Enviva Partners, LP

Q2 2021 Results Conference Call

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CORPORATE PARTICIPANTS

Kate Walsh – *Vice President of Investor Relations*

John Keppler – *Chairman and Chief Executive Officer*

Shai Even – *Chief Financial Officer*

PRESENTATION

Operator
Good morning and welcome to the Enviva Partners, LP Second Quarter 2021 Earnings Conference Call. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star (*) key followed by zero (0). After today's presentation, there will be an opportunity to ask questions. Please note this event is being recorded.

I would now like to turn the conference over to Kate Walsh, Vice President of Investor Relations. Please go ahead.

Kate Walsh
Thank you. Good morning everyone and welcome to the Enviva Partners' second quarter of 2021 earnings conference call. We appreciate your interest in Enviva Partners and thank you for participating today.

On this morning's call, we have John Keppler, Chairman and CEO, and Shai Even, Chief Financial Officer. Our agenda will be for John and Shai to discuss our financial results and provide an update on our current business outlook and operations. Then, we will open up the call for questions.

During the course of our remarks and the subsequent Q&A period, we will be making forward-looking statements, which are subject to a variety of risks. Information concerning the risks and uncertainties that could cause our actual results to differ materially from those in our forward-looking statements can be found in our earnings release as well as in our other SEC filings. We assume no obligation to update any forward-looking statements to reflect new or changed events or circumstances.

In addition to presenting our financial results in accordance with GAAP, we will also be discussing adjusted EBITDA and certain other non-GAAP measures pertaining to completed reporting periods as well as our forecasts. The information concerning the reconciliations of these non-GAAP measures to their most directly comparable GAAP measures and other relevant disclosures are included in our earnings release.

With that, I would now like to turn it over to John.

John Keppler
Thank you, Kate. Good morning everyone and thanks for joining us today. We've actually communicated quite a bit since our last quarter's earnings call, and while it has been an exciting quarter, and one which we achieved some major milestones, I'm also very happy to say it's been a straight down the fairway quarter for us, where we delivered the stable results you have come to expect. Given that, I'll keep my prepared remarks fairly short for this call.

While COVID-19 and its variants remain ever present in the headlines, we've been encouraged over the last few months to see the world making strides in reopening. Here at Enviva, our people have remained healthy and safe and that has enabled us to keep our plants and ports running 24/7, and our supply chain humming.

The durability and resilience of the business model we have built allowed us to deliver financial results that are right in line with our expectations. As I shared with you last quarter and just like in recent years, we expected the second quarter to look a lot like the first and that's just where we landed, generating about $49 million in adjusted EBITDA. That's a 31% increase in adjusted EBITDA over the same period of last year.

We continued to execute on our growth strategy, closing two significant accretive dropdown transactions. These acquisitions increased Enviva's fully contracted production capacity by 14% and increased our deep-water marine terminal throughput capacity by 38%. The projected increase in annual adjusted EBITDA of around $45 million once these assets are fully ramped, translates into an investment multiple of about eight times adjusted EBITDA, again, right in line with past transactions for plants and terminals.

To finance the equity portion of our recent acquisitions, we issued 4.9 million units in a significantly oversubscribed equity offering at an attractive 5.4% discount to the then current market price. Part of the reason, we believe, we have consistently been successful in raising new equity to finance our growth is because of the fully contracted growth profile of the business, which has enabled us to consistently and sustainably grow our distributions quarter-over-quarter, and this quarter was no different.

Based on our solid first half financial performance, coupled with the contracted cash flow acquired as part of the acquisitions, and the growth profile we expect for the second half of the year, the Board declared a distribution of and $0.815 per unit for the second quarter of 2021, a 6.5% increase over the distribution paid for the same quarter of last year. This represents our 24th consecutive distribution increase and maintains the 12% distribution CAGR we have delivered since our IPO.

Importantly, we are reaffirming our full year 2021 guidance, including an adjusted EBITDA range of $250 million to $270 million, and our 2022 guidance, including an adjusted EBITDA range of $310 million to $330 million. From a distribution standpoint, we're guiding to at least $3.30 per unit for full year 2021, and at least $3.62 per unit for 2022, each before accounting for the benefit of future dropdowns or other third-party acquisitions.

