



## **FINAL TRANSCRIPT**

**EcoSynthetix Inc.**

### **2017 Fourth Quarter and Year-End Results Conference Call**

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## PRESENTATION

### Operator

Thank you for standing by. Welcome to the EcoSynthetix 2017 Fourth Quarter and Year-End 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 the time for questions. If anyone has 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 risk 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 30, 2017, posted on SEDAR.

This morning's call is being recorded on Monday, March 5, 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.

**Jeff MacDonald** — Chief Executive Officer, EcoSynthetix Inc.

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Thank you. Good morning, and thank you for joining us today. Yesterday afternoon we released our 2017 fourth quarter and year-end results, which you can find on our website at [ecosynthetix.com](http://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 good quarter and a strong close to fiscal 2017. We generated top-line growth and improved bottom-line performance through disciplined cost management, we won three new paper and paperboard packaging customers in 2017, and awareness of the harmful impacts of formaldehyde-containing products continues to grow.

We delivered 35 percent growth in sales in 2017. We reduced our adjusted EBITDA loss by 37 percent for the year. This improvement in adjusted EBITDA meant that net of our focused investments in R&D, the business was essentially break even during 2017.

Overall, what these figures clearly show is we were able to return to a growth platform, while at the same time reducing our cost structure. And we now have a clear line of sight to profitability for the business.

Overall, we met all of the objectives we set for ourselves this year, except one very important objective: accelerating the prospects, conducting trials in wood composites, to customers wins.

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While our conversions have been impacted by temporary price dynamics in PMDI, the primary market drivers remain intact. Consumers, retailers, and regulators are searching for solutions to minimize or eliminate formaldehyde.

Converting wood composite prospects to customers is our number one priority, and as a team we intend to do just that.

Regulatory standards like CARB 2 continue to raise the bar in driving awareness and reduce formaldehyde levels. More importantly, retailers are starting to demand the removal of formaldehyde from their supply chains.

The retailers that aspire to lead do not want to describe to customers whether a specific level of formaldehyde is safe, while a higher level should be avoided. They're looking for a simpler marketing claim to be able to say our products contain no added formaldehyde.

As an example, in October IKEA presented at the International Conference on Wood Adhesives, and announced its intention to convert presently used adhesive systems from fossil-based to bio-based systems, with formaldehyde reduced to the levels that exist in natural wood. Our DuraBind offering enables wood composites manufacturers to achieve these goals.

It's a bio-based binder that provides a sustainable method to achieve comparable performance to formaldehyde-based binders at a cost that is competitive. However, DuraBind is not a solution that replaced formaldehyde in isolation. It works in combination with another binder, PMDI, to create a no added formaldehyde solution for manufacturers.

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During the course of 2017, the PMDI market has undergone a significant supply shortage, which drove unprecedented price hikes this year; price hikes as high as 50 percent versus 2016. These PMDI price increases impacted our pipeline of prospects looking to replace formaldehyde-based binders with PMDI and DuraBind.

PMDI has been used in wood composites manufacturing since 1987, but its success has primarily been within the oriented strand board market where it's reached an approximate 50 percent share of the binder market. However, it has not been able to significantly penetrate the MDF or particle board segments due to process performance constraints which negatively impact productivity on the manufacturing line.

As a result, MDF and particle board continue to be dominated by formaldehyde-based binders. These large markets represent the most attractive markets for DuraBind as a no added formaldehyde binding system, and our pipeline of prospects trialling DuraBind was dominated by these segments through the first half of 2017.

However, as the supply constraints of PMDI persisted, wood composites manufacturers could not rationalize switching to DuraBind and PMDI, when the combined price significantly exceeded the price of continuing with the use formaldehyde binders. On a practical level, it was challenging for these manufacturers to even source PMDI at times.

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But there is a silver lining in this frustrating pricing environment. When we presented the opportunity for cost savings from our DuraBind system to OSB manufacturers, they recognized an opportunity to reduce their PMDI costs by introducing DuraBind to their resin systems.

Since August of last year, we have rapidly attracted a pipeline of OSB prospects that in just eight months now covers all trail stages from lab trials to multiday trials. These prospects are highly motivated by cost savings, with some prospects moving rapidly through the trials to the multiday stage.

In the near term, we believe these prospects offer the best opportunity for customer wins in the current PMDI conditions. Through the course of January and February, we are also encouraged by early indications that some PMDI supply has come back online, improving the supply conditions, and pricing is beginning to level off. However, prices have not returned to their historical levels at this stage.

