



FINAL TRANSCRIPT

EcoSynthetix Inc.

2018 First Quarter Results Conference Call

Event Date/Time: May 10, 2018 — 8:30 a.m. E.T.

Length: 25 minutes

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Thank you for standing by. Welcome to the EcoSynthetix 2018 First Quarter Results Conference Call. At this time, all participants are in a listen-only mode.

Following the presentation, we will conduct a question-and-answer session. Instructions will be provided for you at that time for questions. If anyone has any difficulty hearing the conference, you may press *, 0 for Operator assistance at any time.

Listeners are reminded that portions of today's discussion may contain forward-looking statements that reflect current views with respect to future events. Any such statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements.

For more information on EcoSynthetix's risks and uncertainties related to these forward-looking statements, please refer to the Company's Annual Information Form dated March 6, 2018, and posted on SEDAR.

This morning's call is being recorded on Thursday, May 10, 2018, at 8:30 a.m. Eastern Time.

I would now like to turn the call over to Mr. Jeff MacDonald, Chief Executive Officer of EcoSynthetix.

Please go ahead, sir.

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Jeff MacDonald — Chief Executive Officer, EcoSynthetix Inc.

Thank you. Good morning, and thank you for joining us today. Yesterday afternoon, we released our 2018 first quarter results, which you can find on our website at ecosynthetix.com.

You can also download a copy of the slides that accompany today's call from our website, or alternatively, access them on the webcast.

It was a great quarter. We continued to generate top-line growth. Net sales were up 51 percent, driven by higher volume and higher pricing. And we continue to deliver improvements to our bottom line, with a 40 percent improvement in adjusted EBITDA in the quarter.

We are committed to achieving profitability in the near term through a combination of new account wins in the wood composites and paper markets and through continued focus on cost management.

For the first time in the Company's history, this goal is clearly in our line of sight.

On the account win front, we are pleased to announce that we've won a new account in the wood composites market. We are commercial on a line with a global top-ten producer of wood-based panels. As we anticipated and referenced on previous calls, this win comes from a line dedicated to oriented strand board.

Our DuraBind offering is being used as a co-binder with PMDI, and the account can now reduce the volume of PMDI they're using on the line by introducing DuraBind into the process. We

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anticipate annualized revenue from this first line to be in the range of 500,000 to \$1.5 million. Initially we'll start out at the lower end of this range, with the potential to build over time.

This win also represents an opportunity for us to expand across other lines within this global top-ten manufacturer.

The pricing dynamics of PMDI globally have impacted the margins of OSB manufacturers. We believe based on the current PMDI pricing our near-term opportunities are more heavily weighted in the OSB market, where PMDI represents approximately 50 percent of the binder used in this space.

However, despite its success in OSB, PMDI has never been able to significantly penetrate the medium-density fibre board or particleboard segments, due to process performance constraints which negatively impact productivity and economics on the manufacturing lines. As a result, MDF and particleboard continue to be dominated by formaldehyde-based binders.

So we think of our wood composites target market in two parts: The OSB market, where PMDI is currently used and where manufacturers have been impacted by the recent supply constraints and the trend of higher-priced PMDI, this is a near-term opportunity; and the MDF and particleboard markets, which are both larger than OSB, and continue to be dominated by formaldehyde-based binders.

MDF and particleboard represent the most attractive markets for DuraBind as part of a no added formaldehyde binding system. These markets remain a vital component of our long-term growth. However, given that our binder works with PMDI, it's more challenging in the current PMDI

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price climate to convert these manufacturers from formaldehyde binders to DuraBind and PMDI today.

One area where we remain optimistic is retailers that are backward integrated into wood composites manufacturing. In these instances, the pull from the retail brands toward an NAF binder is extremely beneficial. They have a long-term view to eliminating added formaldehyde from their supply chains.

We are actively engaged with these thought leaders, demonstrating how DuraBind can differentiate their offerings earlier along the adoption curve.

We also continue to push forward with innovation to our DuraBind offering. Our product development team recently completed successful initial trials with two new products within the DuraBind family. These product candidates improve the value of our offering with enhancements to the DuraBind line.

Our industrial trial pipeline remains robust. We have OSB prospects across all stages of development, and we remain active with select MDF and particleboard accounts. Converting wood composite prospects to customers is our number one priority.

We are engaged with the right players. Our existing pipeline can deliver significant growth.

On to the paper and paperboard packaging side of the business. We continued to see higher SB latex prices in the market, which improves our value proposition for manufacturers to convert from SB latex to EcoSphere.

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The price of SB latex is currently above \$1, depending on the discount to the account. SB latex pricing dynamics have provided us the opportunity to retain pricing power with existing lines, which supported the increase in net sales this quarter.