While these acquisitions may have dominated our financial headlines, during the second quarter, our team also made tremendous progress on capacity expansions at our Northampton, Southampton, and Greenwood plants, and advanced the multi-plant expansions at our Sampson, Hamlet and Cottondale plants. Our production capacity expansions are underpinned by the partnership fully contracted revenue backlog, which now totals $16 billion, with a weighted average remaining contract term of 13.2 years.

When combined with additional contracted production held by our sponsor, including the recently executed agreement with a major Japanese trading house, we announced yesterday, our revenue backlog and our total weighted average remaining term would increase to approximately $20.4 billion and 14.4 years, respectively. Our sponsor continues to develop and evaluate wood pellet production plants to serve as growing backlog of long-term contracted demand, which currently exceeds $4 billion.

Additionally, our sponsor has material contract volumes under various stages of negotiation with utilities, power generators and industrial companies in both existing and evolving markets. Like the MOU, we also announced yesterday with the European utility to supply wood pellets for 12 years to a facility in the Netherlands.

To serve this demand, our sponsor is currently developing a fully contracted wood pellet production plant in Epes, Alabama, for which we expect construction to start in earnest during this upcoming winter, with completion around 12 months thereafter. Our sponsor is also evaluating a potential future plant site in Bond, Mississippi. Given this site's close proximity to the Port of Pascagoula, production from a plant in Bond could be delivered at a low cost and low carbon footprint.

With powerful net zero commitments made by governments around the world, we expect no shortage of new markets and new commercial opportunities ahead for the partnership. I will spend some time later in the call outlining our growing customer contract pipeline and the underlying actions being taken by governments and industry in key jurisdictions to progress the substantial decarbonization initiatives required to meet binding emissions reduction targets.

Now, I'd like to turn it over to Shai to share more detail on our second quarter results and financial highlights.

Shai Even
Thank you, John, and good morning everyone. As John mentioned, our solid results for the second quarter of 2021 were right in line with our expectations. In terms of net revenue for the second quarter of 2021, we generated $285 million which represents a 70% increase over the corresponding quarter of 2020. The significant increase in net revenue is a result of incremental for the sales, as we commence deliveries to new customers and deliver larger volumes to existing customers.

Adjusted gross margin for the second quarter of 2021 was $56.1 million, an increase of $14.1 million or 33.4%, as compared to the second quarter of 2020. Adjusted gross margin per metric ton was approximately $41 for the second quarter of 2021, up from the $49.55 per metric ton in the second quarter of 2020. The decrease in adjusted gross margin for metric ton was primarily attributable to increased purchases of pellets from third parties, that generally as a lower margin than our produced volumes.

Adjusted gross margin per metric ton was also impacted by costs incurred during the commissioning of expansion projects at a number of our plants. Net income for the second quarter of 2021 was $2.6 million as compared to net income of $8.5 million for the second quarter of 2020. Adjusted net income was $9.8 million for the second quarter of 2021 as compared to adjusted net income of $8.7 million for the corresponding quarter in 2020.

As highlighted earlier, the partnership generated adjusted EBITDA of $48.9 million for the second quarter of 2021, an increase of 31% from the second quarter of 2020. The significant increase in adjusted EBITDA was driven primarily by higher revenue. Although we began signing contracts with Japanese counterparties a few years ago, deliveries into Japan are really just starting to ramp this year.

Distributable cash flow attributable to Enviva Partners was $32.9 million for the second quarter of 2021, which represents a 27% increase from the corresponding quarter in 2020, and results in the distribution coverage ratio of 0.61 times, which is consistent with this time last year. The partnership liquidity as of June 30, 2021, which included cash on hand and availability under our revolving credit facility was $568 million.

Enviva's commitment to conservatively managing its balance sheet is unchanged. We continue to expect to fund future dropdowns, acquisitions and major expansion using 50% equity and

50% debt. We also continue to target a conservative leverage ratio of 3.5 to 4 times, and a distribution coverage ratio of 1.2 times on a forward-looking annual basis.

Pivoting now to our financial outlook, as John mentioned, the partnership reaffirmed our full-year 2021 and 2022 guidance. As we have said in the past, seasonality, customer mix and timing of shipments can impact results and cause variances from quarter-to-quarter. We expect the shape of our adjusted EBITDA for this year and next year to look similar to 2019 and 2020, with the second half of the year being materially higher than the first half.

