Sucro Limited

Fourth Quarter and Year-End 2023 Results Conference Call

April 19, 2024 — 10:00 a.m. E.T.

CORPORATE PARTICIPANTS

Ian Tharp

Sucro Limited — Investor Relations

Jonathan Taylor

Sucro Limited — Founder and Chief Executive Officer

Stefano D'Aniello

Sucro Limited — Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Kyle McPhee

Cormark Securities — Analyst

Ty Collin

Eight Capital — Analyst

PRESENTATION

Operator

Good morning. My name is Joelle, and I will be your conference Operator today. I would like to welcome everyone to the Sucro Fourth Quarter and Year-End 2023 Results Conference Call. All lines have been placed on mute to prevent any background noise.

After the speakers' remarks, there will be a question-and-answer session. To ask a question during this time, simply press *, then the number 1 on your telephone keypad. To withdraw your question, please press *, then the number 2. Thank you.

Mr. Ian Tharp, you may begin your conference.

Ian Tharp — Investor Relations, Sucro Limited

Thanks and good morning. Thanks for joining us today as we review Sucro's financial results for the fourth quarter and year ended December 31, 2023.

With me on the call today are Jonathan Taylor, Sucro's Founder and Chief Executive Officer, and Stefano D'Aniello, Sucro's Chief Financial Officer.

Sucro's Q4 2023 and year-end earnings release, financial statements, and MD&A are available on the Investor section of our website at www.sucro.us. These statements have also been filed on Sucro's profile on SEDAR+ at www.sedarplus.ca.

I want to remind listeners today that management's comments during this call may include forward-looking statements. These statements involve various known and unknown risks and uncertainties and are based on management's current expectations and beliefs, which may prove to be incorrect. Actual results could differ materially from those described in these forward-looking statements.

Please refer to the text in Sucro's earnings press release and financial filings for a discussion of the risks and uncertainties associated with these forward-looking statements.

All dollar figures referred to today are in US dollars unless stated otherwise.

I'd now like to turn the call over to Jonathan Taylor. Jonathan?

Jonathan Taylor — Founder and Chief Executive Officer, Sucro Limited

Thank you, Ian, and good morning, everyone. Thank you for joining Sucro's financial and operating results for the fourth quarter and year-end in 2023. I'll review the highlights of our operational and business performance in Q4. Stefano D'Aniello, our CFO, will then provide details of our Q4 financial results, and I'll finish our opening comments with our outlook.

Before we begin, I'd like to thank the incredible efforts and contributions of all our Sucro employees, spread across all operations and offices throughout the Americas. Sucro is currently in a significant growth phase of our business, and I don't believe that any other sugar refiner has undertaken as many separate new refinery projects at the same time. As you can imagine, this is not an easy process. It requires commitment, diligence, and hard work from everyone involved. The results and the future vision we're about to share reflect what an energized, motivated, and fully engaged team can achieve.

As most of you are aware, we started Sucro in 2014 with the goal of building an integrated and interconnected sugar supply business. We're 10 years in now, and I think we've made great progress so far, and there's much to come.

Our team has expertise across the entire sugar supply chain, including sourcing, logistics, refining, project management, and sales to a broad and diverse customer base. This is a unique skill set in the sugar industry, and it enables us to create significant new and differentiated value.

Sucro's first physical processing operation was built in Hamilton in 2014, and in 2017, we made the strategic decision to expand into full granular refining, opening the enhanced and expanded Hamilton refinery in 2019.

Since then, Sucro has become an important new source of domestic sugar supply in Canada. And through 2023, we've successfully ramped our refining capacities to our Lackawanna refinery in upstate New York, and this has strengthened our place as a full-service supplier in the US sugar market.

We continue to see strong sugar demand dynamics in both Canada and the US, and this supports our commitment to grow our internal refining capabilities to serve our customers in both markets. While our original wholesale distribution business remains an important feature of Sucro, the refinery side of our business is the main growth driver going forward.

From an operating perspective, our efforts in Q4 were focused mostly on the continued commissioning at our Lackawanna facility in New York. Lackawanna produced 61,000 metric tons in 2023, which is in line with our original production forecast for the year. Having started as a concept in 2021 and then posting our first full year of production in 2023, we're pleased with the rapid and meaningful progress we've made at Lackawanna.

At our Canadian-based production facility in Hamilton, in 2023, production totaled 99,000 metric tons, another record output. Sucro's aggregate refining volumes in 2023 were 160,000 metric tons, which were 90% higher than 2022.

