MIDWAY LIMITED
ABN 44 005 616 044
10 The Esplanade, North Shore VIC 3214
T +61 3 5277 9255
www.midwaylimited.com.au

MIDWAY LIMITED (ASX: MWY)

25 August 2023

Investor Conference Transcript (24 August 2023)

Speakers:

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

TM: Good afternoon. I'm Tony McKenna, CEO and Managing Director of Midway Limited, and I'm joined here today by Michael McKenzie, our Chief Financial Officer. I appreciate your attendance for our FY23 Results Presentation. I'll quickly run you through our agenda for today.

I'll start by running through what I see as the key highlights of the FY23 Result. I'll update you on important developments in the Midway growth strategy. I'll then hand it over to Michael to discuss the FY23 financial results. Then I'll come back to discuss the operating environment and outlook. We'd be pleased to take questions through the Q&A box at the end of the presentation.

The FY23 Results announcements show an underlying performance improvement. This is demonstrated by the $4.7 million turnaround in underlying EBITDA for the pcp, our strong balance sheet, including low net debt and solid current asset ratio and our progress on key projects to maximize shareholder value. I'll now turn to the key highlights.

I'm pleased to report that Midway is making steady progress on key elements of our strategic plan and the turnaround in performance is beginning to show results. Unfortunately, the sudden downturn in the global pulp market in the second half of FY23 has masked the full extent of the underlying improvement in Midway's performance. But after 18 months, as Managing Director, I remain very confident that Midway's turnaround will gather momentum, as strategic initiatives grow in traction and as the market recovers.

We're also seeing increasing new opportunities to grow revenue and earnings in emerging market segments such as carbon management. As noted in the results announcement this morning, the Board of Directors has not declared a dividend at this time. The highest priority is to ensure that the company has sufficient funds to support its business plan and operations. We do appreciate shareholders' desire for a dividend and the Board will consider a return to dividend payments as soon as trading conditions and operating cashflow have improved. I'll now turn to our strategy.

Midway was founded in 1980 in an active collaboration and creativity to find a valuable market for sawmill waste product. The company is now one of Australia's largest woodfibre processors and exporters, with operations in five regions around Australia. Our fibre goes into growing segments like plastic replacement and recycled packaging, hygiene products and bioenergy generation replacing coal, as well as traditional printing paper.

We have a strong and growing plantation carbon management business that has the potential to transform our company. In 2022, we undertook a strategic review to determine how we could improve our core woodfibre business, maximize the value of our assets, and develop new earnings strengths. We subsequently developed a strategy built on three key pillars.

The three key pillars of Midway strategy are: improving operating performance, leveraging our capabilities, and maximizing the value of assets and positioning Midway to exploit emerging carbon market opportunities. The overriding objective of this strategy is to maximize shareholder returns over time.

Now, let's look at the progress we've made in each of these pillars. The first pillar is to improve operating performance. We had a quick win in closing down the loss-making business Midway Logistics in Western Australia in 2022. The management team also worked hard on remedial strategies to improve performance at each of our key businesses, including increasing access to woodfibre volume through our Geelong site, planning for additional commodities including grain to ship through Geelong, securing additional supply and commencing exports through our newly commissioned site at Bell Bay, minimizing costs and generating biomass sales from the Tiwi Islands and progressing longer term opportunities on the Tiwi Islands through a second rotation plantation and carbon project.

In the plantations and carbon segment, the sale of the plantation estate to MEAG also boosted operating performance by generating revenue from plantation management activities and reducing the holding costs on the Midway P&L. In the longer term, off-take agreements with MEAG will also provide increased timber supply for export through Geelong. This will provide additional value towards our key take-or-pay contract with Geelong Port. While these changes are initially incremental, they will convert the plantation and carbon division from a cost centre into a substantial driver of growth in the longer term.

The second key pillar is to leverage capabilities and maximize asset value. We've considered the natural ownership of our assets and looked at how our core capabilities can be leveraged to improve or grow.

