Sucro Limited

First Quarter 2024 Results Conference Call

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CORPORATE PARTICIPANTS

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Kyle McPhee

Cormark Securities — Analyst

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PRESENTATION

Operator

Good morning. My name is Julie, and I will be your conference Operator today. I would like to welcome everyone to the Sucro First Quarter 2024 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, Julie, and good morning to those joining today as we review Sucro's financial results for the first quarter ended March 31, 2024.

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

Sucro's Q1 2024 earnings release, financial statements, and MD&A are available on the Investors 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 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 will now turn the call over to Jonathan Taylor.

Jonathan Taylor — Founder and Chief Executive Officer, Sucro Limited

Thank you, Ian, and good morning to everyone.

We will be reviewing Sucro's financial and operating results for the first quarter of 2024.

I'll start with highlights of our operational and business performance in Q1; Stefano D'Aniello, our CFO, will give details of our Q1 financial results; and I'll finish our opening comments with our outlook.

On an operational perspective, our teams in Hamilton and Lackawanna remain focused on increasing refining production volumes, as well as ongoing operational improvements in the areas of product quality and operational consistency.

Sucro's aggregate refining volumes in Q1 of 2024 were 46,000 tonnes, which were 16% higher than Q1 of 2023. Refinery production from Hamilton was in line with expectations and is reaching its maximum expected output.

Our Lackawanna refinery in New York made solid contributions to our aggregate refining volumes. However, we experienced delays in our expansion project initiative and this limited the expected gains in production. This particular capacity expansion initiative was completed halfway through Q2 and has impacted our refining volumes during the quarter. However, we expect that we will make up some of the shortfall during the second half of the year. And we continue to work on completing remaining capital investments that will strengthen the Lackawanna refining throughput capabilities through the remaining quarters of 2024 and going forward.

Our wholesale merchant sugar activities experienced a very strong quarter and further underscore the competitive advantage Sucro has by combining its core capabilities of both sugar refining and wholesale merchant distribution.

Sucro's growing customer portfolio, along with expanded geographic reach, helped deliver strong volume growth as compared to Q1 of 2023. Q1 wholesale volumes were 136,000 metric tons, which was a 33 percent increase over Q1 of last year. In aggregate, our Q1 sugar deliveries were 182,000 metric tons, an increase of 28% over Q1 of last year and a newly quarterly record of sugar deliveries for our business.

This highlights the synergistic benefit of our wholesale distribution and refining operations, which provides Sucro with significant competitive advantage in the markets which we operate, including the US, [Canada], Mexico, and the Caribbean.

Moving now to our financial highlights. Q1 adjusted EBITDA was $10.5 million, a 122% increase over Q1 in 2023. The business is benefitting from both segments of Sucro's business, including growth from our refinery business, as well as a tremendous execution of wholesale distribution opportunities in our expanding trade network.

As we continue to execute our plan to scale our North American refining business, we expect performance from our business segments to offer significant growth.

I'll turn the call over to Stefano to review Q1 financial results in more detail.

Stefano?

Stefano D'Aniello — Chief Financial Officer, Sucro Limited

Thanks, Jonathan, and good morning, everyone. My comments today will focus on our financial results for the first quarter of 2024 in comparison of our Q1 performance to the same quarter last year. I'll then talk about our [financial position] at the end of Q1 and our CapEx plan for the next 12 months.

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

Starting with our sugar deliveries. Our aggregate sugar deliveries for Q1 were 182,865 metric tons, which were 28% higher than in Q1 in 2023, due to the combined volume increases from our refining facilities in Hamilton and Lackawanna and also strongly supported by higher wholesale volumes in Q1 based on opportunities we captured across all the markets in which we operate.

Q1 revenues were $184.3 million, an increase of 47% compared to Q1 of 2023, due to higher sugar deliveries combined with higher realized selling prices during the quarter, due to favourable market conditions.

Adjusted gross profit was $15.98 million, 53% higher than Q1 of 2023, due to both our strategic focus on our higher-margin business at our US and Canadian refining operations and our ability to capitalize on wholesale opportunities in the markets in which we operate.

Adjusted gross profit margin for Q1 was 8.7%, roughly in line with Q1 of last year, and adjusted gross profit per metric ton delivered, net of cash settlements, was $87.38 per metric ton, a 20% improvement over Q1 of 2023, mainly driven by strong adjusted gross profit from our refineries.