We are also encouraged by the feedback we've heard from the integrated players in the market that own both production and retail. They have a long-term view to eliminating formaldehyde from the supply chain to only natural wood levels. We are actively engaging with these thought leaders, demonstrating how DuraBind can differentiate their offering earlier along the adoption curve.

Our number one priority is converting prospects to customers. Today, that nearer-term opportunity resides in the OSB market, but we remain engaged with prospects across all segments of

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wood composites. We're engaged with the right players. Our existing pipeline can deliver significant growth.

On the paper and paperboard packaging side of the business, 2017 was a year in which the business returned to growth. We added three new lines in 2017, which included expanding within existing accounts by adding new lines and winning new accounts.

We retained our pricing power and provided sufficient savings to these new lines such that they recognized the value proposition of EcoSphere and converted.

The price of SB latex currently ranges between \$0.90 and \$1, depending on the discount to the account. Given the upward trend in oil prices, which drive SB latex pricing, we expect modest benefit for the value proposition for EcoSphere.

Our long-term growth strategy is straightforward. We will continue to penetrate the global paper and paperboard packaging market and the wood composites market. Wood composites remains our highest priority with 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 million in Q4 2017, an increase of 8 percent compared to the same period in 2016, primarily due to higher average selling prices.

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Q4 2016 included approximately 1 million positive impact on revenues from the timing of orders by a key distributor. Excluding this item, sales increased 35 percent this quarter primarily due to higher volumes and favourable pricing.

Net sales were 17.9 million in 2017, an increase of 35 percent compared to 2016. Three-point-two million of this increase, or 24 percent, was due to higher volumes with the remainder from higher average selling prices.

Gross profit was flat at 840,000 in Q4 2017. Gross profit was 3.7 million for the full year, an increase of 67 percent compared to 2.2 million in 2016.

Net of manufacturing depreciation, gross profit as a percentage of sales was 22.1 percent for the quarter and 25.1 percent for the full year compared to 22.6 percent and 22.3 percent for the corresponding periods in 2016.

The decrease in cash margins this quarter was primarily due to higher manufacturing costs, partially offset by higher average selling prices. For the full year, cash margins improved by 2.8 percent due to higher average selling prices, partially offset by higher manufacturing costs.

Adjusted EBITDA loss was 1.1 million for the quarter compared to 1.7 million in the same period in 2016. Adjusted EBITDA loss for the year was 4.8 million compared to 7.6 million in 2016. The 34 percent improvement in the quarter was due to lower operating expenses. The 37 percent improvement in the annual period was due to higher volumes and lower operating expenses.

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We continue to be disciplined in our approach to cost management. SG&A expenses adjusted for depreciation and share-based compensation was 1.2 million in the quarter compared to 1.4 million in the same period of 2016. In the annual period, SG&A was 5 million compared to 5.8 million in 2016.

R&D expenses adjusted for depreciation and share-based compensation was 1 million in the quarter compared to 1.3 million in the same period of 2016. R&D expenses remained essentially flat at 4.3 million in 2017.

We have recently implemented a cost-reduction plan, with the goal of reducing our operating expenses by up to 20 percent in 2018. During Q1 2018, we have reduced our headcount by approximately 20 percent, and expect to book a provision for termination benefits of approximately \$250,000 in Q1 2018.

We took these steps so the business is in a better position to achieve profitability in the near term while continuing to execute on our long-term growth strategy. We appreciate the dedication and commitment of our team and the former staff through this process.

As of December 31, 2017, we had 49.3 million in cash and term deposits. We used 1 million of cash in operations during the quarter and 4.4 million during the year. We have more than sufficient cash reserves to execute our growth strategy, and will 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.

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**Jeff MacDonald**

Thanks, Rob. Wood composites is a growth industry. New no added formaldehyde binder solutions are required. DuraBind offers a solution that has been proven to work across each of the major wood composite segments.

While our conversions have been impacted by temporary price dynamics in PMDI, the primary market drivers remain intact. Consumers, retailers, and regulators are searching for solutions to minimize or eliminate formaldehyde.

Large retailers like IKEA, Walmart, and The Home Depot set the standard, and they are sending a clear message for their supply chains to reduce or eliminate formaldehyde. The more progressive panel manufacturers are taking a longer view through the recent resin economics to try to gain a leading position with retailers. Our confidence in DuraBind is as strong as ever.

That near-term goal for our entire organization is to achieve profitability. As Rob mentioned, we proactively took steps to rightsize the footprint of the business recently to a level that we believe is appropriate. Regardless of the dynamics and delays that affect our conversion rate in wood composites, our commitment is to do what it takes to deliver on our profitability objective in the near term.

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

And with that, I'll turn it back to the Operator to open up the call for questions. Thank you.

