorded a statutory loss of $12.9 million.

Key drivers of performance for FY22. Midway experienced a $4 million improvement due to the increase in woodfibre prices where the globulus price was set at US $180 per tonne for the calendar year 2022. There are also some green shoots in the business units. PMP Tiwi operations improved by $2.7 million EBIDA, and Southwest Fibre improved by $2.5 million in EBITDA over the prior corresponding period. However, a long-dated FX position, entered into in 2021, cost us just over $10 million compared with the previous corresponding period.

Unfortunately, that FX position will remain in place in the first half of FY23. So, at current FX levels, it will continue to be a drag on financial performance. The other market and weather driven factors causing deterioration from the prior corresponding period were:

- lower volumes, which had a $5.2 million impact;
- The bone-dry fibre content was down 2% because of wetter conditions with an impact of $4.9 million; and
- the supply chain margin squeezes had a $4.9 million impact.

I'll now look at the cashflow. The good news is the contribution from the sale of plantation land Kerrisdale and Wandong, north of Melbourne. The net land sale proceeds of $20 million were used to repay $10 million in long-term debt and help fund the investment in our business at Bell Bay. Long-term net debt, therefore fell from $29 million to $19.1 million. And we will fully repay that with the MEAG proceeds in FY23.

Our gearing ratio is currently 25%. We remain within our banking covenants and have a strong relationship with our banks. We will retain working capital debt and asset finance after the settlement of the sale of the plantation estate, and these are appropriate types of debt for Midway at this time. Midway converts the vast majority of export sales to cash, and we therefore expect an improvement in our cash position when the business is able to capitalize on strong export demand.

Looking at the balance sheet for FY22, our net asset position remains very strong and in knowledge of the impending sale to MEAG, we have used proceeds from the Wandong sale for investing in the Bell Bay development and for repayment of long-term debt. The net current asset deficient position will improve after the first tranche of the plantation estate sales. At that time, further repayment of debt will occur and the unwinding of the expensive Strategy financial liability will commence. The long-dated adverse FX position is another factor contributing to our current net asset position.

Our net tangible asset backing of 140.6 cents per share is well above our current share and it is one of my major challenges to address this gap. We believe the market will more accurately value Midway when current remedial actions are fully implemented and operating performance improves. We will update the market on our cash flow position and balance sheet after the plantation sale to MEAG is completed.

Our trading conditions - woodfibre demand and supply. A frustrating aspect of the Company's performance this year for me was the fact that production constraints have prevented us from taking full advantage of the return of strong market demand in the second half. While the Japanese market is relatively mature with minimal growth, the Chinese market has seen a structural increase in demand with new virgin fibre pulp mill capacity coming online in the first half of 2022. On my recent visit to our Japanese customers, it was apparent that they are feeling the impact of the tight supply and stronger demand environment. Low-cost acacia supply from Vietnam also appears to be more constrained on woodfibre and pulp paper pricing. As usual, the Australian wood chip industry confirmed annual pricing with the Japanese market in early calendar year 2022. This year the global wood chip market dramatically improved after the annual pricing was set and costs rapidly escalated. This meant Australian exporters were not able to benefit from improved trading conditions in the second half. Vietnamese Acacia CIF export prices have experienced an increase around 30%. And it's reported that more recent FOB prices have seen increases closer to 50%. All Australian hardwood woodfibre stock is sold out until the end of calendar year 2022. Global industry expert RISI has forecast a tighter wood fibre market as further new capacity comes on the stream with higher wood fibre prices for export expected for calendar year 2023.

Now looking at the business initiatives that are designed to improve performance. One of the most important business initiatives was the decision to sell our Victorian plantation estate to MEAG. The sale of the Victorian plantation estate and trees is important because it will provide Midway with the plantation management income and long-term offtake agreement for woodfibre and Southwest Victoria. It will simplify the Midway balance sheet by removing the plantation land and trees from the asset register, removing the revaluation volatility from the annual financial accounts. It will enable the reduction of corporate debt, repayment of the Strategy finance liability, and return of capital to investors, and it will provide Midway with a platform to become a leading plantation carbon manager.

Another important project is the completion of the Bell Bay processing and export facility. The first stage on berth seven is complete. And the second stage, the processing and storage site at Norfolk Street, is due for commissioning in September this year. The first soft wood export vessel was shipped from Bell Bay in July and further soft wood vessels are confirmed for calendar years, '22 and '23. The new site gives Midway the ability to segregate woodfibre and allows us to earn a premium for sustainability certification on regrowth hardwood thinnings. Also of great importance to Midway is the proposed grain terminal at Geelong, which is progressing well with planning and design work well underway. We are working through state and local government development approvals.

