The Mullen Group Limited

Fourth Quarter 2022 Earnings Conference Call Transcript

Date: **Thursday, February 9th, 2023**

Time: **8:00 AM MT**

Speakers: **Mr. Murray K. Mullen**
Chair, Senior Executive Officer and President

Carson Urlacher
Senior Accounting Officer

Operator:
Welcome to The Mullen Group Limited Year-End and Fourth Quarter Earnings Conference Call and Webcast.

As a reminder, all participants are in listen-only mode and the conference is being recorded.

I would now like to turn the conference over to Murray K. Mullen, Chair, Senior Executive Officer and President.

Please go ahead.

Murray K. Mullen:
Thank you, and welcome, everyone, to Mullen Group's quarterly conference call.

Before I commence today's review, I'll remind everyone that our presentation contains forward-looking statements that are based upon current expectations and are subject to a number of risks and uncertainties, and as such, actual results may differ materially. Please, for further information that is identifying these risks, uncertainties, and assumptions take a look at the disclosure documents which are filed on SEDAR and at www.mullen-group.com.

With me this morning, I have our Executive team of Richard Maloney, Senior Operating Officer; Joanna Scott, Senior Corporate Officer; and Carlson Urlacher, who will be speaking shortly, Senior Accounting Officer.

What happened in Q4 and in 2022? Well, with today's release and our 2022 Annual Financial Review and this call today, we will be officially putting closure to 2022. Today, what we'll do is we'll focus on the fourth quarter results and highlight the factors that influence these results, and since we telegraphed most of what we will be talking about today just three weeks ago during our '23 business plan call, we'll keep this presentation short and focus on the key points, and truthfully, because nothing has really changed since our last call, we will not be holding a Q&A session. We will not waste your time repeating what we've already discussed. Besides, a complete and full disclosure of the fourth quarter and full year results can be found in the Annual Financial Review, and this document, once again, can be found on SEDAR and on our website at www.mullen-group.com. Carson Urlacher and his team, I've got to give them a lot of credit. They did a great job preparing this detailed report. I encourage anybody that wants to get all the details to take a look at it.

In 2022, our business was running, I would suggest, on all cylinders. We grew consolidated revenues by 35.3%, reaching $2 billion in annual sales, and I would have to classify these as pretty impressive growth statistics. Just as importantly, profitability was enhanced, I would also suggest to you, primarily by pricing increases and a very nice gain in the fourth quarter on the sale of some non-core assets. As a result, net income was a record $158 million or $1.70 a share.

We increased the dividend mid-year to an annual rate of $0.72 per common share. We bought back over 1.8 million shares at an average price of $12.30, and when you compare the MTL stock performance to other leading industrial companies on the TSX, we were one of the top performers last year, but 2022 will also be remembered as the year we did not engage in any significant or meaningful M&A activity, and for one fundamental reason; we did not like the asking prices, so we passed. We used the free cash to strengthen the balance sheet, and as I

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told the team, patience would ultimately be rewarded. Besides, last year, we didn't really have to do anything corporate office. Our 38 business units did an outstanding job managing the freight demand surge that occurred and the inflationary cost pressures. All you've got to do is look at the results and it's evident that they did a great job.

Now, I'm going to pass the call over to Carson Urlacher and he's going to provide additional detail on our fourth quarter results.

Carson, you're up.

Carson Urlacher:
Great. Thank you, Murray, and welcome, everyone.

I'll provide a bit more detail. However, our Annual Financial Review fully explains our financial performance. As such, I'll provide you with some of the highlights.

Overall, the fourth quarter can be characterized in two ways; we strengthened the balance sheet and we set several new financial records that finished off one of the most successful years we've had since going public 30 years ago. Most of our growth this quarter came from our existing business units versus acquisition.

In the fourth quarter, we generated $502.7 million in revenue, a record compared to any previous fourth quarter. Revenue increased by approximately $61 million or 13.8% compared to the prior year, and was primarily due to three reasons.