We believe additional upside exists in our paper and paperboard business to drive incremental top-line growth, especially in the event SB latex pricing remains at these levels or moves higher. However, wood composites remains our highest priority and holds the greatest potential for growth.

With that, I'll turn the call over to Rob to review the financial highlights.

Rob?

Rob Haire — Chief Financial Officer, EcoSynthetix Inc.

Thanks, Jeff, and good morning. From a top-line perspective, net sales were 5.4 million in Q1 2018, an increase of 51 percent compared to the same period in 2017. This increase was primarily due to higher sales volumes of 1.3 million, or 38 percent, and higher average selling prices which improved sales 500,000, or 13 percent.

As Jeff mentioned, the pricing dynamics of SB latex in the paper and paperboard market are providing us with a reasonable level of pricing power.

Gross profit was 1.1 million in the quarter, up 31 percent compared to 800,000 during the same period in 2017. Net of manufacturing depreciation, gross profit as a percentage of sales was 23.4 percent in the quarter compared to 27.1 percent in the same period in 2017.

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The decrease in cash margins this quarter was primarily due to higher manufacturing and freight costs, partially offset by higher average selling prices. We continue to focus on offsetting manufacturing cost increases via higher pricing.

Adjusted EBITDA loss was 875,000 for the quarter compared to 1.5 million in the same period in 2017. The 40 percent improvement in the quarter was due to higher gross profit as a result of higher sales volumes, combined with lower operating expenses.

Net of the 200,000 in termination costs related to staff restructuring in Q1, the adjusted EBITDA loss was 650,000. As Jeff mentioned, our focus is to deliver profitability in the near term on an adjusted EBITDA basis, and this figure demonstrates the significant progress we have made towards that goal.

We continue to be disciplined in our approach to cost management. SG&A expenses adjusted for depreciation and share-based compensation were 1.3 million in the quarter, a slight increase of 50,000 compared to the same period in 2017.

R&D expenses adjusted for depreciation and share-based compensation were 650,000 in the quarter, or 11.8 percent of revenue, compared to 1.25 million in the same period in 2017. The 600,000, or 49 percent decrease in R&D expenses is primarily due to 200,000 of lower people-related costs as a result of our cost reduction program, 200,000 from lower third-party development costs, and 200,000 from lower mill trial-related costs.

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The changes in our third-party development and mill trial-related costs are a result of specific project investments made during Q1 2017.

During the past 24 months, the majority of the operating expense savings have been driven through SG&A expense. Q1 2018 is our first period in which R&D expenses have contributed to ongoing cost savings.

We are confident that our current R&D investment level is appropriate to deliver significant growth.

As of March 31, 2018, we had 47.4 million in cash and term deposits. We used 1.8 million of cash in operations during the quarter.

Cash utilization was higher than normal during the quarter as a result of 1.3 million in working capital changes, primarily due to higher accounts receivable and a lower accounts payable and accrued liabilities compared to December 31, 2017. We expect cash utilization for operating activities to be closer to our adjusted quarterly EBITDA loss, which was 650,000 this quarter when you exclude the termination costs.

We have more than sufficient cash reserves to execute our growth strategy, and we'll remain disciplined and manage our cash responsibly while continuing to invest in our long-term growth strategy.

With that, I'll turn it back to Jeff for closing comments.

Jeff MacDonald

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Thanks, Rob. We've set clear goals across our organization, focused on converting the existing prospects in industrial trials to commercial accounts to continue to drive top-line growth, and deliver on our commitment to achieve profitability on an adjusted EBITDA basis in the near term.

Our pipeline is robust. Converting the lines that are currently running industrial trials is more than sufficient to achieve profitability, and expanding to other lines within those accounts would drive significant growth in the business.

The OSB market will remain our highest priority, shorter-term target while the supply constraints in PMDI exist, as DuraBind provides immediate savings to those manufacturers. But we will remain vigilant by staying in front of the larger MDF and particleboard markets where DuraBind offers a path to an NAF solution for those manufacturers and their retail customers.

The greatest challenge we face is the pace of adoption. Formaldehyde is already recognized as a harmful chemical, but ensuring an alternative binder technology is available, provides comparable performance, and is competitively priced is a requirement of the manufacturing sector before we will see widespread adoption. DuraBind offers a solution that has been proven to work across each of the major wood composite segments.

And our confidence in DuraBind is as strong as ever, as evidenced by our recent new win in the OSB market.

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The changes we have made within the organization, both on the cost management side and the discipline in product development and sales, have delivered tangible results. Our commitment to deliver profitability is within sight.

We appreciate the trust, the patience, and the commitment that all of our investors have shown, and I look forward to updating you on our progress again very soon.