Midway is not the natural asset owner of large tracts of land and trees when compared to investors with much lower cost of capital. We also had a quick win here with the sale of the Victorian plantation assets to MEAG for a 12.5 million profit on the book value. The grain project requires Midway to instigate it and to bring together our assets and the opportunity. However, the ownership of the grain assets and operations probably naturally belong with a third pay.

Our plantation management expertise and growing carbon skills are ripe for leveraging for growth. We are working closely with a range of major companies to help them achieve their carbon emission reduction and offset targets. I'm confident that this will generate new sources of future earnings for Midway. The emerging carbon market presents a most exciting long-term growth pillar for Midway.

The two graphs on this slide clearly show the expected opportunity to generate income from the growth in carbon offset projects between now and 2030. The management team is actively positioning Midway to be a market leading player in ACCU generation and carbon abatement.

Midway has secured access to a carbon endorsed AFSL license that will enable us to provide greater value adding services on carbon projects. We are making good progress on our three-pronged carbon strategy of being a plantation owner, such as with the second rotation on Tiwi Islands, managing carbon aggregation projects, which is starting in Tasmania, and managing carbon plantations on behalf of large investors such as MEAG.

This approach will generate incremental income in the short term and is a natural adjacency to our historic business. It has the potential to be transformational for our business in the future. The carbon market is rapidly evolving and our approach is to position Midway at the forefront of the industry so we can capitalize on emerging opportunities. I'll now move on to some of our sustainability activities.

Sustainability and safety have always been important in Midway's business and are key enablers of our overall growth strategy. For example, our safety LTIFR is consistently below industry averages. Our relationship with the Tiwi people is important to us and over the course of 2023, 27% of our staff on the Tiwi project were Tiwi people. Midway products contribute to bioeconomy initiatives such as replacement of plastic packaging and the growth in bioenergy production.

We'll continue to expand sustainability initiatives as part of our growth strategy in the next few years. FSC and PEFC sustainability certifications are an important third-party endorsement of the way we conduct our business. The certifications help us to achieve better pricing on some products and to access a broader market.

I'll now hand over to Michael to walk you through the key points of our FY23 financial performance.

MM: Thank you, Tony. The key points for me on this slide are lower headline sales revenue due to lower than expected sales to China in the second half of the year, a higher gross margin of 11% due to higher export sales, a higher profit contribution of $2.4 million in FY23 from South West Fibre to the Midway result on the back of increased export volumes to Japan, a $12.5 million book profit on the sale of the Victorian plantation assets to MEAG maximizing the value of those assets for shareholders.

Unfortunately, the downturn in Chinese sales meant we were required to provide $7.8 million for aged receivables held by PMP on the Tiwi Islands. The net result was a statutory EBITDA of $7.5 million, a $3.7 million improvement on last year. I will now turn to the key drivers of this result.

The starting point for the year was an uplift of $2.9 million as Midway Logistics was closed. It didn't negatively impact on FY23 earnings. Other positive contributions included high prices on export sales in the second half with average prices across all products being USD178 per bone dry metric ton versus USD159 in the prior corresponding period, an improved FX position after previous hedging losses were exited, and the $2.4 million South West Fibre profit contribution.

Although this cannot be seen on this chart, QCE in Brisbane also made a solid contribution to earnings in FY23. Offsetting factors included higher supplier costs, comprising higher timber payments to suppliers and higher fuel prices, a lower bone-dry component of exports due to weather, wetter La Nina weather conditions, and product mix with more software shipped out of Midway Tasmania, lower export volumes from Geelong, Bell Bay and the Tiwi Islands in the second half, and a small deterioration in profits at PMP. The management team worked hard to control expenses and reduce our cash outflows once the market downturn became clear by focusing on cost-effective supply sources and reducing production volume. I'll now turn to the balance sheet.

One of the highlights of the FY23 results for me is the way Midway has transformed its balance sheet to a position of strength that not only enabled the company to manage through the second half downturn but provides a platform for future growth. The sale of surplus land, the MEAG transaction combined with prudent capital management enabled Midway to pay off all long-term corporate debt, substantially reduced its legacy Strategy finance liability, and manage an unexpected working capital build.