Focusing in on the financial performance of our refineries, adjusted gross profit increased by 60% to $6.7 million, and adjusted gross profit per metric ton delivered was $144.18 per metric ton. Both values showed significant growth over Q1 of 2023, mainly due to the successful commissioning of Lackawanna over the past year.

Moving next to EBITDA. Q1 EBITDA of $31 million was greater than Q1 of last year, due to higher adjusted gross profit margin and unrealized mark-to-market gains on physical sugar contracts, which I remind readers are non-cash gains.

Adjusted EBITDA was $10.5 million, an increase of 122% over Q1 of 2023, due to a higher adjusted gross profit margin, as I explained earlier.

Finally, Q1 net income was $19.7 million, an increase of $8.2 million, or 72% over the $11.5 million posted in Q1 2023, primarily due to higher unrealized mark-to-market gains on physical contracts and higher adjusted gross profit margin realized.

Net income per diluted share was $0.83 as compared to $0.53 in Q1 of 2023.

Looking now at our cash flow. Operating cash flow before changes in working capital for the quarter ended March 31, 2023, was $5.4 million as compared to negative $600,000 in Q1 of 2023.

Q1 free cash flow, which is net of the effects of investing CapEx, was $5 million, which was $6.5 million higher than Q1 2023. After accounting for the effects of changes in non-cash working capital, cash flow from operating activities in Q1 was $20.9 million, which was $15.9 million higher than in Q1 last year.

Positive factors for the three months ended March 31, 2024, included increases in accounts [payable] and decreases in inventory, both trends consistent with our liquidity strategy for 2024. And these were offset by an increase in accounts receivable, lower sales tax payable, and higher prepaid expenses.

For 2024, our forecast for capital expenditures remains at approximately $46.3 million, the majority of which will be focused in our new Hamilton refinery project in Canada, the expansion of our University Park facility in the US, and, to a lesser extent, costs related to ongoing commissioning of our Lackawanna refinery. Maintenance CapEx is expected to be in the range of $2 million for the year.

The cost of our expansion projects will be mostly incurred in 2024 and 2025, and financing for these projects is expected to be funded predominantly with long-term debt and the remainder with cash on hand and cash from operating activities.

Subsequent to the end of the first quarter, we entered into two financing agreements related to the new Hamilton project. The proceeds of the first financing of $10.3 million will be allocated to the construction of a refinery building, and the second financing of $20 million will be allocated to equipment, as well as soft costs relating to the new refinery.

For Chicago, which has an estimated total capital cost of $20.9 million, we're working on a total of $14 million in debt financing that will be allocated to the building, equipment, and soft costs for the facility. Additional details for the debt funding for our expansion projects are provided in our Q1 financial disclosures.

We exited Q1 in a solid financial position. As of March 31st, our adjusted net debt was $40.2 million, our adjusted leverage ratio was 1 times, and our unused borrowing capacity was over $173 million.

One final update on our listed shares. In mid May, our shares started listing on the OTCQB Venture Market in the US under the ticker symbol "SUGCF" which will facilitate investment in Sucro by US investors.

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

Jonathan Taylor

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

Looking at the current sugar market dynamics in Canada and the US, our outlook continues to be positive. Persistent demand growth, combined with structural deficits in domestic production, has led to strong sugar pricing levels and the continued need for additional sugar capacity in both markets.

Operationally, our refineries saw a 16% increase in production in Q1 of 2024 compared with the prior year. And notwithstanding the installation delays I mentioned earlier, we continue to expect significant volume increases and commissioning progress from our refineries.

We also expect to demonstrate the continued tangible benefits of our combined refining and wholesale distribution segments.

Based on the delays at Lackawanna, we now have updated our aggregate 2024 production estimate for Hamilton and Lackawanna refineries from a range of 225,000 metric tons to 250,000 metric tons to a new revised production estimate between 210,000 metric tons and 230,000 metric tons, which would result in a year-over-year refinery growth in the range of 40%.

As we look forward, another key focus area this year and for much of 2025 are the development and construction activities for our new Canadian refineries in both Hamilton, Ontario and University Park, Illinois.

Looking first at the new Hamilton site, our site preparation at the Port of Hamilton is going well. The main components of the facility are procured and in transit to the site, and we were able to arrange delivery in a way that will reduce our total logistics cost for the project. As I mentioned before, the new location in Hamilton Port area has excellent rail and water access, which will be a continued benefit to us once we're operational.

A significant portion of the 2024 CapEx plan is focused on a new Hamilton facility, and as Stefano mentioned earlier, we've successfully secured new debt financing for the project. We continue to be on track for the initial operation and commercial production in 2026.