First, general rate increases negotiated earlier in year, along with steady demand, resulted in a $23.6 million increase in revenue. Secondly, our fuel surcharge revenue increased by $28.2 million to $65 million due to the 65% year-over-year increase in the price of diesel fuel, and lastly, we recognized $9 million of incremental revenue from acquisitions.

In terms of our adjusted OIBDA, we generated $77.6 million, being the highest amount we've generated in any fourth quarter in over a decade. Adjusted OIBDA increased by $17 million or 28% compared to the fourth quarter of 2021, with all three of our asset-based segments contributing to the increase.

In terms of margin, our adjusted operating margin improved by 1.7% to 15.4% in 2022 compared to 13.7% in 2021, and was mainly due to rate increases implemented in 2022, which more than offset inflationary costs. All three of the asset-based segments contributed to this margin improvement, so let's take a look at how they performed by segment.

Starting with the largest asset based segment, the LTL segment grew revenues by $22 million to $190.8 million. Seventeen point two million dollars of the increase was due to higher fuel surcharge, while acquisitions accounted for $5.5 million of incremental revenue. Segment revenue was negatively impacted in the fourth quarter, as inclement revenue—or sorry, inclement weather and the timing of holidays reduced the number of days available for us to work, particularly in the month of December. Adjusted OIBDA increased by $6.1 million to $31.8 million in the quarter, which was largely due to steady demand and general rate increases implemented earlier in the year, while acquisitions accounted for just under $1 million of the increase. Adjusted operating margin increased by 1.5% to 16.7% as compared to 15.2% in 2021.

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Our second-largest asset-based segment, being our L&W segment, grew revenues by $22 million or 16.7% to $153.8 million. Of the $22 million increase in revenue, $14 million was due to general rate increases and strong demand for freight services at virtually all of our business units, while fuel surcharge accounted for the remaining $8 million increase in segment revenue. Adjusted OIBDA increased by $7.1 million to $30.4 million in the quarter, and was mainly due to rate increases that led to the strong performance at virtually all of our business units. Adjusted operating margin increased to 19.8% in 2022 from 17.7% in 2021, as freight rates remained elevated and more than offset inflationary costs.

Moving to our S&I segment, revenues were up by $26 million to $108 million in the quarter, which was mainly due to rate increases and strong demand for specialized services, including pipeline hauling and stringing services, construction projects in Northern Manitoba, and from greater activity levels in the energy sector, leading to improved results for our drilling-related services business units and from those involved in the transportation of fluids and servicing of wells. Adjusted OIBDA increased by $6.8 million to—or 55% in the quarter compared to the prior year. Our adjusted operating margin increased by 2.7% to 17.7% compared to the prior year due to rate increases, the strong performance of Premay Pipeline and Smook Contractors, and from greater activity levels in the energy sector.

Our non asset-based U.S. 3PL segment revenues were down slightly to $52.6 million, as freight demand in the United States for full truckload shipments continued to soften in the fourth quarter of 2022 compared to the prior year. Adjusted OIBDA decreased by $1.1 million to just under $1 million. Adjusted operating margins were 1.7% on a gross basis, while operating margins on a net revenue basis were 19.6%. Margins were negatively impacted by the combined effect of lower revenues and a slight increase in S&A costs as we added talented IT staff to build out our proprietary SilverExpress technology platform.

Our net income of $61.5 million and our earnings per share of $0.66 per common share were both records compared to any previous fourth quarter. Net income increased by $41 million, and was mainly due to a $30 million increase in the gain on sale of property, plant, and equipment, which was mainly due to the sale of a non-core property located in Surrey, British Columbia. Other increases to net income include $11.8 million increase in OIBDA, a $2.9 million positive variance in negative—in net foreign exchange, and a $2.8 million gain on the fair value of equity investments. Somewhat offsetting these increases was a $7.8 million increase in income tax expense.

We continued to buy back our own stock, repurchasing and cancelling just over 150,000 common shares at an average price of $13.67 in the quarter.

As a result of our strong performance, our return on equity improved to 25.9% in the quarter and 17% on a year-to-date basis.