And with that, I'll turn it back over to the Operator for question-and-answer. Thank you.

Q&A

Operator

Certainly. At this time, I would like to inform everyone in order to ask a question, please press *, then the number 1 on your telephone keypad.

Your first question comes from the line of Steve Arthur from RBC Capital Markets. Please go ahead. Your line is open.

Steve Arthur — RBC Capital Markets

Yes. Great. Thank you. Just a couple of questions to follow up here. First just the focus on the OSB market seems to be working and quite nice to see the win, obviously, in the quarter. I'm wondering if you can offer any more colour on the pipeline activity that's going on there. Are the trials as long as they might have been in the previous MDF and particleboard composites? These customers seem to be working quicker. Is that a fair assumption?

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Jeff MacDonald

Yeah. Morning, Steve. It is. I think the recent win provides a great example of how fast you can move when there's a really good economic carrot there to go along with the change agenda. So if you recall our first customer, Swiss Krono, we said several times that it took us about 18 months to get from start of lab trials through to commercialization with them. This most recent account win took about eight months.

So when that incentive is there and also where a customer has experience in infrastructure to deal with PMDI already, we can go much faster. And we're seeing a newer pipeline progress, yeah, significantly faster than we did in the initial stages with the NAF conversion-type customers.

Steve Arthur

Any sense of how many of those trials are going on in OSB? Or are they still being added?

Jeff MacDonald

They're still being added, for sure. We're active ... I can tell you we're active with the majority of the OSB players around the world. We have trials at each step. Some are early in the lab phases, some are fairly late in the process, but all have progressed quite quickly in the face of this significant increase in PMDI pricing they face.

Steve Arthur

Has this meant any change in your salesforce? Or would you need to make more of a change in your salesforce? Or is it really just their approach in who they're targeting?

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Jeff MacDonald

In some cases, they're actually the same accounts. There are companies who have both—

Steve Arthur

Right.

Jeff MacDonald

—OSB and particleboard and MDF. In some cases, it's just introducing ourselves to new players. And like I said, in many cases it's players that might have even more familiarity and comfort with working with PMDI already.

So there's really been no change in our salesforce, nor their activities, other than maybe knocking a little bit harder on different doors.

Steve Arthur

Okay. If we look at the MDF and particleboard customers or prospects, I guess, you were pursuing for a couple of years, kind of where are we with all those trials? Like have they just stopped their trials? Or are they just on hold for a while? Or are they continuing with trial activity without a sense of urgency und just waiting until the pricing dynamic changes with PMDI?

Jeff MacDonald

I think it's fair to say there's definitely been a step back in urgency with the economic headwinds. But we have customers, and I referenced select customers in my notes.

Steve Arthur

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Mm-hmm.

Jeff MacDonald

We have customers who are committed to that agenda in the longer term. And in some cases, they haven't slowed at all in their efforts to move ahead. But there are fewer of them that have that sense of urgency, and that's why we've got a more focused effort on a few of them to get them across the goal line. And we think those will be the ones that really emerge to serve the retail market strongly when NAF becomes a necessity and/or when PMDI pricing becomes a little bit more normalized.

Steve Arthur

Okay. The ASP price increase in the quarter, was that a function of just a higher mix of DuraBind? Or was that higher pricing in EcoSphere?

Jeff MacDonald

It's higher pricing everywhere, so it's both.

Steve Arthur

Yeah. Okay. I guess just the last one just on the cost reductions, the \$200,000 charge in Q1 now touching R&D, I guess, as well. Are those ... given what you know now, are all those things kind of complete? Or are broader changes still kind of being worked through?

Jeff MacDonald

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We're happy with the team that we have focused on the goals that we've set for ourselves for the balance of this year. We've got ... I think we've got everybody working on all the right things to get us to the goals that we've established for ourselves. The goals are pretty simple and focused. We have line of sight directly to what everyone's working on to achieve those goals.

And I'm pretty happy that we're rightsized on the right activities today.

Steve Arthur

Okay. It all seems to make sense. Okay. Thanks very much, and I'll pass the line.

Jeff MacDonald

Thanks a lot, Steve.

Operator

Again, if you would like to ask a question, please press *, then 1 on your telephone keypad.

Your next question comes from the line of Raveel Afzaal from Canaccord Genuity. Please go ahead.

Raveel Afzaal — Canaccord Genuity

Morning. Congratulations on the new win. A few questions for you. First of all, what's driving this price increase, especially on the DuraBind side? I understand EcoSphere, but what's driving the price increases on DuraBind?

Jeff MacDonald

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Good morning, Raveel, and thanks for the congratulations. We're really happy to have that win to talk about. Pricing, obviously just given the mix that we have, is obviously being more impacted on the EcoSphere side. But there's some dynamics that have happened in the way that our largest customer is taking delivery of our product that has helped us to improve the margins.