Additionally, we expect fourth quarter results to be a significant step up from the third quarter. For full year 2021, we expect adjusted gross margins per metric ton to be within the mid-40s. Our confidence in achieving our guidance is underpinned by the recent acquisitions in tandem with a benefit we expect to realize from our Mid-Atlantic and Greenwood expansions.

Additionally, many of our UK and European customer delivery schedules are slightly weighted to the back half of the year. Similar to 2019 and 2020, we expect the second half of the year to contribute about 60% of our annual projected adjusted EBITDA before accounting for the benefit of an additional $20 million in adjusted EBITDA contribution from our newly acquired assets, resulting in the next two quarters shaping up to be very strong for us.

Before I turn the call back to John, I want to comment on the current macro inflation trends. When we look at Enviva supply chain, we are in the fortunate position of being fairly insulated from inflationary pressures. We have annual price escalators as part of our contracts, which are designed to compensate for inflation. From the supply side, we have seen and expect to see seasonality benefits driving lower cost of productions in the third and fourth quarter, and our team is focused on improving efficiencies across our fleet and leveraging our increasing size and scale to reduce costs company wide. Now, I'd like to turn it back to John.

John Keppler
Thanks Shai. From a market development perspective, as you may have seen two weeks ago, the EU Commission released its Fit for 55 package, which is intended to deliver a 55% reduction in carbon dioxide emissions from 1990 levels by 2030, a key milestone needed for the EU to reach carbon neutrality by 2050. The commission continues to recognize the importance of sustainable biomass in meeting aggressive emissions reduction targets, and the indispensable role biomass plays in mitigating climate change.

As drafted, the proposals under the latest Renewable Energy Directive or RED III, further heighten member countries' obligations to increase the share of renewables, such as biomass in their energy generation portfolios. RED III proposals also outline refinements to the sustainability criteria for biomass, and as proposed, they're generally in line with Enviva's practices.

Another advancement in the EU that is worth highlighting is the constructive carbon price environment that has developed. Since November 2020, EU Emissions Trading System prices have more than doubled, allowing energy generated by biomass to be more profitable than carbon intensive feedstocks like coal and natural gas, even in markets where there are no direct incentives or subsidies for renewable energy generation.

Given this backdrop, we have seen increased momentum around fuel switching decisions, as subsidy frameworks become potentially less influential on end users' decisions to transitions to biomass usage.

In Germany, following last year's formal adoption of the Coal Exit Law, regulations for long-term financial support to decarbonize district heating networks, with renewable alternatives, including biomass are expected to be finalized during the third quarter of this year, with regulations for dedicated power plants expected thereafter.

The finalization of these regulations should provide a path to convert the commercial discussions underway with a number of major German utilities and heat and power generators into long-term fuel supply contracts that support their planned conversions to biomass.

Utilities have long been the prime consumers of biomass in Europe, but the global industrial sector is becoming an emerging market for Enviva, where steel mills, cement manufacturers, lime producers and chemical plants are evaluating large scale coal to biomass switching. Enviva has delivered multiple test cargoes to large European industrial customers that are piloting biomass as a decarbonization solution for their operations.

With the tremendous growth we have achieved, combined with what we see ahead, tools like our proprietary track and trace system and our industry leading responsible sourcing policy will continue to ensure that our wood pellets remain sustainably produced from forests whose inventories have and continued to grow over time. As you may recall, we also subject our operations to stringent third-party annual audits, and we are pleased to report we continue to be certified under leading independent globally recognized sustainability standards like FSC, PEFC, SFI and SBP.

We expect the progress that we are making on our own net zero commitments to further reinforce our environmental leadership and reputation for sustainability. We are progressing efforts to immediately mitigate or offset all of our Scope 1 emissions and we have several exciting process changes and input substitutions underway in our manufacturing facilities. We're also evaluating a number of onsite and adjacent renewable energy generating alternatives in connection with our Scope 2 emissions, which we have committed to cut by 50% by 2025 and mitigate fully by 2030.

Finally, we have several additional partnerships in development in addition to the maritime shipping initiatives we have described previously to help our supply chain partners make measurable progress in our Scope 3 emissions.

Sustainability is at the core of our value proposition, and our net zero advancements only make the product we manufacture that much more valuable in our effort to displace coal, grow more trees, and fight climate change.

Before we close, I want to take a moment to thank the whole Enviva team for the tremendous progress we made this past quarter. Our colleagues continue to do our jobs day-in and day-out safely and reliably, with an unrelenting focus on keeping each other healthy and making a positive impact in our communities.

