

MIDWAY LIMITED (ASX: MWY)

24 February 2023

Investor Conference Transcript (23 February 2023)

Speakers:

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

TM: Good afternoon and thank you for joining the Midway First Half 2023 Results Webcast. I'm Tony McKenna, CEO and Managing Director Midway and I'm here with Michael McKenzie, the Group CFO.

I'll give you a brief rundown of the key points from the investor pack that was lodged with the ASX earlier today, and then Michael and I will be very happy to answer any questions via the chat box. So, if we switch over to the presentation now?

The results show the early stages of Midway turnaround. The good top line numbers, with revenue up 18%, are based on positive contributions from all business units, with the exception of Tasmania. It's also very pleasing to achieve a breakeven EBITDA-S result in an environment of rising supply costs and lower bone-dry component. The successful sale of the Victorian plantation estate to MEAG was a highlight of the first half.

The \$12.3 million book profit on the sale of the plantation estate drove the positive NPAT outcome. It has also enabled Midway to repay \$21.7 million, eliminating all long-term debt. Net tangible assets have also further strengthened to a \$1.51 per share. Despite these positive numbers, operating cash flow remained negative in the first half of FY23 due to high operating costs including fuel, labour, and wood supply, and a networking capital build from June 22 of \$8.3 million.

The board has adopted a prudent approach to capital management and deferred consideration of the intended fully franked special dividend of 19.5 cents per share at this time. The board will revisit its decision on dividends at the end of FY23. It remains the company's intention to pay shareholders this special dividend.

The board believes that ensuring the availability of working capital is one of the levers that is in its control. In the current global economic circumstances, the timing of vessels can change, with big impacts on the company's working capital requirements.

Inventory may need to be held longer to deliver into increased orders. Having been through periods of limited demand, and then supply production limitations, it is essential that production and sales aren't constrained by working capital limitations as we move into more favourable conditions.

Now, to the key drivers of the result. The major contributions to growth came from improved volume and price across the business, and a better FX position. Customer demand was stronger than the previous corresponding period, and Midway is confident of significantly improving pricing for the calendar year '23.

I'm particularly pleased that the Tiwis, South West Fibre, Queensland and Geelong all recorded positive business unit EBITDA-S contributions. Midway Tasmania had a challenging first half, with significant wet weather hampering harvest and haul operations, and managing the commissioning of the new mill at Bell Bay.

In December we used the last of the out-of-the-money FX hedges at 75 cents, and now move into a more favourable FX hedging position. Unfortunately, some external headwinds continue to drag on EBITDA. Supply costs increased significantly in the half. Midway was required to pay suppliers higher wood fibre prices, passing through part of the wood chip price uplift.

An ongoing COVID supply chain disruption and the war in Ukraine increased labour and fuel costs. The other major external factor affecting Midway results was the wet weather caused by the prolonged La Niña weather. Particularly in Tasmania, the wet weather resulted in interruptions to harvest operations and a lower bone-dry factor.

To the first half. Other key drivers. The graphs in this slide show that headwinds that impacted operating margins in the first half of 2023, a lower bone-dry factor and higher costs from fuel and labour. The outlook on these supply costs are that fuel is expected to remain stable, and labour costs are set to remain high in this inflationary environment.

Management will, of course, continue to actively manage these factors to minimize the impact on EBITDA and cash flow. The Bureau of Meteorology has forecast that weather patterns will trend away from wetter La Niña conditions towards drier El Niño conditions over the course of calendar year '24. Drier El Niño weather conditions will contribute towards a higher bone-dry component on the PCP.

Now, a look at the trading outlook. The first half '23 results shows early signs of the turnaround in Midway's operating performance. The global wood fibre market is strong, and we expect to see higher volumes and prices on a PCP basis in the second half of '23. Midway has supply agreements for all its expected hardwood fibre production for this calendar year.