If you recall, we've talked a fair bit about customers taking liquid product versus dry product. And we've had a little bit of an uptick in the use of dry product. We've also been able to pass on some liquid costs where customers have continued to use a liquid product. But overall, the big impact is the change in crude oil, which drives SB latex up, as well as other input costs.

In some cases, we're formulaic in our pricing to some of those input costs to our customers, and that sort of automatically resets our price. And in other cases, we have to by sort of normal sales negotiation recover the cost increases as much as possible that are driven by crude oil.

Raveel Afzaal

Thank you for that. And then when you look at EcoSphere price that you're charging now versus say in 2014, is it still significantly lower than what you were charging at that time?

Rob Haire

So, Raveel, can you, sorry, just repeat that question again?

Raveel Afzaal

Yeah. So I was wondering, the price that you're charging now for EcoSphere versus what you were charging for it in 2014, the price that you're charging, is it still significantly lower than what you were charging in 2014?

Rob Haire

Yeah. So, Raveel, I'll have to answer that offline. I'm sorry, I just don't have the 2014 number in front of me here.

Raveel Afzaal

No problem.

Rob Haire

But I would say it definitely would be lower than the beginning of '14, just because we had very high crude oil at that point. At that point, we were somewhere in the range, I believe we crossed \$100 crude oil level.

But the specific answer on it I can give you offline. Sorry, I just don't have it in front of me.

Raveel Afzaal

Understood. No problem. And then with respect to the two new DuraBind products that you spoke about, can you give us some more colour? What's different about these two new products that you guys are launching?

Jeff MacDonald

So when we're developing enhancements to DuraBind, we're looking at the things that really drive economics, or in some cases, miss on economics when you try to introduce PMDI to these lines. So it's things like speed or a phenomenon in the particleboard world that's known as tack, which is holding the mat together as it transitions down the line. PMDI's not very good at that.

And so our developments are focused on overcoming some of those things and enhancing value. You can imagine if you can improve the speed of a line by 5 percent to someone who's at full capacity, that's a pretty big opportunity for them to earn more margins for themselves. So it's things like that.

In one case, it's an enhancement that would play well across all three major segments. And in another case, it's pretty specific to one segment that we're focused on particularly with the retail crowd.

Raveel Afzaal

Got it. Great. Great to hear. And then is it possible for you at this point to quantify how many industrial trials you have underway on the OSB side? Or is it too early?

Jeff MacDonald

I mean, it's really too early to quantify the number of trials. But I will say that we are active with most of the top 10 players in some way today.

Raveel Afzaal

Okay.

Jeff MacDonald

As I said, some of those are still in the lab, but some of them are closer to the goal line.

Raveel Afzaal

Great. That's all for me. Thank you.

Jeff MacDonald

Thanks, Raveel.

Operator

Again, if you would like to ask a question, please press *, then the number 1 on your telephone keypad.

Our next question comes from the line of Geoff Gilbert from Inukshuk. Please go ahead.

Geoff Gilbert — Inukshuk

Gentlemen, congratulations as well from my side. Just was wondering if—we've heard for a while conversations going on with the retail side, as you mentioned on one of your slides. And I know you can't comment specifically on each of your conversations with individual companies, but as a whole would you be able to give a little bit more colour or clarify where in the process you might be as a whole with the retail front?

Jeff MacDonald

Yeah. And it is—thanks, Geoff—it is something that we do need to talk about on the whole. I mean, there's the big elephant, which is IKEA, and we have shared some of the commentary that

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they've made just in the last six months with respect to their agenda for no added formaldehyde and increased bio-based content.

For them specifically, we've seen definitely no pullback in that agenda. And we've actually seen that they are quite diligent in their own methodical way on advancing that agenda. And they remain pretty interested and engaged with what we can do to contribute to that.

But when we talk about retail more broadly, I guess it depends a little bit on how you'd define retail. But there are other companies out there who are more vertically integrated, and have their own flooring products out there in the market that are branded based on the name of the panel producers; flooring products; you also see some particleboard products that are kind of self-branded as well.

And it's those that are closer to the retail chain that continue to be more active in the MDF and particleboard space, despite the pricing of PMDI.

Geoff Gilbert

Sounds good. Appreciate that.

Jeff MacDonald

Thanks, Geoff.

Operator

And there are no further questions at this time. I will now turn the call back over to Jeff MacDonald for closing remarks.



Jeff MacDonald

Thanks again to everyone for joining us this morning, and look forward to talking to you again soon.

Operator

This concludes today's conference call. You may now disconnect.

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