Looking at our financial highlights, full-year adjusted EBITDA of $33.1 million for 2023 was 48% higher than 2022, and slightly above the guidance of $30 million to $32 million we provided at the time of our Q3 results. This year-over-year growth was, in large part, due to our refining expansion, which has driven growth in both refined volumes and profit per ton. As we scale our North American refining business, we expect our adjusted gross profits to continue to increase.

I'd like to turn the call over to Stefano to review the Q4 financial results in more detail.

Stefano D'Aniello — Chief Financial Officer, Sucro Limited

Thanks, Jonathan. Good morning, everyone. My comments focus on our financial results for the fourth quarter and full year 2023. I'll talk about our financial position and year-end, and our CapEx for the next 12 to 18 months.

Again, I'll remind listeners that unless we state otherwise, all dollar figures we refer to today are in US dollars.

I will first go through our Q4 results. Q4 sugar deliveries were 95,883 metric tons, which were 17% higher than delivered volumes in Q4 of 2022, due to increased production from our refining facilities in Hamilton and Lackawanna which, on a combined basis, produced 34,287 metric tons, which is 77% higher than Q4 of 2022. Our record volume growth in Q4 was partially offset by a slight uptime decrease in trading volumes as compared to Q4 of the prior year, as certain lower-margin trading activities were de-emphasized in select markets.

Q4 revenues were $114.6 million, an increase of 21% compared to Q4 of 2022, due to higher sugar deliveries, combined with higher realized selling prices during the quarter.

Adjusted gross profit was $9.5 million, slightly lower than Q4 of last year, mainly due to favourable non-refinery sugar deliveries made in that quarter. Adjusted gross profit margin for Q4 of 2023 was 8.3%, and adjusted profit per metric ton delivered, net of cash settlements, was $55.64.

Note that we have added some new key performance indicator disclosures for our refineries, including quarterly volumes, adjusted gross profit, and adjusted gross profit per metric ton. These disclosures are intended to further clarify the operating performance of our refineries. For Q4 of 2023, adjusted gross profit from the refineries was $6.2 million, or $182 per metric ton. Both values showed substantial growth over Q4 of 2022, mostly due to the commissioning of Lackawanna throughout 2023.

Moving next to EBITDA, Q4 EBITDA of negative $5.5 million was lower than Q4 of last year due to periodic year-end differences in commodity forward contract mark-to-market adjustments—which I remind readers are non-cash expenses—as well as large volumes of favourably sized physical forward contracts booked in the last quarter of 2022 that were not replicated in 2023, which was a year of more steady growth.

Finally, Q4 net income was negative $10.4 million, lower than $15.7 million posted in Q4 2022, primarily due to the same net unrealized results, and also increased interest expense and higher SG&A expenses as compared to Q4 of the prior year.

Looking at our cash flow, operating cash flow before changes in working capital for the year ended December 31, 2023, was $9.5 million, which was roughly $600,000 lower than in 2022. Free cash flow, which is net of the effect of investing CapEx, was $4.8 million in 2023, which is $1.9 million lower than in 2022. After accounting for the effect of changes in non-cash working capital, cash flow used in operating activities in 2023 was $59.9 million, which was $16 million higher than the prior year.

Increased investments in our working capital primarily related to the growth of our refining business, including inventory investments to support increased purchases for our North American plants, and higher sales taxes payable related to higher sales volumes. These taxes were partially offset by higher accounts payable, lower accounts receivable, sales tax payable, and taxes payable.

Looking ahead into 2024, we currently forecast capital expenditures of approximately $46.3 million in the next 12 months, the majority of which will be focused on the new Hamilton refinery project in Canada, the expansion of the University Park facility in the US and, to a much lesser extent, costs relating to ongoing commissioning of our Lackawanna refinery. Maintenance CapEx is forecast to be roughly $2 million for the year.

Our financing plan for our expansion projects, the cost of which will be mostly incurred in 2024 and 2025, is expected to be funded predominantly with long-term debt, and the remainder with cash on hand and cash from operating activities. Additional details for the debt funding of our projects have been provided in the MD&A.

Subsequent to the year-end, we secured $30 million of additional credit facilities to support our working capital needs going forward. We also continue to maintain our $300 million revolving credit facility. Borrowings bear interest at an effective rate of approximately 8.3% as of December 31st.

We exited Q4 in a solid financial position. As at year-end, our debt, net of collateral value, was $56 million. Our adjusted leverage ratio was 1.7 times, and at the year-end, we had a new borrowing capacity of over $129.7 million.