We are deeply embedded in the communities where we operate, proud to serve their needs as a good corporate citizen and neighbor, and are thankful for the support and recognition, we receive for our efforts and contributions. With the incredible momentum across the globe for renewable energy, I'm very excited about what comes next for our team.

The world continues to want less carbon more quickly and more cost effectively. This quarter again demonstrates the power of the fully contracted business model we've built to serve those markets, delivering solid results with significantly increased financial performance over the same period last year, and continuing our uninterrupted track record of stable quarterly per unit distributions that reliably increase over time.

This is our foundation and one we intend to build upon, but we're really just getting started, and I look forward to sharing more about our progress next quarter. Until then, thank you for listening.

Operator, can you please open the line for questions?

QUESTIONS AND ANSWERS

Operator
We will now begin the question-and-answer session. To ask a question, you may press star (*) then one (1) on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw your question, please press star (*) then two (2). At this time, we will pause momentarily to assemble our roster.

The first question comes from Elvira Scotto with RBC Capital Markets. Please go ahead.

Elvira Scotto
Hey, good morning everyone.

John Keppler
Hi, good morning, Elvira, good to talk to you.

Elvira Scotto
Yeah, you too. So, I know you talked about insulation from inflationary pressures, but can you comment on labor? Are you seeing any impact from labor shortages?

John Keppler
So not directly Elvira, as you know, we generally tend to build plants where there are lots of trees and few people, and so what we have is, we like to believe is a relatively stable workforce. Where we have seen it is, frankly, a little bit at the margins kind of right at the entry level position for some of our facilities, and this is three or four people per facility, but what you have is given some of the unemployment benefits, and sort of the effective wage rate of the government paying people to stay at home. We have seen that, in terms of recruiting, in terms of the number of people applying, but as that has begun to abate, I think that are -- those entry level applicants have returned and reasonably enforced.

Elvira Scotto
Okay, thanks for that, and then I know we've talked about Germany for a while. Can you give us an update there? And then, in your prepared remarks, you note that Enviva has been in commercial or had commercial discussions underway with multiple major utility operators of heating networks and power generation facilities. Can you provide any more granularity on those discussions? And if you were to convert those discussions into contracts, how big that opportunity in Germany in aggregate be for Enviva?

John Keppler
Yes, absolutely, Elvira, and I think we're pretty excited about the progress that we continue to make in Germany. As you know that the country that put itself on a path to eliminate in coal as a generating resource similar to the way they've done so on nuclear, and it made some very, very substantive, and strong commitments to decarbonization.

I think you'll also note that in the passage of the Fit to 55 package and some of the recent announcements from the German Supreme Court, they're looking for incremental specificity on exactly how and when and how soon they're going they're going to deliver that massive decarbonization, and so at the Coal Exit Law has now come into force, the regulations that will promulgate and enable both operators have places like district heating networks, that have been principally fired with fossil fuels, to convert to things like biomass and so that draft regulation is now out.

Frankly, we're pretty excited about it, and the number of the customers within we're working now have what they believe is a pretty clear runway over towards not only converting but generating renewable baseload heat on the basis of biomass for a long time going forward. We expect the power component of those regulations to be issued sort of later this year. I think the election – given that it's an election year, there's probably a little bit of noise around timing of that, but again, all these pieces remain firmly on track given Germany's commitment to decarbonization, and as we look at the total addressable market, we would see the total addressable market in the sort of 5 to 10 million tons per year range, which should, if you believe that we're able to maintain our overall market position, translate into a couple million tons for Enviva.

Elvira Scotto
Great, thanks and then, you also mentioned in your prepared remarks that the global industrial sector is an emerging market opportunity for Enviva. Is there any way you can quantify how big that opportunity could be? And then is that just in Europe or is that opportunity elsewhere like in the U.S. as well?

John Keppler
Well, I think that that as jurisdictions around the world, really begin to understand the pricing mechanisms for the carbon intensity of industrial activity, lots of opportunities will open up around the world. Of course, Europe is leading, that is as oftentimes they have historically, and reducing remarkable opportunity in the industrial adjacencies. You've heard us talk about steel, cement, lime, chemicals, sugar – frankly, any one of those markets, and frankly, even any one of those customers in those markets. Like you've heard me reference previously, a single steel company in Europe consumes as much coal as the equivalent wood pellet market as it existed for the industrial generation of power and heat existed two years ago. So, you've got not just sort of step functions in market growth and potential, but as industries look at decarbonization, we're obviously very happy with the test cargoes that have been successfully processed for a number of utility or potential industrial customers around the world.