Our carbon strategy. The forecast for the surge in global demand for carbon offset credits to meet net zero commitments by 2050, present an enormous opportunity for Midway. There is currently limited supply of high quality forestry plantation projects to generate carbon credits. The commitment to further planting by MEAG demonstrates that global fund managers are keen to invest in sustainable plantation forestry assets in Australia. Midway is at the leading edge in the Australian market, contributing to the regulatory framework, including having input to the CSIRO and clean energy regulators processes.

Now looking at Midway's competitive advantage in carbon management. Midway's business model of forming partnerships, establishing and managing plantations, and generating a commercial return from those plantations is the same process that generates plantation carbon credits. We are at the table with large international investors as they look to participate in the carbon offset industry. And we are at the table with local landowners as they consider how they can participate in the generation of carbon sequestering projects. Providing carbon credit management, usually also secures supplier for the underlying woodfibre business. Under the new plantation forestry carbon rules, replanting now qualifies for carbon credits. This rule is essential for the retention of current plantation areas and enables us to harvest the plantation and generate new credits on replanting. This becomes a virtuous cycle of growth for Midway. The regulatory and execution complexity of the carbon credit registration management process, and the need for an industry presence with feet on the ground, fortifies Midway's position in this field.

There are a few companies in Australia with the ability to work across the whole forestry plantation supply chain, with investors and growers, in the way Midway can. This is an organic expansion of our business that can be transformational for the company.

Moving to the carbon revenue models that we are working on. This is a new and rapidly changing environment. We've identified three complimentary business models immediately ready for pursuing. Firstly, as carbon rights owner, we can generate, own, and trade Australian Carbon Credit Units, or ACCUs. The Tiwi Islands is an example of where we can work with indigenous owners to generate and share carbon credits when we replant as part of a second rotation. Secondly, as a plantation aggregator, we can manage plantations on behalf of small land-owners and share carbon credits at an agreed rate. Our work in Tasmania shows that there is very compelling opportunity that has not been fully tapped yet.

And thirdly, as a carbon manager, we can manage carbon assets on behalf of others. The MEAG transaction is an example of how we can do this with global investors, looking for local industry experts to manage projects for them. These projects provide benefits for Midway, including greater economies of scale. Importantly, these business models are capital light and do not require Midway to own large tracts of land.

Now, the outlook on the key factors that will drive performance in FY23. We expect stronger export pricing and a more favourable exchange rate in the second half of FY23 to benefit the business. However, lingering COVID 19 supply chain disruptions persist and will impact volumes in the first half of FY23. And we expect continued margin pressure in fuel and labour markets in the first half. It is too early to say what the net impact of these factors will be across the whole financial year. We will provide an update on business and trading conditions at the Annual General Meeting on 30 November. However, we remain confident that once supply chain disruption eases, Midway will be well placed to take advantage of strong demand and higher woodfibre prices in calendar 2023. We will continue the next phase of the strategic review to consider the future growth opportunities in carbon and adjacent markets and to consider the natural ownership structure of the business. All options remain on the table, as far as I'm concerned.

Despite the unsatisfactory financial performance in FY22, I'm convinced that the Company's operating financial performance can be turned around and that Midway can be repositioned to capitalize on the opportunity presented by rapidly growing demand for carbon emission offsets. My management team and I are very focused on generating improved shareholder returns. Michael and I are now happy to take questions through the Q and A box.

RH: First question, Tony. Is there any update on who will be the joint venture partner or lessee of the Geelong Grain Terminal Project?

TM: Thank you. At this stage, that remains confidential information, but we are making good progress in discussions. There are some negotiations that still need to be worked through, but there's a lot of work happening behind the scenes.

RH: No other questions at this stage. We'll just wait for a moment. Participants can ask questions through the Q and A box on the top of the Zoom screen. Charlie Kingston's asked a question. At current spot and wood chip prices, how profitable would you be?

TM: That's a speculative question that we probably shouldn't be going to answer. I won't answer that one.

RH: Another question from Charlie Kingston. What is the FX hedging policy going forward?

TM: Our FX hedging policy remains as it has been, with a level of cover that scales as we go into the future, we are averaging our position down, obviously with the better FX rates now, and we will continue to remain fully covered to the level that our policy allows. We won't be going to extend that position at the moment, but we're constantly monitoring our FX position.

RH: Charlie's on fire today. Is Bell Bay fully funded now, so of the major projects, only Geelong is pending?