Looking at some other notables, we continue to generate cash in excess of our operating needs, as net cash from operating activities in the fourth quarter was over $100 million compared to $65.8 million in 2021. This increase of $34.7 million or 52% is mainly due to two things; one being the $11.8 million increase in OIBDA, and the other due to a $23 million variance in changes in non-cash working capital items. This strong cash flow generation and the sale of the non-core asset and business enabled us to reduce the amount being borrowed on our credit facilities by $76 million in the fourth quarter alone.

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Our balance sheet remains strong. Our debt to operating cash flow covenant under our private debt agreement is down to 1.67 to 1, which is the lowest we've seen since 2014. We have also a total of $250 million of bank credit facilities available to us, which we had $22.8 million drawn at the end of the fourth quarter, leaving us with over $225 million of room available. Our private debt has an average annual fixed rate of 3.93% and matures in two tranches, with principal repayments net of cross currency swaps of $217 million and $208 million due in October of 2024 and October of 2026, respectively.

We've entered 2023 with ample financial flexibility on our private debt covenants and on our credit facilities, allowing us to be opportunistic on the acquisition front. Now, to really put this into perspective, if we chose to leverage up to 2.5 times on our debt to operating cash flow covenant, we could effectively borrow up to $750 million of total net debt, meaning we could add approximately $200 million of debt to pursue acquisitions and still have one full turn of debt to operating cash flow on our covenant.

With that, Murray, I'll pass the conference call back to you.

Murray K. Mullen:
Once again, good summary, Carson, and just to kind of put an exclamation point on Q4, December was kind of a tough month, but part of that was just the way the holidays fell; Saturday, Sunday, and then you have Monday, Tuesday off, so you kind of—we kind of lose, really, 10 days, and then the weather hit kind of bad, so it's tough to really use December as a barometer, but it was a difficult month, there's no doubt about it, and that hurt our numbers in the fourth quarter; a little lower than what we anticipated, for sure, so some closing remarks before we call it a day.

On January 16, we provided a full analysis of our expectations for ’23, along with the business plan that we believe reflected reality, and our early January numbers are confirming our forecast, with revenues trending—I would say trending a little stronger than what we'd expected and showing a very nice recovery over December, which, as I just said, it was a short month due to holidays and a virtual shutdown due to weather impacting a lot of our business.

Just to summarize our overall view for 2023, we believe that the combination of rising interest rates, stubbornly high inflation, and fewer supply chain bottlenecks will impact the overall freight demand/supply situation, so on the consumer side, spending is—which is generally, by the way of speaking, a derivative of the job market, we still think that should remain reasonably constant provided employment levels stay at or near current levels. Now, that's a positive for our business, but to be clear, we don't see any overall demand growth. Where we do see some weaknesses, there will be some pricing erosion as the supply chain bottlenecks normalize, but this also creates the opportunity for our business units to focus more on cost and on productivity; initiatives that will minimize the impact of the lower freight rates, and since we're a diversified company and we operate in multiple verticals of the economy, we believe that we will see some growth in our Specialized Industrial Services segment.

Lastly, last year, you heard me comment earlier, I said we were—we—‘22 was the year in which we didn't do a lot of acquisitions and M&A activity, but the consolidation thesis that we’ve talked about on so many equations, that's still going to provide Mullen Group with a lot of growth opportunities in ’23. All we need is the right fit at the right price point, and I would reiterate, the tuck-ins are our preferred acquisition target, because we can realize synergies relatively quickly, and in our view, that's the purest way of adding value to our existing shareholders. I think all of

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you know by now we don't do acquisitions to grow—just to grow. We do it because we can add value to our business and to our shareholders.

This brings our call to a close today. We want to thank you for participating this morning. We look forward to updating our expectations for ’23 in April on the—it’s not going to be that far away, in conjunction with the release of our Q1 results, and I would close with this: ‘23’s going to be a year full of challenges, but there's going to be opportunities, and I would say this, we are prepared.

Thanks folks. Have a great day. Talk to you again.

Operator:
This concludes today's conference call. You may disconnect your lines. Thank you for participating and have a pleasant day.

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