In February this year, we announced our newest refinery construction initiative for our University Park location, which is south of Chicago, Illinois. This new project allows us to leverage our current land access and logistic infrastructure to reduce our capital costs. It will bring us new specialty sugar capabilities to meet the needs of new high-growth market categories, and the plant's location position us to access customers in the Midwest.

The Chicago project is earlier stage than Hamilton, but as Stefano mentioned, we're making good progress on our debt financings, and we will fund the remainder of the project using our available cash and cash flows. Start-up and initial production is expected in 2026.

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 into these markets.

In Canada, demand is enhanced by sugar-containing products (SCP) manufacturers in Canada, and our Hamilton refinery is well located as a cost-effective source of supply for these customers.

The US market is a much larger, more geographically diverse with more sugar suppliers and customers. Our Lackawanna and University Park facility gives us competitive advantage in the large sugar-demand regions in the US Northeast and Midwest.

We also continue to operate a highly efficient network of importing organic sugar into North America, which has led to its market share leadership in this segment.

To wrap up my comments today, we're pleased with our Q1 results and the progress we continue to make across the business.

Thanks for joining the call. And I'll turn it back to the Operator to provide instructions for Q&A period.

Q&A

Operator

Thank you. Ladies and gentlemen, should you have a question, please press the *, followed by the 1 on your touch-tone phone.

If you'd like to withdraw your question, please press the *, followed by the 2. If you're using a speakerphone, please lift the handset before pressing any keys. One moment, please, for your first question.

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

Kyle McPhee — Cormark Securities

Hi, everyone. First, can you speak to the process of ramping up the Lackawanna refinery throughout the rest of this year? What are the outstanding deliverables or pieces of equipment needed to get the facility ramping towards your exit 2024 goal? How well understood are the bottlenecks that you need to deal with? Or is it really an iterative as-you-go type of process?

Jonathan Taylor

Hi, Kyle. This is Jonathan. Yeah. So everything is installed. We're at the capacity that we need to be at the moment. I think the issue is we lost about 10 weeks at not being at that capacity.

So going forward, we're hoping to exceed that capacity slightly and make up some of that. But we're where we need to at the moment. We finalized the installation of the two vacuum pans and they're both operating now.

Kyle McPhee

Okay. What type of goal do you have for the exit 2024 run rate at Lackawanna, if all goes as planned? Like should it still be tracking around 200,000 metric tons a year by the end of this year as a run rate? Or has that goalpost changed?

Jonathan Taylor

So we're looking to be at around 500 tonnes a day run rate. Right? So more or less puts you close to 200,000, I think, slightly below that on a daily run rate.

Kyle McPhee

And, okay. And you mentioned the delays, the pan installations, was all kind of done and caught up by mid-Q2.

Jonathan Taylor

Correct.

Kyle McPhee

Like by mid-Q2 are you already close to that 500 tonnes a day? Or there's remaining work to do beyond just the vacuum pans to bridge that gap?

Jonathan Taylor

We're close. We're about 350 tonnes to 400 tonnes a day. And then there's some small tweaks that'll get it to that 500 tonnes a day.

Kyle McPhee

Got it. Okay. That's helpful. And then in terms of funding your growth CapEx budgets, you have your free cash rolling in nicely. It arrived again better than expected in Q1, so great to see that.

It looks like you made some progress closing on a couple more debt tranches. A landlord loan and an equipment loan were completed during Q1. Do you foresee any issues closing on the remaining, I think, it's mortgage and equipment loans that you disclosed but are outstanding? And are those the final tranches of capital needed to fully fund your Phase 1 budgets at Hamilton and Chicago?

Stefano D'Aniello

Hi, Kyle. This is Stefano. So the Chicago project was announced a little later than the Hamilton project, so it's tracking a bit behind also, not surprisingly, on the process for the financing. We're working on $15 million in loans there.

We have one that is a mortgage for the building, the buildout. That's a construction loan that's thoroughly imminent. In fact, we have signature pages being exchanged as we speak. So that one should be … didn't make it to this release, but it's very imminent that it's going to be closing.

And we have an equipment loan as well that is now with credit with one of our lenders and it should be coming in the coming weeks. So we're pretty confident that that is coming. It will be in the next release. You'll see it.

And that should finalize basically all the funding for the projects that we have right now.

Kyle McPhee

Got it. Okay.

Thank you. That's it for me.

Operator

Ladies and gentlemen, as a reminder should you have a question, please *, 1.