MM: Yes. From a capital perspective, in FY23, there's about four to five million to be spent in the early part of the year, just before commissioning in September, October. From our perspective, fully funded with a combination of bank debt and what we've already spent. And then the only other major capital initiative at the moment is obviously the grain project.

RH: Simon Conn has asked a question. Have you seen your competitive position change through this period? Have any competitors disappeared? How have they coped with the increased cost you have witnessed?

TM: Talking to our competitors, none have disappeared because the nature of the industry is very long-term, but we do know that they are suffering very similar pressures to us. We're all experiencing the impacts of high fuel costs. We're all experiencing the impacts of labour shortages, truck drivers' availability, those sort of things are putting pressure on. And as I said, we are very frustrated, and this is industry-wide, not to be able to deliver more volume into the strong, buoyant markets at the moment.

RH: Another question is coming, two questions. The first is, is there any timeframes around when the Grain terminal project may process?

TM: That's a fair question. There are multiple parties involved to finalise this and we aren't able to put a timeline on it. We are moving as quickly as we can and I'd like to be making announcements, but we're not at that stage yet. We will be making announcements in due course, hopefully.

RH: Second question from Charlie Kingston. Once corporate debt is repaid, what is the working capital required by the business? How much cash will you need to retain to fund the business?

MM: Well, again, Charlie, at any point in time, it depends on the cycle. But as we know, a vessel proceeds six to eight million in cash coming in, so we need to build stock for that vessel. Our working capital facility will reduce to 15 million from the 31st of December or when the MEAG deal settles. Once we repay the debt, we'll need to maintain a level of working capital to support inventory build. Across the business, we would like to have a couple of vessels in stock, so that could be between 10 and 15 million just to cover working capital from an inventory build perspective.

RH: A question from Richard Wilkins. How much do you estimate the carbon credit part of the business to be worth, and when is this likely to occur?

TM: It's a really good question. The carbon side of the business is, as I said, it's a new and emerging industry. It's fast-growing. It's exciting in that way, but there's also a lot of uncertainty. What is certain is that we are lead players in the actions and activities that generate ACCUs through plantation forestry, and it will be an increasingly important part of the business. Quantifying an emerging industry is really difficult, but you can look at the projections for both the number of ACCUs that are required and the value of those ACCUs. One thing certain is that the importance of parties who can generate ACCUs for all these companies and countries that are looking to offset their emissions, I think puts us in a very good place.

RH: Question from Anthony Bak. Are there any opportunities to replace the lost Eastern European supply of wood pellets to European and Asian markets due to the Ukrainian war in associated sanctions on Russia with our wood chips?

TM: Not directly, but we are seeing knock-on effects as demand for, for example, biomass out of Japan is increasing, and we probably will see the same out of China. So while there's not a direct opportunity to replace that supply because of freight costs and other issues, that is creating additional demand for other products. The demand for Vietnam wood chips, which was a major source of supply for biomass plants in Japan, for example, and it is just getting more competitive for that, which is pushing up the wood chip price.

RH: Just pause for further questions. Another question from Simon Conn. Has there been any progress with bringing in other sources of wood chip storage at Geelong? I understand there is another operator in the area whose volume could go through Midway’s Geelong terminal.

TM: We have had some discussions on that, but to date, there's been no significant progress. There's some history to be worked through, but it makes good commercial sense, but there's some work to be done before we make some real meaningful progress on that.

RH: Just waiting for further questions. Two more questions. The first is from Richard Wilkins. When do you think the business will be profitable again? Record revenue last year, but no profit.

TM: Thank you, Richard. I'd be disappointed if we're not profitable this current financial year that we're going into, but with all this, everything that we've seen happening globally and within our industry, it's very hard to make any projections or predictions that way.

RH: Another question from Charlie Kingston. What are the capex requirements of the carbon opportunity? Appreciate there are multiple ways this could play out, but what is your preferred way to invest in the opportunity and required funding?

TM: Yes. Good question. Thank you, Charlie. Around that aggregation model, there is limited capital required, although if there's capital available to invest in owning trees alongside landowners, that would increase our ability to grow that business. Obviously in the management model, there's minimal capex required at all for managing MEAG. We have the infrastructure in place, so there's no further investment required for that. The option where we, for example, the project in the Tiwis on the second rotation, there would be capital required to own the trees and lease the land and to establish those projects.

And while it's my personal preference that we could find a way to do it, because I think it will present some very attractive opportunities, I think we need to have a look at the risk return that provides and whether that's the optimal use of whether Midway as a company stands today as the natural owner of those trees. So we are still to work through that and just thinking about it from who is the natural owner of those trees, but the main thing from Midway's point of view is that we are at the table and part of the project and capturing value for being able to establish and manage those projects.

