

Midway Limited - HY Results

Teleconference Administrator

Thank you for standing by and welcome to the Midway Limited HY results conference call. All participants are in a listen only mode. There will be a presentation followed by a question and answer session. If you wish to ask a question, you will need to press the star key, followed by the number one on your telephone keypad. I would now like to hand the conference over to Mr Tony Price, Managing Director and CEO. Please go ahead.

Tony Price

Thank you and thank you everyone for joining our FY20 half year profit results. You'll all have read the ASX announcements this morning, so I'll just focus on touching on key points. As you'd appreciate, as we can all appreciate, the numbers are very disappointing, given we achieved a record profit in the same period last year. The reality, however, is that the last six months of 2019 were probably the worst global trading conditions we've had to deal with for the last 10 years. The US-China trade war, overproduction of pulp in Brazil resulted in excess stock globally and had a significant effect on the market pulp price dropping from about \$760 US a tonne down to 450, which has had flow-on effects to the woodchip demand and price.

As a result, our EBITDA numbers, a key measure of profitability, was only \$4.2 million for the half. This is well down on the previous period of \$12.2 million. The [unclear 0:01:42.7] net profit after tax for the first half was again well down, under \$1 million, compared with \$14.3 million in the previous corresponding period. Before the impact of significant items, Midway recorded an underlying NPAT loss of \$1.2 million. The two significant items that resulted in a write-down were PMP to the value of -\$4.8 million and also a write-off of \$1.5 million for our investment in ADCO, a logistics business. These significant items or this result came about due to the deterioration in the global trading conditions with both companies finding it very difficult to operate.

As a result of these low profit numbers, the board of directors has decided that Midway will not pay an interim dividend this year. However, Midway does retain a strong balance sheet. It's strongly supported by our banks and we're confident the profit and dividends will grow again as the long-term fundamentals of the global market outlook are very positive still. I'll now touch on some of the key business drivers for the first half. Lower sales volume resulted in a reduced EBITDA of \$7.5 million for the first half. The impact of higher payments to forest owners also resulted in a reduction of 2.1 million in the first half. Midway also recorded lower earnings for our logistics business and PMP as a result of the market downturn as I mentioned earlier. Bone-dried fibre content was also slightly down on the previous period.

These negative impacts on EBITDA were partially offset by a more favourable exchange rate and a higher sales price for blue gums, our highest quality product from Geelong and Portland. The average exchange rate in the first half was 71 cents compared with last year, where it was 73 cents. This contributed to a positive \$2.2 million towards EBITDA in the first half.

However, the main driver of the result is due to the product mix that we sold. So, our higher quality fibre that we generally produce from Geelong, we lost sales to one of our major customers in the first half and as a result of that, most of that volume was replaced by lower quality material which generated a lower margin.

In terms of the balance sheet; net debt increased to \$55.4 million as a result of higher working capital requirements due to the need to fund quite high stock levels, particularly in Geelong. Cashflow was also affected by the higher inventories and working capital payments during the first half. However, our banks have been very supportive and they're prepared to adjust the covenants to ensure that we operated within those whilst we got through the short-term trading issues. Our banks are very comfortable with the debt to equity ratio of 31% that we have, particularly given our interest cover is 14.9 times.

So, moving onto business despite development. Despite the challenging trading conditions, we continue to pursue a range of opportunities to assist the future growth of the business. Wood fibre processing will remain the engine room of Midway in the foreseeable future. The Midway logistics and plantation management have been fully integrated into the business now and we're very confident they'll contribute to future earnings. Midway continues to explore options to increase exports, particularly from our Geelong site which is underutilised. We're looking at such things as grain and also softwood. We're growing rapidly our business in Tasmania where we're trading cargos for third parties along with developing our own business in that state.

Midway is also expanding our biomass business in Western Australia and that's likely to grow very quickly over the next three to four years. We're also exploring further biomass export opportunities on the east coast of Australia, focusing in the first term, first instance on our operations in Brisbane.

We're very pleased to advise that the largest global timber investment manager, Hancock Timber Resource Group, which has about \$10.6 billion of forest and land assets under management, has acquired the ex-Midway plantations in Victoria, which were purchased by GMO. This is a very good outcome. We've got a very strong strategic relationship with Hancocks and we see them as a potential partner in the future, in terms of expanding our plantations in the state.

We're also progressing discussions with investors for a second rotation plantation on the Tiwi Islands. We sent out a flyer on Tuesday to 15 potential parties, and we've already had five come back within 24 hours expressing strong interest. So, we're very optimistic about getting a second rotation plantation program happening on the Tiwi Islands. Therefore, we strongly believe that all of these investments will positively position Midway to rebuild our sales and earnings once the global market turns, which we believe is just around the corner.

In terms of the market outlook, woodchips, Midway is seeing signs of improved demand from our Chinese customers and we've actively diversified or increased our sales into the Japanese market. Global pulp and wood fibre stocks are gradually returning to normal levels and pulp and woodchip prices have stabilised. As a result, Midway will have shipped as much wood fibre from Geelong in the first two and a half months of this calendar year as we did in the six months of the full first half. However, in this current market, there's still ongoing uncertainties that may play out over the next six months, however, we do have some confidence that we're starting to see the market recover.