We expect negotiations will soon be finalized for the benchmark E Globulus price for calendar year '23 at around US\$200 per bone-dry metric ton, a US\$20 increase on the PCP. We've already seen a \$25 increase in the eucalyptus Nitens price, and a US\$23 price increase in the North American softwood benchmark price. The strong growth in demand from China saw growth in exports from Australia, but supply chain constraints caused Australia to lose market share.

Customers continue to buy a range of wood fibre products from Midway for the China market, including regrowth thinnings from Tasmania. Japan also continues to provide steady demand for higher quality wood fibre from Geelong and Portland. The emergence of Indonesia as a net wood fibre importer is also important. Midway

exported its first wood fibre cargo to Indonesia in early February and is contracted to do more vessels in this calendar year. Industry experts expect that the continued gap between regional supply and demand will underpin wood fibre export prices into the future.

I'll now turn to the capital management and balance sheet. Since the strategic review started in March 2022, the company has been investigating ways to generate total shareholder returns that reflect the underlying value of its assets. A key outcome of that approach was the sale of the Victorian plantation estate to MEAG.

\$97.3 million in upfront sales proceeds has allowed Midway to repay all of our long-term corporate debt, and substantially pay down the expensive "Strategy" financial liability. The elimination of net debt is particularly important in a rising interest rate environment.

Less visible, but nonetheless important, is that the sale of the plantation assets will take biological assets off the balance sheet and remove annual P&L revaluation volatility. It remains the company's intention to pay the special dividend, and the board will consider this at the end of FY23.

A stronger balance sheet. The sale of the Victorian plantation estate has also improved our balance sheet. Midway has a strong current ratio of over two times. Net tangible assets of \$134 million, or a \$1.51 per share, compare with \$124.8 million, or \$1.41 per share, at the end of June 2022. Retaining cash within the business will ensure the company can ramp up production, build and sustain higher inventory levels, and fully exploit sales opportunities in stronger export markets.

Now, onto the company strategy. Over the last 12 months, I was focused on three priorities to generate total shareholder return, reflective of the company's underlying asset value. Firstly, lifting operating performance. Secondly, leveraging our core capability for future growth. And thirdly, maximizing the value of our assets. We are making good progress in each area.

On operating performance, we've seen positive EBITDA-S contributions from all key business units with the exception of Tasmania and our plantation segment. We expect Midway Tasmania to turn around in the second half with much better weather conditions expected and the Bell Bay mill in full operation. The plantation business unit has been repositioned with the sale of the plantation estate to MEAG, and the second half will see it bed down into a new management fee model. We've exited the loss-making Midway Logistics business.

On leveraging for growth, at North Shore Geelong, we're establishing a softwood line, and have progressed with the grain terminal proposal. We've commenced wood fibre shipments from Bell Bay in Tasmania, progressed the second rotation on the Tiwis, and gained a foothold in the carbon management sector. In maximizing the value of our assets, we've sold surplus assets and the Victorian plantation estate all above book value, and we are working on initiatives to add value to our Geelong site.

After 12 months in the job, I'm very clear what needs to be done to create shareholder value, and I'm confident that we're making strong progress. There are three key areas

where I see short and longer-term growth opportunities for Midway. Firstly, we must continue to expand our core business. Wood fibre production and export will remain the engine room of the company for the foreseeable future. Expansion of the Victorian plantation estate and its management, expansion into regrowth thinnings in Tasmania, and the new softwood opportunities, underpin future growth.

Secondly, the proposed grain terminal at North Shore leverages our existing asset base and commodity capabilities. The grain terminal will add value to our property asset and increase utilization of our “take or pay” commitment with GeelongPort. We've made good progress with counterparties on project design and management and with the planning of the site. We're engaged with counterparties and GeelongPort on negotiating commercial terms.

Thirdly, carbon management is a natural complement to the Midway value chain. We are very well-placed to be leading generators of high-quality carbon emission offsets, creating ACCUs for global and domestic investors in the next 10 to 20 years.

Midway's strategies aligned with some fundamental growth strengths. Firstly, the ongoing regional deficit in the supply and demand balance for wood fibre. China's demand has structurally increased with new emerging fibre mills in operation. More mills are under development. We are also seeing signs of biomass demand tightening the supply demand balance for wood fibre. This places Midway in the box seat to leverage wood fibre supply and demand.