RH: Richard Wilkins has asked another question. Are you able to give an update on the progress of the FIRB approval for the plantation assets?

TM: Yes. Thank you, Richard. The FIRB has come back to us a number of times requesting extensions for their consideration. We have seen draft conditions, which is a very good sign. Those conditions are, there's nothing objectionable in those. There's still some process to work through internally within the FIRB, and then the process goes to the treasurer. Things going well, we should hear from them by the end of this month.

We've seen that they've extended probably three times now. So I can't be certain about timing, but feel very confident that we'll get there and expect to hear hopefully this month.

RH: Thank you. Another question from Simon Conn. Have you had any discussions with other asset owners about managing their plantations? Does the MEAG deal allow Midway to manage assets for other parties?

TM: Thank you, Simon. Our priority would be to try and establish and manage new plantations. At the moment most of the plantations, the scale plantations have managers attached to them, but what we're seeing is a transition from the TIMO with the fund management model, and we're seeing that shift more to a direct investment, working with industry players like Midway.

So MEAG describe themselves as being one of the early investors in the TIMO model, along into those assets, and we now see them investing directly with an industry player. We expect to see more and more of that, and we definitely are open to it, but it's more likely to be for establishing new plantations rather than existing ones.

RH: Carl Kingston's asked a question. When do you think you'll be able to deploy the additional $200 million from MEAG, and when will Midway begin receiving revenue from this?

TM: Thanks, Charlie. We will be looking to start deploying that as soon as contracts are signed. We've had people working on it around identifying suitable properties and doing preliminary work. It will take a little bit of time to start seeing that come out and to be invested over a course of five years. So we expect the first year startup will probably be a bit slower than subsequent years, but we're definitely working on that and that progress is being made in that way. So far as when will we start seeing revenue, that comes from when we first start establishing plantations and make those acquisitions.

RH: Anthony Bak has asked a question. Does the FIRB approval include the planned $200 million of investment, or will each acquisition require separate approval?

TM: Great question. Thank you, Anthony. It will include a certificate of exemption for future purchases and that's why it's taken longer than it would've normally. To not have that certificate of exemption would've made it significantly harder for us to acquire land and that's been an important part of the process, but it has made things take longer and delayed settlement and the commencement of the project. But yes, that's the way the FIRB approval will work.

RH: Charlie Kingston's got another question. How much of the loss this year was due to Geelong?

TM: Geelong hasn't made a loss, but it hasn't made the returns that it has in the past, and that's been a drag on the business and that's significantly around having volumes going through. But Geelong's not a loss-making asset as it stands. It's not a loss-making part of the business.

RH: Just waiting for further questions. Charlie Kingston again. Do you have a mid-cycle EBITDA margin target?

TM: No, we don't. And to commit ourselves to something like that I think would be, as I said before, foolish in the environment that we're currently experiencing that we've experienced in the past.

RH: Charlie Kingston: Are you focusing on the voluntary or regulated carbon markets?

TM: We're focusing on the regulated carbon markets and we're doing that because there's a higher value attributed to it and because the type of carbon credits that we generate attract that higher value. So that's the commercially optimal place for us to be playing. It plays to our strengths as high-quality carbon offsets.

RH: Waiting for further questions. No further questions then we might draw the conference to a close. Thank you very much.

TM: Thank you everyone for your interest. We really appreciate your interest in the company, and as I said, we're completely committed to turning around this performance, turning around the financial operating performance, but also repositioning the company for growth in an emerging market that sits so closely to what we're doing, and I think it presents a great opportunity for us as a business and hopefully will present great opportunities to you shareholders. Thank you for your time.

The conference can be viewed at:

https://www.youtube.com/watch?v=CLiPncX_CR8

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

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About Midway Limited

Midway Limited is a leading Australian plantation management and woodfibre export company with headquarters in Geelong. Midway was founded in 1980 and is now primarily involved in plantation management and the production, processing and export of high-quality wood fibre to producers of pulp, paper and associated products in the Asian region. Midway owns 100% of Midway Tasmania, based at Bell Bay and Plantation Management Partners (PMP), based on Melville Island. Midway also has majority shareholdings in South West Fibre Pty Ltd (SWF) based in the Green Triangle and Queensland Commodity Exports Pty Ltd (QCE) based in Brisbane. Midway is also building a carbon management portfolio based on forestry plantations. For further information, visit www.midwaylimited.com.au.