A point to note, given the strong interest in the coronavirus, we've had none of shipments to China at this point affected by the virus. In fact, all of our customers have operated through the Chinese New Year. We've had a number of vessels arrive in China in recent times and at this stage, we're not seeing much impact with the small exception that banks have been a little slow in opening LCs or putting LCs in place but that's just a timing issue that we're working through.

Price negotiations with our Japanese customers will be conducted over the next few months. We're hoping that we'll be able to secure pricing at the same level as we have some Chinese customers of \$175 US a bone-dry tonne. It's probably worth noting, we've just signed a contract with a Chinese customer that we've not been dealing with much in recent years for seven cargoes in 2020, and we've secured the price of 175 for the full calendar year. Finally, we also have some uncommitted cargoes, and we're talking actively with customers about securing that volume.

If the export prices remain stable and our customers meet their contracted shipments, Midway is confident we'll record a much stronger second half and at this stage, Midway remains very comfortable with the current consensus earnings forecast for FY20. So, with that, I'll just hand back over to those on the call, and Ash and I would be happy to answer any questions that people might have.

Teleconference Administrator

Thank you. If you wish to ask a question, please press star 1 on your telephone and wait for your name to be announced. If you wish to cancel your request, please press star 2. If you are on a speakerphone, please pick up the handset to ask your question. Your first question comes from John O'Shea from Ords. Please go ahead.

Josh Goodwill, Ord Minnett

Hi Tony and Ash. It's actually Josh Goodwill on the line for John here. My first question is around the full year consensus EBITDA. When you say that you're confident you'll meet that consensus EBITDA, does that take into account the AASB16 accounting changes, or is that pre the changes that you're referring to?

Ashley Merrett

That's underlying EBITDA, Josh.

Josh Goodwill

Okay, and the second question on accounting; just in terms of your exposure to China and Japan, where do you... I can see it's come down or gone more in favour of Japan throughout the half. Do you have a medium to longer-term target for how you'd like that split to look?

Tony Price

Not in terms of numbers, Josh. We've brought down our Chinese sales. Was it 7% to 53 I think it was?

Ashley Merrett

Around 55.

Tony Price

Around 55%. 50-50 would probably be nice, but now we've established those sales in Japan, we'd expect those to be ongoing, so we'd maintain at least the current levels of sales into Japan that we have now.

Josh Goodwill

Sure, okay. Thanks for that, guys.

Teleconference Administrator

Thank you. Your next question from Heath Andrews from PAC Partners. Please go ahead.

Heath Andrews, PAC Partners

Yeah, hi guys. My question is really around stock levels. Could you perhaps give us a bit of an indication of how many boats of sales already this half and what quantum of stock decrease you've seen?

Ashley Merrett

At the end of December, Heath, we had approximately 31 million of stock. Normal stock levels would be around that 15 million mark. Come the end of March, we'll be back down around the normal stock levels. So, the high stock at 31 December, a lot of that was in the Geelong area where we'd lost a customer. We've now, as Tony alluded to, signed up some new Japanese and a Chinese customer that's meant that we've been able to get that stock sold and yeah, get back into normal stock levels.

Tony Price

Probably just to give you a sense, Heath, so I think we ran into the end of the first half at say 160,000 tonnes of stock. It's high-end stock as well. It was all eucalyptus globulus. We've had our contractors back operating at full production and by the middle of March, I think we'll be down to less than 40,000 tonnes of stock on the pile. So, we've turned a lot of that stock into cash.

Heath Andrews

In that first half as well, were you operating at full capacity, or were there periods where your plant was idle because of the stock build?

Tony Price

Yeah, no we had a number of shutdowns. I think in total we would've had five to six weeks, I think. Is that right?

Ashley Merrett

Most probably from about October, Heath, we put - particularly in the Geelong or Victorian catchment areas - we put contractors on 70% of their quotas and some of them even went lower than that in... out of South West Fibre. Basically, mid-December, we shut down for roughly a two ... somewhere between two and four weeks, depending on which facility you were at.

Heath Andrews

Just last question; could you perhaps give a bit of guidance on the discount between globulus and the other varieties, whether that's opened up or...

Ashley Merrett

Well yeah, look, the globulus is that headline price number and then there's various discounts off that for the different products, whether it be out of Tasmania, out of Queensland, native hardwood and then most probably the lowest quality is the product out of Melville Island, or the Tiwis. The range can be roughly \$50 US a bone-dry metric tonne.

Tony Price

Yeah, so it could range between 120 for the lowest quality product through to 175 for the highest quality product.

Heath Andrews

No worries. Thanks guys.

Teleconference Administrator

Thank you. Once again, if you wish to ask a question, please press star 1 on your telephone and wait for your name to be announced. Your next question comes from Mile Stojanovski from Aurum Group. Please go ahead.