Secondly, the global push for net-zero emissions by 2050 will drive increased demand for carbon offsets. As I've said, Midway is ideally placed to be a large-scale generator of high-quality Australian carbon credit units. The Labor Government's proposed legislation for the safeguard mechanism is expected to heighten demand for offsets.

Midway has three scale projects underway to leverage its core capabilities and capitalize on this market. The Tasmanian carbon aggregation project, the Victorian plantation and carbon management and the Tiwi second rotation are all progressing well. Midway is building a strong presence in the carbon offsets market and securing future revenue streams for the company.

In summary, these results show that the Midway turnaround is gaining traction. Trading conditions are stronger and will drive improved financial performance. We have clear strategic priorities, aligned with favourable macro trends, and we will continue to focus on maximizing shareholder returns. We understand that some shareholders will be disappointed that we have not declared the intended fully franked special dividend at this time.

However, I believe it's a prudent approach to capital management, and it will ensure that we are able to confidently build inventory to deliver into our supplier agreements without being vulnerable to working capital constraints in the event of customer vessel delays. I'm confident that our revenue, operating cash position and earnings will improve in calendar year '23, on the back of higher export prices volumes and a better FX position.

Midway will also receive the next tranche of the MEAG sale proceeds in September this year, and the final tranche of the sale proceeds around September 2025. I'll now turn to questions via the checkbox.

RH: That's Q&A.

TM: The Q&A box in the Zoom screen.

RH: Thanks. We've got several questions. The first from Chris Honig. "How will Midway qualify for ACCUs through its operations such as the Tiwi Islands, how many ACCUs are anticipated? Can Midway distribute ACCUs to shareholders as dividends?"

TM: So, there are four ways that you can earn plantation ACCUs across four different schedules. The two that we are focusing on are Schedule 2, which is a short rotation to long rotation, and Schedule 3, which is a retention of a plantation operation where it wouldn't otherwise occur. We are doing some Schedule 1, which is greenfields to plantations. So, through those three methods, the government regulator calculates ACCUs that have accrued for a particular activity.

We go through the process of registering and earn the ACCUs either for ourselves or for our clients or a combination of both. Can we distribute ACCUs to investors? That's something that we don't have the capability or desire to do. It would overly complicate things, but what we are working on is building revenue streams from managing the process of managing ACCUs, from earning a share of ACCUs ourselves, and for developing projects where ACCUs make the project economics work to support new plantations going in.

RH: There's a follow-up question from Chris Honig. "For MEAG, where will the new One Estate be located, and what pricing is provided for tender under this strategy?"

TM: The new One Estate? I'm not exactly sure. Oh, yes, sorry, I'm just reading it on the screen. Yes, so for MEAG, we are looking in the Otways and Heytesbury regions. We have made an offer and settled our first acquisition, around \$5 million invested in that. We have two other properties that we have MEAG's approval to submit offers on, and a number of others in the pipeline there, as I said, in the Otways and Heytesbury regions that will naturally feed into the Geelong site.

RH: Final question from Chris Honig, the \$200 million investment, I think the question is, where and when will that occur?

TM: Yes. So, as I was saying, we've already settled on the first \$5 million of that. Over the next five years, we'll be looking to invest that as the opportunities present, but we have a good pipeline, and we're working through the process with offers out at the moment.

RH: And the next question's from Campbell Morgan. "Can you please detail how much hedging at 75 cents cost you in one 1H23?"

TM: Michael?

MM: I can take that. So, thanks for that question, Campbell. As we know, that was a long-standing position that was taken out nearly two years ago when the forecast FX

was going up to 80 cents. Unfortunately, the average was 67 cents over the period, so it ended up costing us between \$10 or \$11 million to the bottom line, at our current estimates.

RH: Next question comes from Robert Thomson. "What are you paying, approximately, per ton at the farm gate for uncontracted supply?"