The key numbers for me are a reduction in debt to only $3.9 million down from $38 million in the prior corresponding period, a $15 million increase in inventory to $35 million highlighting the working capital build, a strong current asset ratio of two times current liabilities, and net tangible assets of $1.43 per share. The sale of plantation assets has also simplified the balance sheet and substantially reduced our exposure to the swings in the value of biologic assets as market prices flow through to the value of trees.

Given our strong balance sheet, Midway is reviewing our financing structures to better manage working capital cycles and to improve our ability to take advantage of the expected recovery in the global pulp and woodfibre market. I'm now looking in more detail at how we use the proceeds from the MEAG transaction.

The Board decision to preserve cash proved to be wise in hindsight as it enabled Midway to pay down debt in a period of high interest rates and manage through the sudden downturn in the China pulp and woodfibre market for the second half.

As you'll see from the waterfall chart, the sale proceeds allowed Midway to repay all long-term debt, substantially reduce the legacy Strategy finance liability, repay the working capital facility and build inventory, purchase $5.1 million worth of pine trees as a part of the MEAG deal, fund a small capital spend and pay tax liabilities. Carrying higher inventories positions Midway well to capitalise on a recovery in the market from a sales and cashflow perspective.

Future cashflows will also be supplemented by outstanding proceeds from the sale of the Victorian plantation assets in the next two financial years as can be seen on the table on screen.

I'll now hand back to Tony to talk through the operating environment and outlook.

TM: Thank you, Michael. These two graphs clearly show market dynamics in FY23. The top chart shows that the Japanese demand for woodfibre was slightly higher in 2023 as they recovered from COVID. This along with a strong pulp price enabled Midway to secure a 10% increase in the headline export price with our Japanese customers in the second half of FY23. However, Chinese demand for woodfibre slumped in 2023 and our export sales were adversely affected, particularly from Geelong, Bell Bay and the Tiwi Islands. New pulp mill capacity came on stream in China at a time when demand was falling, and as a result old stocks rose to more than 2 million tons and customers deferred woodfibre contracts. The volume chart shows the dramatic fall in global pulp prices from April 23 onwards, which was triggered by overproduction and weakening consumer demand causing a rise in pulp stocks.

The pulp price now has stabilised and some price increases are being achieved. We're closely watching for a return to normal pulp stocks to reactivate wood chip demand in 2024. Midway is heavily invested in market analysis to ensure we have the best insights into future market movements through our customer contacts, technology and industry analysts. This will enable us to minimise information lags and move as quickly as possible to manage market downturns and to position ourselves to capitalise on market upswings. While the market remains volatile in the short term, the good news is that the industry analysts continue to predict a woodfibre supply shortage that will underpin export prices in the future. I'll now summarize the key points from today's presentation.

The key takeouts in today's presentation are: Midway is improving underlying performance despite the headwinds of trading conditions in '23, we are seeing results from some important quick wins in closing down the loss-making logistics business and selling our Victorian plantation estate. We have clear remedial plans in place to improve performance in each of our businesses. We are establishing new businesses that will generate incremental earnings over the next few years. These include woodfibre processing and export facility at our new Bell Bay site in Tasmania and a second rotation on the Tiwi Islands. We are leveraging our capabilities and maximizing asset values through projects such as the proposed grain terminal at Geelong, and we are positioning Midway to be a market leading player in an emerging carbon project sector.

Midway is moving forwards. We are making solid progress on our strategy and we are repositioning the business for future growth. I believe that farsighted, patient investors will reap future benefits from this strategy. Thank you.

Michael and I are now happy to take questions from the Q&A box.

RH: Thank you, Tony and Michael. We've got about a dozen questions. I'll start with a question from Anthony Bak. The first question is how do you account for the sudden and significant change in wood chip demand between the investor presentation in February and announcements to the market in April and May? How are you forming an accurate and independent view of demand for Australian wood chips [inaudible] longer term?