Mile Stojanovski, Aurum Group

Hi Tony. A question in relation to potentially your banking covenants, given the fall of the share price and the reduction in cashflows or net profit or EBITDA; are we still within a reasonably comfortable position with the banks?

Ashley Merrett

Yeah, no we're in a ... the banks have been strong supporters of us and we went in anticipation of being close to our operating leverage covenant at 31 December. We went to the bank and asked for them to review those, which they increased. So, we would've still been within our old covenants, but the bank has given us an increased covenant for December, March and June quarters and a slightly increased one for September '20 and then back to normal levels for the operating leverage covenant from December 2020.

Mile Stojanovski

So, you're pretty comfortable that we will be able to meet them without having to do a capital raise at a significantly declined share price?

Ashley Merrett

Absolutely. Look, the long-term debt is still around that 30 million mark. We had working capital debt at 31 December of around 19 million. Now, effectively, come the end of March, and that 19 million will be gone. So, the operating leverage covenant is a net debt to EBITDA calculation, so there'll be no issues.

Mile Stojanovski

Thank you.

Teleconference Administrator

Thank you. Your next question is from Damien Williamson from Bell Potter. Please go ahead.

Damien Williamson, Bell Potter

Yeah, hi guys. Just a question; have you got a pipeline on any further pricing, contracts that ... you put the announcement out on 10th December, but is there a pipeline of further announcements that you can give to the market just to show how that price is sticking on any further contracts? Also, the ability to shift supply into Japan versus China; what's the appetite for your Japanese customers to shift that supply away from China?

Tony Price

Well, I'll answer your second question first, Damien. So, we've already moved, as I said, probably significant volume back into Japan within the current calendar year. It's probably unlikely to change outside the ranges we've currently got. So, the balance we're currently operating at is probably what it'll be. But as I said before, we've significantly reduced our exposure to China.

In terms of the pricing; so, when we made the announcement last year, that was to do with the contractor we've got with a sizeable buyer of eucalyptus globulus in China. Subsequent to that, a couple of other exporters from Australia have also settled with another customer at that price level of 175. We've only signed a contract with the customer that we'd settled a price with. We've signed a full-year contract for 2020, for seven vessels at the 175. So, we've got some good price points. It doesn't mean the Japanese customers won't try and negotiate something different than that, but that's a discussion we're currently having and I can't really confirm exactly where that's going to end up, but needless to say, we'll be wanting to end up at that point.

Damien Williamson

Just a follow up question in terms of operating cashflow; the last couple of reporting periods, that metric hasn't reflected well on Midway. Is there an opportunity to say you produce a very strong cashflow this half to get that into more in line with where your EBITDA will report at?

Ashley Merrett

One of the key things for that, Damien, is the high stock levels that we had. So, we'd be expecting that there's going to be reductions of somewhere like 15 million on what the stock levels were at 31 December, come 30 June. So, that should reflect well in the operating cashflow.

Damien Williamson

Okay. Thanks. That's all from me.

Teleconference Administrator

Thank you. Once again, if you wish to ask a question, please press star 1 on your telephone and wait for your name to be announced. Your next question is from Shaun Sutor – a Midway Shareholder. Please go ahead.

Shaun Suitor

Sorry guys. Sorry, I was on mute there, guys. Would you be able to provide a bit of commentary around the impact of the falling Australian dollar? Do you have at all that quantified? So, for example, if it falls by a cent, how much impact that has on your bottom line?

Tony Price

Yes, we do. I think for every one cent - if we don't change anything - I think from memory was ... was it ... just hang on for a sec.

Tony Merrett

Now, Shaun, if you're talking the FX plus or minus 1% on an NPAT basis has about \$1.3 million impact, in isolation. Obviously, we do also hedge, so yeah, look we have a hedging policy in place. We don't hedge 100%, so the falling dollar is obviously going to be a positive. But we have got some cover through to 30 June already in place. So, we won't take the full benefit of it because ... but I think we should be able to average somewhere around the 69 mark for the second half of the financial year.

Shaun Suitor

Yep, one more; although it's unfortunate you've had potentially a couple of competitors knocked out of the market with Kangaroo Island plantation and Eden Woodchip Mill, is that had any impact, positive or negative, on your business or potential to get future business or to sell your unallocated loads?

Tony Price

Well, if you're talking about Eden, for example, we've already picked up ... helped them out with a cargo and I think ... I'm assuming you're from Tassie. So, I think Tassie will benefit from a couple of cargos in the short term until Eden gets up and running again. So, that's a new thing. In terms of Kangaroo Island; I think that's yet to be understood, but obviously Kangaroo Island are progressing plans for developing a port to start exporting. That port's not in place at the moment, so that might take some time to come to fruition. So, there weren't any sales happening anyway, so there's no benefit to us in terms of what happened there.

Shaun Suitor

Yep, no worries. That's all.

Teleconference Administrator

Thank you. Once again, if you wish to ask a question, please press star 1 on your telephone and wait for your name to be announced. There are no further questions at this time. That does conclude our conference for today. Thank you for participating. You may now disconnect.