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## Q&A

### Operator

Ladies and gentlemen, we will now conduct the question-and-answer session. If you would like to ask a question, please press the \*, followed by the number 1 on your telephone keypad.

Your first question today will come from the line of Steve Arthur with RBC Capital Markets.

Please go ahead.

### Steve Arthur — RBC Capital Markets

Great. Thank you, and good morning. Just wanted to follow up on a couple of things. I guess, Jeff, you talked about the clear line of sight to profitability. And I just want to talk a little bit about the steps of getting there. Twenty percent cuts, I'm sure very, very difficult move, but part of that process. Beyond that, is it really just playing out these trials, waiting for the conversions and that to drive revenue growth as being the main factor? Or are there any other hurdles or roadblocks along the way that you'll see?

### Jeff MacDonald

Good morning, Steve. Thanks for the question. I don't anticipate any other further hurdles or roadblocks that we haven't discussed already. The time it takes to convert an account has been the biggest hurdle to overcome. That's been complicated a bit by the PMDI pricing dynamics. But I think

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we've turned that into an opportunity with the focus we've put on OSB and the progress that we've made there.

Cost reductions, yes, are difficult. The footprint is set such that our breakeven level is really in sight today. And I think other than that, what we're relying on through the course of this year, I think, is some further growth within the paper and paperboard packaging market, in addition to converting some of those wood composite lines. So it gives us confidence that having taken these steps, the two levers in our two markets are there for us to pull in order to get to profitability, as we said, in the near term.

**Steve Arthur**

And in terms of the greater focus now on OSB—I may have missed it earlier in your comments—but just to understand the nature of those trials, do they need to restart? Or are they as long in duration probably as what you were looking at previously with the boards? And when you do land one of those as a commercial customer, is that an equal-sized deal to what you were looking at before on an annual basis? Or larger or smaller?

**Jeff MacDonald**

The opportunities are pretty similar to what we've talked about before in terms of magnitude, so no real change there. Again, we've had one customer success so far that took us 18 months to get to the goal line. We haven't seen the speed of, let's say, early stage progressing to multiday trials that we've seen with some of these more recent OSB accounts, however. So we are

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optimistic that some of these could convert faster. And some of them have progressed pretty close to the goal line already.

But again, without having a data point that says we can do it faster, hard to say that we'll get there with speed that's greater than 18 months. The only thing I would say is that in the OSB players' world, remember that they're already using PMDI.

**Steve Arthur**

Right.

**Jeff MacDonald**

And so that infrastructure and that experience with the industrial hygiene of using a new chemistry, the piping, the hosing, the familiarity with the process is all there already. And so that's a fairly significant hurdle for a customer who's brand new to PMDI to overcome, and these guys have already overcome it. And I think that's one of the reasons why we've seen some of them progress faster than we've seen someone who may be converting from formaldehyde for the first time.

**Steve Arthur**

No, it makes sense. And I guess just a final one for me. Just on the large retailers you mentioned Walmart, and IKEA, and Home Depot, I think, and the others we've talked about in the past. They seem to be sending all the right signals to the supply chain; they're making the right kind of public comments about eliminating formaldehyde and so on. I guess I'm just wondering how we should think about that translating into them putting products on the shelves or seeing it through;

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sending the right signals to the supply chain. But any way to gauge what kind of activities that they're taking specifically to move the products in this direction or timelines in which they might do that? Just their level of urgency on it beyond sending signals?

**Jeff MacDonald**

Yeah. And I think—

**Steve Arthur**

And to the degree you can comment. I realize it's a touchy one.

**Jeff MacDonald**

Yeah. It is. It is a little bit. I think one thing that's no secret is that IKEA has its own captive operations. And so when they think about pushing this through the supply chain, it's not just pounding the table with external parties; it's actually working in their own operations. So they're able to take charge of that.

Interesting fact, I guess, when it comes to furniture using particle board. To make the conversion even in this PMDI environment, if you take an average bookcase at IKEA, we ran the math and it's something like a \$0.35 cost difference on what would be a 40 to \$50 bookcase, let's say. That's a small price to pay to be able to walk the talk in terms of what they've committed to their customers. That could be a cost that gets passed on, but I think in their case it's more likely to be an opportunity to drive higher sales as a result of having differentiated products.

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But I think if you're a purchasing manager looking at spending what you'd have to spend on PMDI today to make a panel, if you're in kind of the micro world like that it can look like a pretty big increase if you're facing a 50 percent increase. But if you take it all the way through to buying a kitchen or buying a Billy bookcase, the impact on the cost of the end product is minimal, something in the range of 1 to 4 percent. And so even in this pricing environment with PMDI, there's an opportunity to take the big picture view and continue to drive change.