We generally tend to see a really robust market in those areas of industry that are very, very difficult to decarbonize, and so tremendous opportunity, again, multiple segments, multiple customers at scale that differently dwarf in industrial wood pellet market as it stands today.

Elvira Scotto
Great and then my last question, I promise, can you provide a little more detail on BECCS? Specifically, how do you see that evolving? And then how does the economics work for Enviva?

John Keppler
Yes, so I think, I would characterize it more from our customers' basis itself. Again, we're pretty good at making sure that we deliver the right product at the right time at the right place around the world, and if that's ultimately used in power and heat generation, or ultimately through carbon capture and sequestration or displacement in industrial activities, we're really that field supply chain partner, but our customers who are investing very heavily in BECCS approaches, I think that the opportunities out there is given the world focus on net zero, you're going to need negative emission solutions as part of that and BECCS is available now and alternative that can be executed very quickly and effectively. If the research from folks like the coalition for negative emissions continues to pencil out as favorably as we think it does, that's a market that on the basis of power and carbon pricing. If the net effects of those things are in the sort of 150-pound range, that's probably something that [unintelligible] scale, which is not too far away from where power prices and carbon prices are right now.

Elvira Scotto
Great, thank you so much.

John Keppler
Absolutely Elvira, great to talk to you.

Operator
As a reminder, if you have a question, please press star (*) then one (1). The next question comes from Pavel Molchanov with Raymond James. Please go ahead.

Pavel Molchanov
Thanks for taking the question and appreciate you guys providing the detail about Fit for 55. As relates to Europe, I saw a small off-take agreement in the Netherlands. Is that going to be country number four for Enviva in the European market?

John Keppler
So, Pavel, great to talk to you, and thanks. As a practical matter, we've delivered into the large-scale utility generating market in the Netherlands for some time. The MOU and deliveries that we just announced into the Netherlands, yesterday, really are focused on a new segment, and again, that's a focus on the industrial segment in Netherlands, an area that that particular country has been intensely focused on. As you may recall, they have essentially announced the end of fracking in the Groningen field and the utilization of natural gas as a resource to most of the industrial customers across the nation, and so, the generation of steam and thermal loads across the industrial sector there, they need to intensely focus on decarbonizing.

Of course, biomass and the 12-year subsidy that exists for that today, for high temperature heat applications, is a very attractive alternative for a number of industries, looking to both decarbonize your own industrial activities but do so on profitable generation opportunities, and so that, I think, another entry point for us in the market segment that we believe is going to grow very rapidly both in the Netherlands as well as elsewhere across Europe.

Pavel Molchanov
That's helpful. Japan, I realize will be a relatively modest slice of your revenue mix this year, because of course, the dropdown just closed, but how much do you think that will be of revenue in '22?

John Keppler
So, I think you've got a relatively linear growth profile in terms of its percentage of revenue growing from, if you look two years ago, zero to about 50% by 2025, and so as those contracts continue to come to life, and as Shai mentioned in his remarks, we've begun substantive deliveries last year, really ramping this year, and you can expect that growth curves to occur effectively linearly between 2021 and 2025.

Pavel Molchanov
Okay, so, 10% this year or 20% next year, roughly?

John Keppler
I think it's a little bit more than that next year, I think you're sort of hitting 25%, 50%, 75% of that 50. For instance, we have 40 ships heading to Japan this year.

Pavel Molchanov
Okay. Any impact that you're noticing from the COVID situation in Japan, which needless to say, it's been getting worse rather than better?

John Keppler
No, our deliveries have continued uninterrupted to customers around the world.

Pavel Molchanov
Thank you, guys.

John Keppler
I appreciate, Pavel.

Operator
This concludes our question-and-answer session. I would like to turn the conference back over to John Keppler for any closing remarks.

CONCLUSION

John Keppler
Thanks everybody for taking the time to join us again today. We're very privileged to be in the position we're in and we believe we have a responsibility to continue that strong track record. You can count on us, and frankly, the entire Enviva team continued to work very hard every day, stably, safely and reliably displacing coal, growing more trees and fighting climate change, and we very much look forward to talking again soon, and hope you guys stay healthy, and have a great day. Thanks so much.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.