TM: So, that varies across our different products, our different sites, mill gate prices. And mill gate prices are also confidential information because we've got a range of suppliers and a range of different arrangements.

RH: Question from David Zhou. "In your view, how much further can Vietnam increase their capacity?"

TM: That's a really good question. We don't have a definitive answer. There's competing land uses. Each year we think that they're reaching maximum production. Over the last year we saw a big increase in what was harvested and exported because the prices were very strong. It remains to be seen how much of that... I was in Vietnam around the middle of last year and saw their cutting trees younger and younger. So, that'll be eating into the maturity profile of the Vietnamese crop. But all that area will have been replanted and will be coming back through.

RH: There's several questions from Charlie Kingston and Anthony Bak. I'll take Charlie's questions first. The first question is to you, Tony. Charlie says, "You spoke a lot about realizing shareholder value, yet the only way shareholders can access is through the share price after today's sell offer is chronically below NTA and IPO prices. How do you intend on fixing that? Are you still investigating the natural owner of Midway? Clearly, the rest of the market is fed up."

TM: Some fair points in that. We are particularly aware of the gap between NTA and our market capitalization, and it's something that we are constantly conscious of. Yes, we're always open to thinking about the natural ownership. It's part of the way I think about things inherently.

To increase the share price, we have to get the earnings up, we have to be executing on the growth opportunities, and then we need to be thinking about the other initiatives, which I have included today, sale of assets that the market doesn't appear to be appreciating the value of, and obviously it's an ongoing exercise.

RH: The second question from Charlie. "Can you explain how Midway's leveraged to increase prices given some shared with suppliers and other costs remain elevated, putting all else equal, including FX, will Midway finally make an operating profit this year?"

TM: We believe so. Everything is lining up, as I said in the talking points. We do have better prices and we are very confident. We have contracts for volume, the FX rate will be more favourable than what we've had last year, and there's a number of other factors that are working that say, absolutely, we should be profitable for the second half.

RH: Now, Charlie's got three quick questions. "Can you explain the revenue model of MEAG? Do you get paid a percentage of funds on your management performance fees, et cetera?"

TM: Yes. So, with MEAG it's a fee per hectare. There's an establishment fee, which is a higher fee, on establishing new plantations in the greenfield, and then there's the ongoing management fee that applies across the brown and greenfield sites. Yes, there is a small component of it which is leveraged to what we can do with carbon in the existing plantation, but primarily it's a fee-for-service across hectares.

RH: Another question from Charlie, "Can you elaborate on the delay in the Geelong grain terminal?"

TM: I'm a bit limited in what I can say, but we are talking to counterparties who are very credible, but we need to have a three-way agreement between ourselves, them, and GeelongPort. GeelongPort have been a bit delayed and distracted with their sales process, but we've had some constructive re-engagement just recently, and we are expecting some progress on planning as well in the coming weeks.

RH: Last one from Charlie Kingston at the moment. "Can you guarantee that you'll pursue no further growth capex until you've paid the dividend?"

TM: Not my position to make any guarantees on dividends. That's a decision for the board. We don't, at this stage, envisage any major capex projects. There are some small capex projects in line with what we normally spend in a normal year. The softwood project a little bit, there may be some required upfront on the grain that we've flagged previously, depending exactly on how that is structured.

RH: We've got three questions from Anthony Bak. The first one covers the grain terminal discussions, which I think you've covered off with your response to Charlie's question. The second one was, how much revenue did Midway generate from carbon management in the first half?

TM: So, for the first half it was limited to the fees that MEAG are paying, which had only just started flowing, for the management of their estate that we've sold to them, and we're building the business model in Tasmania and the Tiwis. Still early stages in the revenue model.

RH: Last question from Anthony at this stage, can you outline what the \$12 million in borrowing in the half was used for?

MM: Yes, I can take that question. So, that \$12 million is really part of our working capital funding. So, as you can see, we had a working capital build of \$8 million to December, which is included in the operating loss. So, some of that is funded by our working capital facility, which was drawn down by \$13 million at December. So, our net debt position, excluding AASB16 liabilities, was \$12 million cash surplus, which is positive.