So we're seeing that playing out with retailers, let's say, but we're also seeing that there are some panel manufacturers who really get it. And they're taking the longer view on it and continuing to push ahead. Some have definitely slowed with the price of PMDI, but we've seen some that have changed continued to push ahead and try to get to the goal line and be first to serve these retailers.

**Steve Arthur**

Okay. Good. Thanks very much for your comments.

**Jeff MacDonald**

Thank you, Steve.

**Operator**

And again, if you would like to ask a question today, please press the \*, followed by the number 1 on your telephone keypad.

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

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**Raveel Afzaal** — Canaccord Genuity

Morning, guys. Thank you for hosting the call. A couple of questions. First, can you quantify how many trials you have underway with wood manufacturers that are already using MDI and then the ones that are not using MDI at the moment? And we're talking about multiday advanced-stage trials.

**Jeff MacDonald**

Good morning, Raveel. Thanks. Yeah. In terms of quantifying the number of customers, if we take a step-back view for a second, the top players in the industry, most of them are using PMDI in some way somewhere in their organizations. Some of them are OSB manufacturers as well as in the other segments, and some of them use PMDI as a minority ingredient in some products. So there's at least some level of experience in the organizations.

But the OSB accounts that we're talking about having moved really quickly since last August, they are predominantly using PMDI today. And the savings that we're able to offer them by adding DuraBind into their mix is what's really driving them to progress as quickly as they have since August.

**Raveel Afzaal**

Okay. And is it possible to quantify these cost savings to the OSB manufacturers?

**Jeff MacDonald**

So we have to be talking to them about cost savings of at least \$0.5 million a year to make it meaningful. And in all cases where we're talking about the kind of progress that we've seen with

them, we are confidently able to offer that kind of cost savings. And that's why they're engaged with us.

**Raveel Afzaal**

So what does that represent in percentage terms 0.5 million per year?

**Jeff MacDonald**

So if you think about an average wood line, they're using somewhere between 10 million and \$15 million worth of resin in a year. So it's meaningful in terms of cost savings. But you have to think about it, too, in terms of their overall cost-reduction opportunities on a line. They could be doing things other than resin cost savings, for example, to improve their productivity and take costs down.

You have to provide a value proposition that stacks up to any of those initiatives. And typically, \$0.5 million gets it on the radar as a meaningful cost reduction that they're willing to invest in.

**Raveel Afzaal**

Thank you—

**Rob Haire**

And, Raveel, just to add to that, when Jeff's referencing the 500,000, that is a per line metric. So some of the manufacturers have at a low point of 5 lines to a high point of upwards of 20 lines, so you can use that as a multiplier if they think about that across their whole enterprise.

**Raveel Afzaal**

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Right—

**Rob Haire**

But it's very meaningful of savings that we can put on the table.

**Raveel Afzaal**

Makes sense. Thank you. And then what types of jobs were eliminated during this cost-saving initiative?

**Jeff MacDonald**

It was quite broad, Raveel. The one thing that we really focused on was not impacting direct customer-facing responsibilities. Our success is going to come from top-line growth, and we've built a strong reputation for how we support our customers, both in paper and wood. We didn't want to impact that in any way.

So it's—but otherwise, it's fairly broad across the organization. It wasn't from one specific area in particular.

**Raveel Afzaal**

Got it. And final question for me, a housekeeping question. How should we think about margins in 2018? I know margins in Q4 were impacted by relatively higher depreciation expenses and manufacturing costs. So taking both of them into account, you were close to 16 percent. How should we think about these gross margins in 2018?

**Rob Haire**

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Yeah. Thanks, Raveel. So our margins this quarter were just over 22 percent on a cash basis, which was I'd call it flat to Q4 '16. Sequentially, we came off where our full year margin profile was 25 percent. We target margins in that range. We feel that we have an opportunity to increase our margins once we get greater penetration into the wood composite market.

But overall right now, we did have in the quarter some pricing pressure for some of our input costs. And now we're actively looking at obviously passing those cost increases on to our customers or trying to minimize any impact. But overall as a business, we're targeting margins that are closer to what our full year margins were in 2017.

**Raveel Afzaal**

Perfect. Thank you so much for your time.

**Jeff MacDonald**

Thank you, Raveel.

**Operator**

And again, if you would like to ask a question, please press \*, followed by the number 1 on your telephone keypad.

And I'm showing no further questions in the queue at this time. I would now like to turn the call back over to Mr. Jeff MacDonald.

**Jeff MacDonald**



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

**Operator**

Thank you to everyone for attending today. This will conclude today's call, and you may now disconnect.

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