TM: Good question. As you'll see, or you would've seen from the slides, the pulp price (and there's also information available on pulp inventories), but the pulp price plummeted. There was additional pulp manufacturing capacity coming online at the same time as demand was dropping off, and that's partly related to the Chinese domestic economy and Chinese exports particularly relevant to our market. That happened very quickly as you could see on the chart, and we are putting in place or have put in place some really good initiatives around other than just following what the independent analysts are doing. We have our own sources of information. We track all the vessels in the wood chip fleet. We monitor inventories at export ports in Vietnam, our major competitors of country, and we also monitor inventory levels at our customers both by aerial vision and site visits.

RH: Thanks, Tony. A follow-up question from Anthony "have the deferred Chinese sales now been completed or if not, have the wood chips subsequently been sold?"

TM: Yes, so we are working through our contracts with our Chinese customers. As Michael said, we've slowed production down to match demand. Now that's caused pressure on our business, but that's what we need to do. If we don't have the demand, we can't keep building inventory both from a funding point of view but also from a physical storage point of view. So there's been a reduction in production. We're just working through vessel by vessel and the customers are performing, but more slowly than we would like.

RH: A related question from Damien Williamson on the market activity. Can you outline the factors you see behind the weaker customer demand in China? In particular, how are customers substituting Midways premium product for cheaper products?

TM: Yes, so there's been some Chinese domestic supply coming into the market that's more than usual as land has been cleared in China for food production. That's a one-off, and so we're seeing that replacing our product a bit, but the Vietnamese exports have dropped right off this year, so we are not seeing a big factor of substitution away from our products, and we do have a range of products from the premium globulus products through to the regrowth thinnings products, mixed and acacia products. So it's really an overall demand story rather than replacement away from our products.

RH: Tony, a separate related question from Charlie Kingston. When do you realistically think you'll clear the $14 million in inventory build that you have at the moment? Do you anticipate you'll make a profit on this and what market are you likely to sell into?

TM: Yes, so absolutely we'll make a profit on the inventory that we're carrying, that's assessed at the end of the year and we carry it at significantly below what we can realise it for. So, to comment on that, we will continue to work with our Chinese customers to have them perform their contractual obligations and we will also continue to work with our Japanese customers for the sale of that.

The timing for moving that inventory through or reducing the inventory back down will depend a lot on the market. In some ways, and I think I've said in previous presentations, carrying inventory is not a bad thing. It means that when the market comes we can quickly respond to that, but there are finite, well, there are constraints on how much inventory we can carry, both physical and financial.

RH: Thanks, Tony. Another question from Charlie Kingston. Can and will Midway reduce reliance on the Chinese to become a more stable business? How much of Midway's current issues are structural market issues?

TM: Obviously, this year we've had a tough time with a couple of Chinese customers. They are very major players in the Asian pulp market and they're customers who will always be part of our program. Longstanding relationships with Japanese partners are still strong and we're obviously building on that and we are seeing growth in their interest in wood chips for bioenergy production going as biomass, which is particularly coming out of the Tiwis and that's one area where we've seen some growth since the downturn in the market.

RH: Thanks, Tony. Anthony Bak and one other shareholder asked about the Indonesian market and what's the potential for India or [inaudible] we need to sell [inaudible] wood chips.

TM: So we still have Indonesia on the radar. Their domestic production appears to have reduced, but they're experiencing the same issues as the Chinese mills with demand constraints, so they're slowing their production down, so there's not a lot of demand coming out of there at the moment. India is a harder market. We've had a look at it, they don't make the sort of prices and volumes that we need to be achieving at this stage, but it's always another option. We continue to look at it, particularly when there's difficulties in China, but it's a global pulp market issue.

RH: Thanks, Tony. Question from Charlie Kingston. On the current trajectory and assuming market conditions hold steady when you make a cash profit in FY24, surely FX at USD 64 cents to the dollar provides a decent boost?