So, some of that working capital was receivables, round about \$13, \$14 million receivables that was realized early in January. So, at the end of January we were actually in a net cash position of \$24 million. So, really, it was useful working capital.

RH: Just a follow-up question from Robert Thomson about the timber at farm gate, supply price. He's asking, "What has been the approximate percentage increase in farm gate supply price over the last twelve months?"

MM: So, I can probably take that one. In the last half versus the previous corresponding period, on average, some of our timber prices might have gone up \$10 to \$15 per GMT. That is made up of a number of components, 50% might be stumpage, which is linked to price. The remaining 50% is really fuel, CPI, and labour increases. And that hurt the margins for the half as we flagged.

But going forward, as we're flagged, we expect some of the key drivers of the business to turn around so that that's what will improve the performance of the business.

RH: Follow up question from Campbell Morgan. "Thanks for the previous response. So, based on your reported results, your underlying EBITDA ex hedging in the half was around \$11 million. Is it reasonable to assume this is the basis for the second half prior to the implementation of the \$20 per ton wood chip price increase?"

MM: Thanks, Campbell. I don't want to pre-empt exactly what our results are going to be, but obviously, if we go through the key drivers of the business, volume, we expect to be slightly favourable, price we expect to be favourable, FX, we expect to be favourable, as we're flagged, and bone-dry, we also expect to be favourable. So, as we're flagged, we expect a better second half. We're not going to give the exact guidance on what we expect, but all I can say is that the four key drivers of the business are looking favourable in the second half.

RH: Question from Craig McGrath, which is probably another one for you, Michael. "I believe your receivables increased significantly. Why? Is there any significant credit risk?"

MM: Thanks for the question, Craig. The short answer is no. So, there's two things in the receivables. One is the MEAG deal. So, we've got tranche four and five settling in September '23 and September '24. So a large portion of the receivables on the balance sheet are linked to a contract with MEAG, just pending settlement of the final two tranches.

Then, we also have some trade receivables which increased up to \$14 or \$15 mil on the balance sheet. That's low credit risk on the basis that all our vessels, particularly from China, are linked with LCs, so the credit risk is lower, received in January '23.

RH: Question from Emma Alsop about the grain terminal project, but this relates to the question, is there a timeline for the project?

TM: It's a fair question. I'm very keen to get it done as soon as possible, but it will take the time that it takes to bring the multiple parties together to plan on an agreed position.

RH: Emma has also asked whether you can give some details about the expected scope of the grain project, for example, amount of grain stored?

TM: Again, at this stage, that's confidential information that we're working with our partners.

RH: Just scrolling down the list of remaining questions. Anthony Bak has asked, "What is the status of the second rotation in the Tiwi Islands?"

TM: Yes. So, we are working on the structuring of that. There's a couple of opportunities that have presented themselves that we are pursuing that could be very interesting for the company. We have initial engagement with the Tiwi people around the consultation for that second rotation. We've had the Chairman of the Tiwi Land Council and the Chairman of the Tiwi Plantation Corporation down in Geelong, and we've spent some time with them last week. And one of our project staff is up there at the moment working with them on some consultation and around the structure so that we pursue the project through.

RH: Charlie Kingston's got a further follow-up question around dividends, and he's asking what your preference is to pay a dividend before any growth happens.

TM: It would depend on the project. Absent a really compelling project, then it's certainly obvious that the right way to go is to pay shareholders dividends, but were there a really compelling project, then that's something that the board and management would have to consider.

RH: Thanks. I'm just waiting to see whether we get any further questions. No further questions at this stage, so I think that completes the Q&A session. Tony, is there anything else you want to conclude on?

TM: No, other than to thank you all for your attendance and attention. I understand it's a busy day in the market, and appreciate your interest in the company, and hopefully look forward to your support going forward and delivering you some results that really do create some shareholder value. Thank you.

RH: Thank you very much.

The conference can be viewed at:

<https://www.youtube.com/watch?v=VKUFtK6iJK0>

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 woodfibre 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.