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

Ty Collin — Eight Capital

Morning, guys. Congrats on the quarter. Thanks for the questions here. My first one just on the refining margins; really, really solid this quarter, but a little bit lower, obviously, than the previous quarter. I'm wondering if you could provide a little colour around the quarter-on-quarter move in the refining gross margin? And maybe if you could speak in more general terms about what the sources of volatility are from a refining margin perspective.

Stefano D'Aniello

Hi, Kyle. It's Stefano. So our refining margins are, for this quarter, just to reiterate, at $144 a metric ton, and exiting Q4 we were at $182 a metric ton. We think that our Q1 refining margins are in line with our expectations and where we have budgeted.

One thing that we noted in exiting Q4 was we have this integrated model where we can take advantage into our expansive reach into different geographies and we can take advantage of market opportunities to make spot sales and that's how we can capture those higher-price sales. And that we did in Q4.

We captured some disruptions in certain markets and we were able to do that. But coming into Q1 it's been normalized.

Ty Collin

Okay. Great. That's really helpful colour.

And then you guys booked some pretty strong mark-to-market gains in the quarter. I think it was $21 million. It sounds like most of that related to strong margins you're booking in the Mexico and organic business. Could you maybe just provide a little more detail on those two markets in particular?

And also, did any of that mark-to-market gain in the quarter relate to the refining side of the business? Or was it all kind of sitting on the wholesale side?

Jonathan Taylor

Hey, Ty. It's Jonathan. Yeah. A lot of it is renewal of contracts for '25, so we start seeing new contracts coming into our books. Some of it is on the refining side. I think a lot of it was on the organic side for the quarter.

Ty Collin

Okay. And could you maybe dive into what you're seeing in the organic side of the business in particular? I know there had been some … a little bit of pressure in that business later in in 2023. Is that improving at all? Or just appreciate any trends you could call out there.

Jonathan Taylor

Yeah. I mean, I think we see it, I think we exceeded our budget a little bit on the organic side in this quarter, but I think it'll level out through the rest of the year. And we're seeing it more or less in line with what we budgeted. No surprises there.

Ty Collin

Okay. Great. And then last question for me, really impressive reduction in the inventory this quarter. Obviously, the line of credit was still flat. I think you're still waiting to collect on a lot of those sales.

Are you expecting to pay down a little more in the line of credit as the year goes on? And kind of what do you expect that to do to your interest expense?

Stefano D'Aniello

Yes. So interest, I mean, inventory we reduced it by about roughly $50 million. As we noted, we were slightly higher than where we wanted it to be going into the end of a year.

We expect to end a year—right now it's low. We're going into the summer. We don't need a large buildup on inventory.

We would expect to finish the year at around 120 days, 130 days of days inventory by the end of a year because there is a buildup that naturally we have to have because of the lakes freezing and where our refineries are located.

You mentioned that sell down of inventory does result in some accounts receivable getting higher, right, and that naturally it will get repaid and our line, it will come down even further. So it will reduce naturally the size of our book and the size of our balance sheet going into Q2.

I think we've done some very good progress with interest expense just by keeping the balance sheet as small as we can, at a right size for the Company. But again, I think that going into the end of a year we have to be mindful about the lakes and where we are and that we are running a business and our business is dependent on vessels. Right?

So inventory does tend to be cyclical and it does tend to go up and down.

Ty Collin

That's really helpful. Thanks for the questions, guys.

Operator

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

Kyle McPhee

Hi. Just wanted to follow up on the refining margins, the adjusted gross margin per tonne. So it was down quarter over quarter, and that was just the reversal of the abnormal benefit from Q1. I think you were capitalizing on opportunities in Mexico, and you made that clear last quarter.

So going forward from this $144 gross margin per tonne for the refining business in Q1, going forward should we see that start to directly climb up as it sounds like you're getting some good volume ramp up at Lackawanna? Is that also benefitting the refining adjusted gross margin per tonne?

Stefano D'Aniello

No, that's in line … the margin that we saw in Q1, that's in line with what we budgeted for the remainder of a year. That's what we have locked into a lot of our long-term contracts.

Obviously, if there are additional market disruptions, we may see odd opportunities as we saw going into Q4 of last year.

Kyle McPhee

Got it. Okay.

Thank you.

Operator

And there are no further questions at this time.

I will turn the call back over to Jonathan for closing remarks.

Jonathan Taylor

I just want to thank everybody for joining us today.

Appreciate everybody's time, and thank you.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for joining, and you may now disconnect your lines.

Thank you.