TM: So the FX is certainly helps us. Now we've got positions that we've taken as the currencies come down, so we are not at 64 cents across all our sales, but it certainly does help. Will we make a cash profit? We're not making any forward-looking statements, but that's certainly our plan.

RH: Thanks, Tony. A final question from Charlie Kingston. What level of profitability will enable the board to deliver the intended 19 cent per share dividend for shareholders?

TM: Yes, so that's not a question for me to answer. I mean the Board will look at what's happening with cashflow from the grain business, what demands there are for capital projects that are required and the cashflow coming in from the MEAG sale and other initiatives that we have on and decisions will be made on that basis. But we do understand and do appreciate that investors were disappointed with the way that played out, as are we, and we are very conscious of investors' desire to see dividends resume.

RH: Supplementary question, Tony, from Chris Honig on the dividend. Would Midway consider splitting the dividend to retain cash but still return value to shareholders given that splitting the dividend is good for income tax for shareholders and gives a runway to turn around operations?

TM: Yes, absolutely. Considering all options. Again aware one of the key drivers is looking at how we can return to paying dividends to shareholders as soon as possible and that's certainly one option that we are looking at, and will be high on the agenda as conditions improve.

RH: Question for Michael from Anthony Bak. How much of the $27 million current receivables as at 30 June have been received in this new financial year?

MM: Thanks, Anthony. Of the $27 million, approximately $24 million related to the next tranche of the MEAG sale, which is expected to settle in this first half. So yes, the short answer is there's only three or four million after that, of which some has been received in July/August, but no credit risk on that amount.

RH: Thanks, Michael. Several questions for you, Tony, about ACCUs generally and on the Tiwi Islands. The first question is from Anthony Bak. How many ACCUs does Midway currently hold for clients or own directly or via its carbon management subsidiaries?

TM: So we don't currently carry or only carry a very minimal number of ACCUs. We have signed, well, we've got a number of projects on the go that will generate ACCUs going forward and we'll look at how we manage our position with it. We're going to have to have a look at how we treat things the way things are going at the moment. We'd be looking at selling ACCUs as we receive them rather than carrying them as an asset on the balance sheet, but we're in the process of preparing a policy around how we manage that.

RH: Question from Damien Williamson. Tony, can you outline some examples of projects, that qualify for carbon credits and the potential annual revenue opportunity?

TM: Yes, so the sort of projects that we are looking at, the easiest ones are where there's a greenfield opportunity. We are doing, for example with MEAG in the Otways and Heytsbury area around Geelong, we buy a farm that doesn't have trees on and plant trees and earn carbon credits for the carbon that's sequestered by those trees as they grow. That's the classic one and there are variations around that and we are rolling those out in different models in Tasmania. The Tiwi project is where you have land that's been fallow, hasn't had trees growing on it for seven years, and we establish a plantation on that. So you generate carbon credits that way.

RH: One more question on ACCUs from Chris Honig, not all plantation estate will qualify for ACCUs. Have you looked at other types of international carbon credits that would apply to R2 and the Tiwis establish short rotation plantations? If so, specifically what credits?

TM: No, so our focus has been very much on ACCUs. We think that there is a really strong policy framework around ACCUs and that will help with the value preservation and creation around generating ACCUs. There's the plantation methodology that we were involved in the formation of through the industry body and it suits our business very nicely. So our highest focus is on ACCUs. There are other side activities that can generate credits like CORCs [CO2 Reduction Certificates], those sorts of things which are on our radar, but at the moment, our bread and butter is doing our business and managing the process around registering for ACCUs. We're working very closely with the regulator to make sure that we have is working really well, leading what's happening in the industry.

RH: Thanks, Tony. Another question from Anthony Bak on R2. What's the expected timeframe for completion of agreement between the indigenous [inaudible] to commence?

TM: Yes, so we're working through a process with a good number of major emitters and traders of carbon credits to find a way to finance the project off a forward sale of the ACCUs. This will enable Midway to retain some ownership in a very “capital light” way and it'll also enable the Tiwi people to own a good share of the project.