With that, I'll pass the call to Jonathan.

Jonathan Taylor

Thank you, Stefano. I'll finish our comments today with a few words on our strategy to build the long-term value of Sucro.

Our outlook remains very positive on sugar market dynamics in both Canada and the US. Structural deficits in domestic production continue to persist and demand growth support has led to stronger sugar pricing levels and the need for incremental sugar capacity on both sides of the border.

Looking specifically at our refining operations, we have seen continually improving operating levels in Hamilton through Q1 of this year, and we have provided production estimates for Hamilton at between 105,000 and 115,000 tons for 2024. Moving south of the border, after a successful first year of commissioning at Lackawanna in 2023 and a productive start of 2024, we are estimating production volumes between 120,000 to 135,000 metric tons in 2024. As mentioned, at the time of our Q3 results, additional CapEx was committed to Lackawanna in the first part of 2024 to support ongoing commissioning efforts and add our throughput.

Our main focus areas this year are the development and construction activities for our new cane sugar refinery in both Hamilton, Ontario, and University Park, Illinois.

Starting in Hamilton, we are on schedule with our site prep at the Port of Hamilton, and the main components have been procured and are currently being delivered to the site in a low-cost and innovative manner. The new location is primarily a greenfield site that has excellent rail and water access, which will be very valuable once we're operational. I believe Stefano mentioned earlier, a significant portion of our 2024 CapEx plan is focused on the new Hamilton facility. We continue to be on track for the initial operation in the early 2026 time frame.

In February of this year, we announced our newest refinery construction initiative for our University Park location, which is south of Chicago, Illinois. There are several exciting advantages and features to this project.

First is the site itself, which allows us to leverage our existing land access and sugar logistics infrastructure to be more efficient on capital costs.

Second is our specialty sugar capabilities, including large grain, crystals, brown, and powdered organic sugar, and specialty liquids, which are growing in high demand for Sucro's customers.

Third is our market access. Once it's operational, Chicago will be the most inland cane refinery in the US, and we'll be positioned to serve food processors and manufacturers in the Midwest with a more efficient supply of refined cane sugar and specialty sugars. We also expect additional synergies from our combined production across our Hamilton, Lackawanna, and Chicago locations.

To fund the project, we're advancing our negotiations of term debt for the site and, similar to Hamilton, we'll fund the remainder of the project using our cash flows. Long-term annual production is anticipated to be in the same range as Lackawanna, and start-up of production is expected in early 2026.

Across both our current refinery operations and our announced expansion projects, we have outlined a viable path to our long-term goal of 1 million metric tons of annual production from our refiners.

From a market perspective, we see strong, steady growth in demand in Canada and the US, and this supports our plan to expand our presence as an essential supplier to these markets. In Canada, demand is enhanced by the sugar-containing products, or SCPs, manufacturers in Canada, many of which have been cost-effectively supplied from our Hamilton refinery. We remain committed to strengthening our place as a preferred supplier in the sugar market in Canada.

The US sugar market is much larger in size and more geographically diverse, with more sugar suppliers and customers. Our facilities give us competitively advantaged access to our large sugar demand regions in the US Northeast and Midwest. We also continue to believe that Sucro operates the most efficient network for importing organic sugar in North America, which has led it to be the market leader in important segments.

To finish our comments today, we're pleased with our Q4 results and the progress we've made across the business in 2023. Our current operating platform is strong, dynamic, and growing, and we have a capital-efficient growth plan that will bring new facilities and market access to our platform.

Thank you for joining today. I'll turn back to our Operator and provide instructions for a Q&A period.

Q&A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session.

Your first question comes from Kyle McPhee with Cormark Securities. Please go ahead.

Kyle McPhee — Cormark Securities

Hi, everyone. First one for me, great to see the disclosure breaking out the self-refining business, including the adjusted gross margin per ton for that self-refining business. And we can see the margin's been increasing, quarter over quarter. Is that increasing margin a trend that should continue for the self-refining business throughout 2024? Or are we kind of at a short-term ceiling until another big wave of capacity output comes online?

Jonathan Taylor

Hi, Kyle. This is Jonathan. Great question. I mean, I think we have plans to continue to increase the volume throughout '23, and that should help with margins throughout as we—as the year progresses. I'm not sure it's going to be as steep as what we saw earlier, as the volumes picked up quickly as the ramp-up started. But we're optimistic on margins throughout the year.

Kyle McPhee

Okay. And then, maybe you can't offer this level of detail, but can you offer some colour on the type of exit margin per ton for the self-refining business that you would hope to attain by the end of the year, that's kind of on an exit run rate goal?

Jonathan Taylor

You're asking where we plan to end up?

Kyle McPhee

Yeah. What kind of exit run rate?

Jonathan Taylor

On the volume? On the margins? Sorry, I'm trying to...

Kyle McPhee

On the self-refining adjusted gross margin per ton.

Jonathan Taylor

I mean, again, we're optimistic on the growth and, we're happy with where the margins ended in Q4 for '23. We're happy there and we're optimistic that, that can continue to grow.

Kyle McPhee

Okay. That's good enough. Sugar price benchmarks have weakened a lot since late last year. I know most of your business is more of a tolling model with profits per ton not really linked to sugar price benchmarks. But can you just confirm that the benchmark sugar pricing trend is not impacting the margins per ton you're able to negotiate with your self-refined offtake clients? And I guess, also, given that supply in North America still seems to be very tight, are you able to get even better terms with your offtake clients, which seems to be the case with another public sugar company, a peer of yours?

Jonathan Taylor

Yeah. No, that's right. I mean, the number 11 or the commodity itself isn't really playing an impact on margins. Refining margins remain very good, and that's a better definer of our margins. And we're optimistic that the refining margin in both US and Canada is going to remain firm. So yeah, I mean—we're still bullish on that.

Kyle McPhee

Okay. And then on working capital and how it's impacted by that benchmark sugar pricing, I suspect that as benchmark sugar prices come down, your inventory investment intensity also comes down, and the cost of financing that inventory also comes down. How much of a timing delay is normal for your business until we see that type of inventory financing cost benefit?

And also, can you provide any colour on the days inventory in 2024 versus what we saw in 2023? Seasonally adjusted, is there any structural change for how many days' inventory you're going to hold throughout your supply chain?

Jonathan Taylor

Sure. I'll let Stefano address that one.

Stefano D'Aniello

Hi, Kyle. Good to have you on the phone again. It does have—it does affect our working capital. It does benefit our working capital when sugar prices come down. It also—remember, it also—sometimes, you'll see an effect also on our mark-to-market gains of inventory. Right? So it has an effect on our balance sheet.

I think the thing that we were working on the most last year, we ended the year a little high on inventory in volumes. Remember, there's also a seasonal adjustment because of the lakes freezing, our refineries all being around the Lakes region. Right? So we—and as our volumes increase, you will see a year-over-year increase in general on raw sugar.

Having said that, we did end the year a little higher than we would have liked in some areas. And we have been trimming that down already in Q1 of 2024. I think you should see something to the tune—and that's preliminary as of March, right, and that's, you know, a lot of these price decreases have been happening now in April. So as of March, I think you should already see over $40 million in a decrease in inventory as we have been selling down a lot of our position. Our target is—we ended the year at over 170 days' inventory. And our target is to end the year at 120, 130.

Kyle McPhee

Okay. That's helpful colour. Thank you. And a last quick one for me. In your new free cash flow disclosure, you broke out the CapEx spend into PP&E and what you called value-added CapEx. Can you tell us the difference between those buckets? What exactly lands in each bucket?

Stefano D'Aniello

Value-added CapEx is discretionary investment, growth CapEx, investment CapEx or growth CapEx. The other one is basically maintenance CapEx, right, just to keep plants going at the current level. Maintenance CapEx right now, because of the [young] age of our refineries and the stage we're on, it's $1 million to $2 million a year. That's what we're budgeting for, and that's what you should have in your models as well.

Kyle McPhee

Got it. Okay. Thank you. That's it for me.

Operator

Your next question comes from Ty Collins with Eight Capital. Please go ahead.

Ty Collin — Eight Capital

Hey. Good morning, guys. Thanks for the questions here. Congrats on a strong finish to the year. My first one, I wanted to start on the guidance. So looking to 2024, you maintained the full-year adjusted EBITDA guidance that you gave out at the time of the IPO, but you did touch down the self-refining volume guidance a little bit. So it does sort of imply higher profitability.

Obviously, earlier in the call, you discussed the improving profitability metrics from your own refineries. But I'm wondering, is there any benefit in 2024 from the trading side of the business? Or is the higher profitability guidance really all just from the self-refining side?

Jonathan Taylor

Hi, Ty. Yeah. This is Jonathan. Good question. There is the wholesale side; there's a margin contribution on that. And there's a slight increase on that side, which is helping. But as you mentioned, the margins, in both Canada and the US on the refining side, are looking good, and that's helping offset some of the lower volumes, potentially lower volumes that we could see. So yeah, that's correct.