That process is underway. Once we have really good read on what the market is and what's possible, then we will finalise our agreement with the Tiwi Plantation Corporation and the Tiwi Land Council and the family groups on the Tiwi Islands and we've got a framework of an agreement that's subject to securing the financing.

RH: Thanks, Tony. I've got two questions that cover the same ground about the proposed Geelong grain terminal. One from Anthony Bak, one from Campbell Morgan. Two aspects to it. The first aspect is why is it so complex and why is it taking so long? And the second part of it is how long should we expect to wait for implementation of the main strategy?

TM: Fair question, I’m acutely aware that we've been talking about it for a long time and that I've been talking about it since I've joined the Company. It's important that we get it right. We get one crack at it. We need to get it done as soon as possible, but we have three parties, all with very different needs, different management structures, different ownership and different ways of doing things, and bringing all of that together to an agreement that works for everyone takes time.

We have some momentum at times and then we get stuck on issues. We're confident we'll get there. There's still a fair bit of work to do, but we've got some really good core principles to it in place and we think that we are getting a lot closer timeframe. I was wrong last time I gave a timeframe, so I'm reluctant to do so again, but I can assure you that there's a lot of work going into it to nail it down.

RH: One final question, Tony from Anthony Bak. On timber sourcing, what is the impact of the early cessation of native forest logging in Victoria on Midway's woodfibre supply?

TM: Yeah, it's a really interesting question. It's obviously been front of mind for our Geelong operation here. We historically have had volumes and historically had planned for that to be up to 400,000 tonnes a year of product coming through. Now that was in the past and obviously as things have... It's becoming apparent that it's going to phase down. We'd expected 120,000 tonnes of native to come through this year. It hasn't because the supply got cut off, but it's also created other opportunities where Opal Paper, who in Gippsland have historically consumed plantation hardwood down there.

Now they've closed the line that was using that and we've been working on sourcing that, so it's created other opportunities. It didn't impact our earnings this year because the market wasn't there for the native and it's created an opportunity around plantation hardwood out of Gippsland.

RH: Thanks, Tony. One final question in the Q&A box at this stage from Richard Wilkins about sustainable earnings. It says "Midway made approximately $20 million per year as the first three years as a listed company, but it's struggled in the last four years. What can shareholders reasonably hope for in future years? Is a $20 million profit long gone? Would you consider a $5 million profit a good result?

TM: Yes, so when we think about it on an EBITDA or EBITDA-S basis, and I think $10M to $15M sustainable through or an average through the cycle is what our woodfibre business should generate. The business has changed. The supply of wood coming for Geelong has reduced, but there is potential to sustainable $10M to $15M through the cycle EBITDA-S level and we see that potential to grow a really meaningful business off the back of the carbon opportunity. Granted it's an emerging area, we don't know exactly what it's going to look like, but we do know that we're getting really good interest. We've got projects getting up and going and we think that that gives us a great opportunity to reposition the business.

RH: Thank you, Tony. I don't have any further questions at this stage. I might just wait for 30 seconds to see if anyone wants to chip in a final one before we end the conference call. Okay. It looks like you have answered all the questions being raised as a result of the webcast today, so back to you Tony.

TM: Thank you very much. I'd just like to close by thanking everyone for their interest in the Company. To reiterate, I think we're making some good progress. I know that it doesn't stand out in the results and we're not seeing what we'd like to see in the financial figures at this stage, but I think there's some really exciting stuff ongoing, both with turning the operating business around and pursuing some growth opportunities. We appreciate shareholders' patience and we do think, as I said, there's some really exciting opportunities going forward. So thank you all for your attention and we can close off the call.

The conference can be viewed at:

https://www.youtube.com/watch?v=_Qi7LTzYsFk&t=32s

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

For further information contact:

Robert Hadler
Investor Relations and Media Adviser
T: +61 437 745 462
E: robert.hadler@yahoo.com.au

Rob Bennett
Company Secretary
T: +61 438 556 145
E: rbennett@midwaylimited.com.au

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.