Ty Collin

Okay. Great, great. That's helpful colour. And then, could you maybe touch on why you're expecting lower volumes out of the Hamilton facility specifically, given that that's kind of a mature plant at this point? Any colour you could provide around that?

Jonathan Taylor

Yeah. I mean, I think our focus is really on the new site. We are building a complete new site. And I think, as we get closer to that, there's less and less real need to keep investing in the old refinery. And so, I think that's—it'll be kind of a little bit of a juggling act as we get both running at the same time, but as one comes to the end and the other one starts up.

Ty Collin

Okay. Yeah. Yeah. It makes sense. And then, in terms of the volumes out of Lackawanna through 2024, the midpoint of the guidance you put out is maybe a touch below the original guidance you put out. Is that mostly just a timing thing because of the CapEx investments you were putting in during Q1? And if so, should we expect Lackawanna volumes to progress in 2025, more or less in line with the original expectations? Or should we expect that to be higher or lower? I guess any colour around the cadence into next year would be helpful.

Jonathan Taylor

Yeah. I mean, our CapEx projects are going well. We're almost done. We're probably a few weeks away from that. And we're being a little cautious and adding the range there just to make sure that we don't run into any issues there, but yeah, I mean, so far, so good on the construction there, so we're optimistic on that side.

Ty Collin

Okay. Great. And, I mean, any colour around the cadence of output out of Lackawanna this year, just given some of the investments you're making in Q1? Should we expect Q1 to maybe be lower than the rest of the year? Or how can we maybe expect volume to progress as the year goes on?

Jonathan Taylor

Yeah. Q1 is going to be our lowest volumes. But Q2, and especially Q3 and Q4, you'll see it'll be more of a reflection of where we should be with all the investment and the new pans that have been added this quarter. So we'll be seeing that in Q2 and probably more in Q3 and Q4.

Ty Collin

Okay. Great. And then I think this will be my last question, just on the University Park facility. You mentioned one of the strategic reasons you're making that investment is the proximity to customers kind of in that Midwest region. Can you maybe just help us understand where those customers are currently getting their supply from? What sort of competition you'll have to displace to get the volumes of that facility close to where Lackawanna's going to be, as you said?

Jonathan Taylor

Sure. So these are clients that are being—these are cane-only clients that get—that buy only cane sugar, primarily, and they're coming in from coastal refineries via rail. And so that's—I think that's what we're referring to, by being—by that proximity advantage that we'd have there. We'll be right there, serving these customers.

Ty Collin

Okay. Great. Thanks for the questions, guys. I'll pass the line.

Jonathan Taylor

Thank you.

Operator

Your next question comes from Kyle McPhee with Cormark Securities. Please go ahead.

Kyle McPhee

I just—I see in your MD&A, you made a comment about the organic sugar trading business. A decision was made to switch from FOB to delivered import pricing, and it seems to have been a detractor from margins per ton. Can you explain what's going on there? Why the decision was made not to handle your own import logistics for that side of your business in Q4?

Jonathan Taylor

Sorry. Can you repeat that again?

Kyle McPhee

And in your MD&A, where you're talking about the moving parts for gross margin per ton, it mentions that the organic importing business switched from FOB pricing to deliver it into the US, and it's looked like it hurt your margin. So what's—just looking for an explanation on why, like what's going on there.

Jonathan Taylor

Yeah. I think we're referring to us delivering the product to the customer versus the customer picking up. And I think the slightly lower margins have to do with just slightly lower prices that we're seeing in '24. Small.

Kyle McPhee

Okay.

Jonathan Taylor

But we are seeing a slight compression there.

Kyle McPhee

Got it. Okay. And then a last quick one is, it looks like there's some cash settlement instead of physical delivery in Q4, and you disclosed the dollar amounts. Can you tell us what the volume attached to that cash settlement was?

Jonathan Taylor

Sure. Stefano, do you have that?

Stefano D'Aniello

About—yeah, 15,000 metric tons.

Kyle McPhee

Got it. Okay. Thank you. That's it for me.

Operator

There are no further questions at this time. I will now turn the call over to management for closing remarks.

Jonathan Taylor

I just want to thank everybody for joining us today. We appreciate your interest in Sucro. Please reach out to us with any questions. Our contact details are on our website and listed in our Q4 results press release.

Thank you again, and have a great day.

Stefano D'Aniello

Thanks, everyone.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines.