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Maple Leaf Foods, Inc. (MFI.CA)

Q2 2024 Earnings Call

CORPORATE PARTICIPANTS

Janet Craig

Vice President-Investor Relations, Maple Leaf Foods, Inc.

Curtis E. Frank

President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.

David Smales

Chief Financial Officer, Maple Leaf Foods, Inc.

Dennis Pat Rick Organ

President-Pork Complex, Maple Leaf Foods, Inc.

OTHER PARTICIPANTS

Irene Nattel

Analyst, RBC Capital Markets

Mark Petrie

Analyst, CIBC World Markets, Inc.

Michael Van Aelst

Analyst, TD Cowen

Luke Hannan

Analyst, Canaccord Genuity Corp.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen. Thank you for standing by and welcome to Maple Leaf's Second Quarter 2024 Financial Results Conference Call. As a reminder, this conference call is being broadcast live on the Internet and recorded. All lines have been placed on mute to prevent any background noise. Please note that there will be a question-and-answer session following the formal remarks. We will go over the introductions – instructions, sorry, for the question-and-answer session, following the conclusion of the formal presentation.

I would now like to turn the conference over to Janet Craig, Investor Relations at Maple Leaf Foods. Please go ahead, Ms. Craig.

Janet Craig

Vice President-Investor Relations, Maple Leaf Foods, Inc.

Thank you, Ken, and good morning, everyone. Speaking on the call will be Curtis Frank, President and Chief Executive Officer; Dave Smales, Chief Financial Officer; and Dennis Organ, President, Pork Complex and the Incoming CEO of new Pork Company.

Before we begin, I would like to remind you that some statements made on today's call may constitute forward-looking information, and our results may differ materially from what we discuss. Please refer to our second quarter 2024 MD&A and other information on our website for a broader description of operational and risk factors that could affect the company's performance. We've uploaded our second quarter investor deck to our website, which includes support material for the quarter. And as always, the IR team will be available after the call for any follow up questions you may have.

And I'll hand over to Curtis.

Curtis E. Frank

President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.

Okay. Thank you, Janet, and good morning, everyone. It's great to be with you here again today. In our comments this morning, I'll begin our discussion with an overview of our strong second quarter results and outline the progress we are making in delivering against our 2024 priorities; David Smales, our CFO, will provide a deeper dive into our financial results, along with the outlook for 2024; and Dennis Organ, the President and Incoming CEO of our Pork Company and I will touch on our transformative transaction that will unlock value and unleash our two distinct businesses, Maple Leaf Foods and the new Pork Company. And we will, of course, open up the call for your questions.

And with that, I'll go ahead and jump right into our second quarter where the headline is that we made excellent progress in advancing the execution of our priorities. As a result, adjusted EBITDA grew approximately 37% year-over-year to CAD 141 million, and free cash flow increased by CAD 103 million in the quarter versus last year. Our adjusted EBITDA margin of 11.2% was a 310 basis point improvement versus last year, which was largely fueled by the improvement in pork markets and the contribution from our large capital projects in London poultry and the Bacon Center of Excellence.

And we also saw a sequential quarterly improvement in adjusted EBITDA in terms of our margin of 110 basis points from Q1 with seasonally improving results in prepared meats and poultry, along with accelerating contributions from our large capital projects, while pork market conditions improved from last quarter. The net benefit of markets when including Japan, had a minimal impact on adjusted EBITDA margins sequentially.

From a relative performance perspective, our margin of 11.2% not only establishes us as leaders amongst our peers, but also continues to provide us with the confidence that we can deliver to build on the quarters and years ahead, as we continue to migrate toward our 14% to 16% target in normal market conditions. Of course, it will not be a straight line and not every quarter will improve sequentially along the way, but the long-term potential of the business to create value continues to be very exciting.

Turning to revenue, sales of approximately CAD 1.3 billion were essentially flat year-over-year, which was in line with our expectations. There are three reasons that we were pleased with this outcome. The first is the strengthened sales growth that we saw in our Prepared Foods operating unit, which consists of prepared meats, poultry and plant protein, where we grew revenue by 1% and our core CPG prepared meats business delivered a 3.2% increase in revenue year-over-year. This level of sales growth against the backdrop of the current consumer demand environment, clearly demonstrates the resilience of our brands, the ability of our sales and marketing teams to quickly adapt to changing market conditions and the strength of our connection to both customers and consumers.

Second, poultry sales were down 3.9% as compared to last year. However, the important context in poultry is that we delivered significant growth in the retail channel of over 12%, which was more than offset by reduced sales to industrial channels, which we expected as part of executing our plan to repatriate volumes from a co-manufacturer and into London poultry. The mixed benefit from this shift, supported by improving profits in the poultry business, helped us this past quarter. The impact of this transition will continue to play out in Q3 as well and will be fully lapped by Q4 this year.

Third in the Pork Complex, it's important to note that sales are not a key metric since the business is driven by spreads. In Q2, despite the fact that revenue in the Pork Complex declined by 4.2%, a result of less buy/sell activity and foreign exchange impacts. Our financial results improved materially relative to the prior year and also

improve sequentially. Within the supplemental materials we provided earlier this morning, we included a summary of our second quarter business highlights to provide some additional context to our performance.

Within prepared meats, we delivered solid results in what is clearly a dynamic consumer demand environment. And although there is work yet to do to fully recover volume and mix in the retail channel, and we haven't been immune to the consumer environment. It was certainly a positive quarter of progress overall. We've continued to adapt our brand and growth strategies to the evolving consumer environment, and we are seeing improvements in specific areas of focus.

In Q2, prepared meats sales grew at just over 3% year-over-year for the second consecutive quarter. Foodservice volumes were positive, supported by the capital investments we've made to enable higher sales of pre-cooked bacon and further processed poultry. We saw double-digit growth in both sustainable meats and in the US market, including sales growth at every one of our current US Greenfield brand customers, while gaining incremental distribution of Greenfield brand offerings through a very large retailer in the United States.

In the poultry business, our financial results improved sequentially and year-over-year. The London poultry facility is delivering in almost every aspect. Majority of the year-over-year improvement was driven by the contributions from this capital project, and we remain fully on track to achieve the full business case by the end of the year. Outside of London, what really stood out in this quarter was the resilience of our leading brands where we grew retail channel sales by nearly 13% and increased our market share across our key brands Prime, Maple Leaf and Mina Halal. Here too, while it's important to recognize the progress we have made, we are also clear that we still have work to do. Like many other companies, we are seeing softness in consumer demand for premium offerings such as RWA and organic fresh poultry, largely attributable to the overall economic environment as we've shared previously. As well supply and demand are still working their way into balance.

Looking at plant protein, we did not deliver on breakeven levels of profitability this quarter as our SG&A increased sequentially from a seasonality point of view, driven by higher levels of ad and promo that were aimed at stimulating sales demand. With these slightly elevated levels of investment, our sales performance did outpace the overall refrigerated category in the US, but we were not able to deliver the volumes that are required to achieve profitability. The focus for the plant protein business remains on achieving overall profitability, in line with the balance of our business through a combination of reigniting growth and continuing cost efficiencies.

In the Pork Complex. The important takeaway is that our financial results are improving, largely due to actions taken to optimize our sales mix, along with the improvements in the vertically integrated pork margin, which were partially offset by the impact of the Japanese market. The net impact of market headwinds, including Japan, was approximately CAD 16 million or about 125 basis points in the second quarter as compared to what we would describe as normal markets, the five-year pre-pandemic average.

All told, with a significant step up in profitability versus a year ago, along with subsiding capital needs of the business following the completion of our two large projects, we have improved our free cash flow performance and we continued to strengthen our balance sheet. We have been clear that deleveraging is a priority and we are making progress as our net debt to EBITDA closed Q2 at 3.4 times.

I'm now going to turn the call over to David to discuss our financial results in a little bit more detail. And then I'll hop back on to update you on our transformational transaction, our playbook for the future and our progress against the balance of our 2024 priorities. David?

David Smales

Chief Financial Officer, Maple Leaf Foods, Inc.

Thank you, Curtis. And good morning, everyone. Turning to our results this quarter, and I'll touch briefly on the company's consolidated results before addressing balance sheet items and discussing outlook for 2024. Total sales in the second quarter were CAD 1.26 billion, a decrease of 0.4% compared to last year. Adjusted EBITDA increased by 37% to CAD 141 million, with an adjusted EBITDA margin of 11.2% compared to 8.1% last year. Loss for the quarter was CAD 26 million or CAD 0.21 per basic share, compared to a loss of CAD 54 million or CAD 0.44 per basic share last year.

After removing the impact of the non-cash fair value changes in biological assets and derivative contracts, startup costs and restructuring costs, adjusted earnings were CAD 0.18 per share for the quarter compared to CAD 0.00 per share last year. As I mentioned, sales were marginally lower in the second quarter by 0.4% compared to last year. Within Prepared Foods, sales were up 1% year-over-year. We saw an increase in sales in prepared meats of 3.2%, which was offset by declines in poultry of 3.9% and plant protein of 2.5%.

Within prepared meats, we saw higher volumes in foodservice and improving retail mix as Curtis noted. In Plant Protein, our sales performance were stronger than the refrigerated category performance. And in poultry, we have increased production capacity for tray packs as we as we ramped up the new facility in London during 2023. We no longer require a third-party to fulfill tray pack demand for us. This allowed us to repatriate this higher value volume to London and reduce sales into the industrial channel.

In essence, London has allowed us to improve our mix by increasing our tray pack capacity, replacing lower value of volatile industrial channel volume, resulting in the decline in poultry sales year-over-year by improved mix and margin performance. Pork sales came in 4.2% lower year-over-year on lower buy and sell activity and in favorable movements in FX. Occasionally, we engage in more transactional sales opportunities, purchasing additional pork and other products for resale to existing customers, which offer some additional profitability, albeit at lower margins, which wasn't reflected to the same extent in this year's sales results.

Adjusted EBITDA significantly improved year-over-year, growing to CAD 141 million, a 37% increase compared to the second quarter of last year, with both Prepared Foods and pork contributing positively. Within Prepared Foods, profitability was primarily driven by positive contributions from poultry and plant protein results. Poultry saw better mix and contributions from the London facility and plant protein's improved performance reflects efforts through 2023 to right size the business and drive costs down. We did see some offsetting pressure on margins in our prepared meats business this year as we continue to invest to support volumes in a more dynamic consumer environment.

Bull markets were also a tailwind to our year-over-year results as market conditions have improved, although remaining well below what we defined as normal. Q2 adjusted EBITDA was negatively impacted by CAD 16 million or 125 basis points, relative to what we view as normal market conditions. Adjusted EBITDA margin came in at 11.2%, up 310 basis points from the year prior and 110 basis points higher than the first quarter. Compared to the first quarter, Curtis touched on the main drivers of adjusted EBITDA improvement, being prepared meats, poultry and contribution from our capital projects, offsetting some of the margin expansion with higher SG&A costs, which largely reflects one time consulting fees associated with programs related to operational improvement initiatives.

In total, during the quarter, we invested CAD 16 million in capital expenditures compared to CAD 53 million in Q2 last year. The decrease is largely due to the completion of our large capital projects. We've updated our outlook for capital expenditures for the full year to between CAD 120 million to CAD 140 million based on our current

spending levels. This reduction is due to a recalibration of current year maintenance capital requirements, primarily related to completion of major capital projects and the closure of legacy poultry plants.

Free cash flow improved year-over-year to CAD 27 million, up CAD 103 million from negative CAD 76 million in the second quarter last year as we start to see the year-over-year benefit of improved earnings and reduced capital requirements. On the balance sheet, net debt was flat from the end of the first quarter at approximately CAD 1.7 billion. In line with our stated priorities, we saw a significant improvement in leverage ratios over the past four quarters, with a net debt to trailing four quarter adjusted EBITDA ratio of 3.4 times at the end of the second quarter of 2024, compared to 5.8 times at the end of Q2 last year and 4.1 times at the end of 2023.

As profitability of the business continues to improve, combined with the conclusion of our large capital programs, we expect this deleveraging trend to continue through 2024. Our outlook has been updated to reflect our current expectations and we have slightly revised our revenue expectations to low-single digit sales growth in 2024 versus 2023. Our adjusted EBITDA margin expectations remain unchanged and we expect to see growth in 2024 over 2023 progressing toward our 14% to 16% adjusted EBITDA margin target in normal market conditions. As we continue to exercise discipline in our capital expenditure program, we have lowered our expected spend CAD 120 million to CAD 140 million, as I mentioned a moment ago.

I'll now turn the call back to Curtis.

Curtis E. Frank

President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.

Okay. Thank you, David. I'd like to take the opportunity now to provide you with an update on the announcement that we shared a month ago with respect to our transaction to unlock value and unleash potential by separating into two independent public companies. The reception from our investors has been great and we have certainly appreciated the engagement, the insights and the feedback as we move through to close and beyond.

We remain confident that this is a move that will lead to greater levels of growth and value creation as each business has provided the opportunity to pursue its strategies with a dedicated management team that's focused on executing its unique playbook. Maple Leaf Foods will now realize its vision to become the most sustainable protein company on earth as a more focused, purpose driven, consumer packaged goods company. Within Maple Leaf Foods, we will continue to be guided by our blueprint and our playbook for the future, all of which are coming more clearly into focus.

As we look to 2025 and beyond, we will be reshaping our portfolio to consumer packaged goods by spinning off our pork business and continuing our deleveraging efforts to give us the balance sheet strength we need to create a platform for long-term profitable growth. Our focus remains, as always, on delivering sustainable growth for the organization through executing our growth platforms, of investing in our portfolio of leading brands, accelerating the pace of impactful innovation, leveraging our leadership in sustainable needs, expanding our geographic reach into the US markets and plugging our unique capabilities into our customer strategies.

To unlock and fuel the growth that we need for the business more broadly, we are also evolving our cost focus. We have a number of initiatives in place that are at various stages of maturity and have the potential to be supportive of margin expansion that's further from where we sit today over the course of time. These initiatives include harvesting the last of the benefits of our recent capital projects. Optimizing the performance of our manufacturing network and optimizing our SG&A as well as important work to be done in strategic sourcing, simplification and modernizing our capabilities to ensure that we keep pace with the changing world around us.

As these programs are about more than just cost, they're focused on outcomes that improve our competitive edge. As we move through to the close of the spin-off, we will look forward to diving into each of these in a bit more detail as part of outlining our ambitions for the company over the next several years. And of course, the new Pork Company will be unleashed as a world leading organization, taking advantage of its unique business model and unlocking its own significant growth potential.

I'll turn it over to Dennis now to spend a few moments on the call today to share his thoughts on the new Pork Company's business drivers and their playbook for the future. Dennis?

Dennis Pat Rick Organ

President-Pork Complex, Maple Leaf Foods, Inc.

Okay, thank you, Curtis, and good morning, everyone. I want to extend my gratitude to those who have had the chance to connect with over the past few weeks. These conversations have been valuable in helping me refine our communication and guidance efforts moving forward. Today, I'd like to outline our top priorities as we approach the completion of the spin in 2025. We believe these initiatives will significantly drive our growth and enhance EBITDA in the coming years. First, a quick update on the market. As you may recall, we raised approximately 45% of our hogs internally. This segment of our business has historically been more volatile. Thankfully, feed markets have begun to normalize to pre-2020 levels and this improvement is reflected in our results.

As a management team, our focus remains on operational excellence rather than market fluctuations. We have two primary near-term objectives. First, we aim to reduce our control over raising costs. We closely track critical KPIs and have pinpointed performance gaps by location while we have made some progress in these areas, there is more work to be done.

Second, we are focused on lowering our processing cost. Our brand and facility is currently underutilized and we have both short and long-term plans to address this. In Q2, we processed around 5% more hogs year-over-year. Our processing facilities also have critical KPIs that we are focused on. We have line of sight to our potential processing costs and have worked to simplify operations to increase the success rate of our front line associates. Our commitment to operational excellence spans the entire Pork Complex and will drive cost improvements throughout our network. We are also advancing automation projects. Some are in the early stages of execution, while most are fully vetted and will be executed as we generate cash.

Looking further ahead, we see high return, low risk investment opportunities in multiple areas of our business. These opportunities are not overly capital intense and can be implemented in small increments. These efforts, along with other initiatives, will drive operational excellence and efficiency throughout our network. Today and going forward, transparency will remain a high priority, continue to provide clear and consistent updates about our financial results and our financial potential in the months ahead. We are all very excited to unleash the potential in the pork business and I look forward to speaking with you again.

With that, I'll pass it back to Curtis.

Curtis E. Frank

President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.

Okay. Thanks, Dennis. Before I wrap up the call, I just wanted to reiterate some important next steps for the spin-off transaction. Our project management team is making excellent progress as they work to advance the detailed separation and the planning work that is essential to successfully executing the transaction. We know that you're

keen to learn more details. And to that end, the most important upcoming milestones will be filing the prospectus, which will contain detailed information about the new Pork Company and the information circular, which will include the details about the transaction, including the capital structure, tax consequences, governance agreements, supply agreements and shareholder approvals. A recruiting for a high caliber independent set of directors to serve on the board of the new Pork Company is also in flight and we are fully on track and on pace for a 2025 closing as communicated and planned.

As we wrap up the call this morning, I'd like to close by saying that I'm pleased with the progress that we've made in our results this quarter. Our 2024 outlook remains largely unchanged, and we are focused on delivering against our six top priorities for 2024. As I've said in prior discussions, the opportunities ahead of us are tremendous. We are clear on what needs to be done. There is positive momentum building in our business and I'm very much confident that we're on the path to delivering.

And before we move on to questions, I do want to extend my gratitude to the entire Maple Leaf team, whose exceptional contributions and remarkable skill in navigating a complex operating environment have been nothing short of outstanding.

With that operator, we can now turn the call over to questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. [Operator Instructions] The first question comes from Irene Nattel. Please go ahead.

Irene Nattel

Analyst, RBC Capital Markets

Q

Okay. Good morning, everyone. Looking at the results for Q2, which thank you roughly. It looks like we're seeing improvement in operating performance everything we've been waiting for. Can you walk us through the key factors maybe in order of contribution that are really driving the gains of both prepared food and pork and notably, how should we think about the evolution in the back half of the year and into 2025? Thank you.

Curtis E. Frank

President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.

A

Hey. Good morning, Irene. Yeah, it was very much a solid quarter. I mean, we were in a position where obviously we increased our adjusted EBITDA by 37% year-over-year, which to your point, we've been waiting for pork markets to move towards normalization for some period of time along with the potential that comes from executing our large capital projects and we certainly made progress here in the last quarter, so we're quite pleased with that. In terms of the headlines for the quarter, I'll start with saying the Pork Complex for certain saw a material improvement on a year-over-year basis in market conditions. So, that's been long in the works and something we've been very much looking forward to and we saw progress within the quarter, which was very promising news.

I think probably what we're equally excited about is the fact that our Prepared Foods sales revenue grew headline by 3.2% in the prepared meats business, which is our core CPG engine. And in the context of the current consumer environment, we saw it as a very good outcome from a revenue point of view, 3.2% growth in prepared meats. And it was really good to see sustainable meats in our US growth platforms having an excellent outcome

in the quarter as well. So, those are important drivers. The two large capital projects in London and in the Bacon Center of Excellence continue to ramp up and are going well. We've been consistent in saying that we fully expect to have the full benefits of those two projects in place for Q4 and that will for certain be the case.

Poultry results improved sequentially and year-over-year. I've said in my comments, there's still work to do, particularly in the premium segment, in the poultry business, in RWA and organic, and getting our mix of – our sales mix to a place that we would expect it to be operating at. But we had market share growth. It was pretty significant in the poultry business. So, that was a good outcome. So overall, as I said, it was a solid quarter in the context of the current environment and we've made progress.

Second part of your question I think was focused in on what does the back for second half of the year look like? And I'll be clear in saying, we are super focused on executing our priorities and made good progress, as I said, in Q2. And we expect to make further progress in the back half of the year. We're not going to give quarterly guidance, as you know, but there's a few things that I think that are important to consider as we head through the back half of the year.

The first is that we're paying very careful attention to the consumer landscape, I think as most or all CPG companies are and certainly the retailer community and in particular the impact on prepared meats volumes and in RWA and organic sales, as I said, in the fresh poultry business. So, that's certainly one thing we're paying careful attention to. Second is, we're very focused on driving home the last of the benefits at London poultry and the Bacon Center of Excellence. Those will continue to play meaningful role in the back part of the year. I would say, they're predominantly Q4 items as we expect to be fully on business case in Q4 and are transitioning towards that.

And then, of course, pork market conditions are clearly improving on a year-over-year basis and we're hopeful that will continue, although less in our control. Japan's a bit of the – perhaps the wild card in the short-term in the sense that the pork cutout has moved up and as the pork cutout moves up, that has offsetting impact on the Japan market. So, we're obviously staying close to that as well. But in the context of the controllables, as Dennis would say, in the pork markets and the fact that markets are proving particularly the vertically integrated market, actually we saw a little bit of an offset in the packer margin, but particularly in the vertically integrated market, we're paying careful attention to how pork markets are playing out without the predictive capabilities to properly forecast exactly what's going to happen in pork markets over the course of the year. So, positive momentum, but there's things we're paying, obviously, a mindful attention to, in particular the consumer environment.

Irene Nattel

Analyst, RBC Capital Markets

Q

That's really helpful. Thanks, Curtis. And then just in both the script and the documentation, you reiterate the 14% to 16% margin. And I know that this is very simplistic math, but if we take the Q2 run rate of 11.2%, we have the 125 basis point, ongoing headwind. We're kind of in the mid-12%. I guess, there's still some more benefits of London and the Bacon Center of Excellence to come. Can you walk us through the key pillars and if the environment remains as is, so in other words, if nothing else changes or we assume a neutral environment, when is it reasonable to expect that we could see that 14%?

Curtis E. Frank

President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.

A

I'll start with the – thanks, Irene. I'll start with maybe the key drivers of what's between us and 14% to 16% today. And then we can talk a little bit about when. There are four items from my perspective, that are important for consideration to bridge the gap from where we are today to delivering in the 14% to 16% range. The first is the

normalization of pork markets, which you appropriately characterized. But the second is the remaining benefits from our large capital projects in London and the Bacon Centre of Excellence.

The third is, we still had a slight loss and we were fully transparent with that in the plant protein business. The third is finishing the play on turning plant protein profitable. And the last is, more normal conditions in the poultry business. Yeah, supply and demand, Irene, we've talked about in the last couple of quarters is not yet perfectly imbalanced. It's improved, but not yet perfectly imbalanced. And as I said earlier, our mix in the premium segments of poultry continues to be an opportunity for us.

So, those are the four big drivers. They put us squarely in the – kind of in center cut into the 14%, 16% range. And then there are a couple of items that are important to us from an executional point of view that also have the potential to contribute. That is a prepared meats volume and market share growth, which we certainly expect to deliver over the course of time. And any of the operational excellence opportunities that we started to talk through in some of our materials, those will not be next quarter items, but they'll certainly be important to us in the quarters and years ahead. So, certainly, continue to be confident with respect to our ability to deliver into the 14% to 16% range in our business today.

As to when, I'm going to follow our guidance we've given for 2024, which is we continue to expect to make progress towards our 14% to 16% margin target. And I think, obviously in Q4, I'm saying we expect to close the capital benefits gap so that will be a contributing factor in the fourth quarter. And I don't think – I think I'll resist the temptation to answer the question of precisely when, because it will be largely dependent on the consumer response to continued levels of stress and inflation, normalizing pork market conditions, and the pace at which that continues and how things play out in the poultry complex here where we're clearly making progress, but still have a little bit more work to do.

Irene Nattel

Analyst, RBC Capital Markets

That's really helpful. Thank you.

Q

Curtis E. Frank

President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.

Thanks, Irene.

A

Operator: The next question comes from Mark Petrie. Please go ahead.

Mark Petrie

Analyst, CIBC World Markets, Inc.

Yeah. Thanks. Good morning. I wanted to ask just first on the new CapEx guide, David. I think you said that the predominant driver was dialing in on your maintenance CapEx, but I just wanted to make sure I had that right. And is it a reasonable expectation that this is sort of the run rate on CapEx for the foreseeable future outside of high return projects that you might decide on at any given point?

Q

Curtis E. Frank

President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.

Go ahead, David.

A

David Smales

Chief Financial Officer, Maple Leaf Foods, Inc.

A

Yeah. So, in terms of changing the outlook, it is a combination of obviously heavy focus in the last little while in terms of ramping up the capital projects at London and the Baker Center of Excellence as well as closing some legacy facilities as part of that program. And as you've seen, that's kind of led to lower CapEx in the first half of this year and as we look at the second half, it's probably a function of just how much we can actually get done in a period of time, as well as the fact that as we look across our manufacturing base now, it's calibrating to a more normal run rate in the second half of the year.

I'd say the first half of this year was kind of lower than the normal. But in terms of what – next year looks like, we're obviously in an intensive budget cycle right now. We're in the process of splitting the businesses between our Prepared Foods and the pork business going forward. So, that will have some impact and we're working through that. So, we're not in a position to give guidance for next year right now. But the reasons for this year are really just a combination of different asset base and some focus in other areas in the first half of the year.

Mark Petrie

Analyst, CIBC World Markets, Inc.

Q

Okay. That's helpful. Thank you. And Curtis, hoping you could just sort of outline kind of specifically the steps that are needed for the recovery in poultry. How much of that is sort of outside of your control, a better balance in the supply management process and how much of it is execution? I guess, that would encompass a variety of things, some probably shorter term, some of it longer term, but could you just give us a sense of that, please?

Curtis E. Frank

President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.

A

Yeah. Hey, Mark. I would start with saying and I think important context, the poultry results improved materially, sequentially and year-over-year. So, it's very important context. The sales declines, which sometimes get more of a spotlight shine on them than we would prefer, are just noise, they're just noise that we have planned for them in a sense, which means we had planned for reduced external purchases and reduced external commodity market sales, which are good for our mix and part of the reason why are the results of improvement. What's in our control is, how we execute in our sales margin expansion platforms. And we saw, as I said in the quarter, really sound results in our market share and in retail performance and in food service development that shows up in our further processed poultry business. So, utilizing the raw materials.

The poultry business, as I commented before, is very different than pork in the sense that it's a Canadian supply managed business, as you know, which means supply and demand get reset every eight weeks and they tend to come into balance much more quickly than a global pork market. So, maybe we don't have control, but we certainly see changes on that on every eight week basis. So, the one thing that's I never like to say out of our control, because I think we're pretty good marketers and sellers and that's our job.

And I would like to think that we do it fairly well, but maybe a little bit less than our control is the consumer response to the inflation that they felt over the last little while, and in particular how that impacts our sustainable meats portfolio and fresh poultry in RWA and organic. And even though we had 12% sales growth in retail, we would have liked a little bit different mix and that meaning more RWA and more organic than what we saw and that will be our focus for the back part of the year is getting that fully on track and we'll do that through the combination of a brand marketing, revenue management and engaging in partnerships with our retail partners. So, I think it's – I always take the view that operationally it's in our control and it's our job to make it happen.

Mark Petrie

Analyst, CIBC World Markets, Inc.

Q

Okay. Thanks for that. And then just the last one. I recall specifically to Bacon and the ramp up of the facility there, that there was a new contract coming online around the beginning of Q3. I just wanted to make sure that that was right and that timing hasn't changed?

Curtis E. Frank

President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.

A

Yeah. No, it hasn't changed. Things are going well. It's ramping up through the third quarter. And that's why I've been pretty consistent in saying, the bacon benefits I think of as a Q4 item, because we expect that ramp up to be substantially complete by the by the start of the fourth quarter.

Mark Petrie

Analyst, CIBC World Markets, Inc.

Q

Yeah. Understood. Okay. Thanks. All the best.

Curtis E. Frank

President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.

A

Thank you.

Operator: The next question comes from Michael Van Aelst. Please go ahead.

Michael Van Aelst

Analyst, TD Cowen

Q

Yeah, thank you. So, just getting back to the poultry side, you did talk about the margins on that side of profitability, improving year-over-year and sequentially, but it doesn't sound like it's back to where it should be. When we saw that – after you saw the cut in supply midway through the quarter, did that restore margins by quarter end or do you think more cuts are required and is there any talk of that yet?

Curtis E. Frank

President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.

A

Well, it's – Mike, when those things happen, sadly, we don't wake up the next morning, it has immediate impact. The time it takes to rebalance between the channels, industrial, retail and food service. And the foodservice operators have been pretty clear from what I've read that they're facing headwinds from a consumer point of view as well, which is putting a little bit more pressure on poultry sales. So, has it helped? Absolutely. To your point, are we all the way where we need to be in our poultry business? No. No. And so, are further reductions required? Yes. Further, I wouldn't necessarily describe it as reductions per se, but I would say a more balance is required. So whatever the demand there needs to come more closely in balance with supply. And I'd like to think that we're headed in that direction. But I also am mindful that there's a consumer element of this, which is, what's the pull in the foodservice channel after the QSRs and what's the pull in the retail channel. And I think as a market and an industry, we're still working through that.

Michael Van Aelst

Analyst, TD Cowen

Q

Okay. Some – maybe a little bit more cuts required, but your retail volumes on poultry are up 12%, look quite strong.

Curtis E. Frank

President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.

Yeah.

A

Michael Van Aelst

Analyst, TD Cowen

Does that – I mean, that can just be some rebalancing of the market. So, I'm assuming you might be gaining market share?

Q

David Smales

Chief Financial Officer, Maple Leaf Foods, Inc.

Yes. Yes. Our market share was up 1.2 share points in the quarter and it was up across our Prime brand, our Maple Leaf brand and our Mina Halal brand. So, we saw excellent results in the retail channel. Yes.

A

Michael Van Aelst

Analyst, TD Cowen

Okay. And then on the sustainable meat side, it seems like it regained a bit of momentum in Q2. And is this mostly tied to new US distribution or has it...?

Q

Curtis E. Frank

President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.

Go ahead [indiscernible] (00:43:07).

A

Michael Van Aelst

Analyst, TD Cowen

Well, I'm just looking at, is mostly to the US distribution or I guess and does the Canadian consumer still are kind of moving trading down and away from these items?

Q

David Smales

Chief Financial Officer, Maple Leaf Foods, Inc.

It's a – I'm trying not to frustrate you with a complicated answer, but I'll share with you my view of what's happening. The positive news is, we had double-digit growth in sustainable meats. And our brand that resides inside of sustainable meats, Greenfield was the leader of the pack, and it grew in both Canada and the US. And then, we had new distribution on top of that with a large US retailer. So, that's positive and constructive. The only place that I would add some level of complexity is that's within the prepared meats business. In poultry, we did see pressure on sustainable meats in the Canadian market. So, kind of two different parts of our business, maybe had slightly different outcomes in the quarter. Very happy to see what's happening in prepared meats and we're hoping to sustain that momentum, but at the same time we've got to do a little bit better on sustainable meats, sales mix in the fresh poultry business.

A

Michael Van Aelst

Analyst, TD Cowen

Q

Okay. And then just finally on Japan. So, we saw that kind of rise in that clearly pressures there. But I assume the weakness in the yen, which is pretty sharp during the quarter, was...

Curtis E. Frank

President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.

Yeah.

A

David Smales

Chief Financial Officer, Maple Leaf Foods, Inc.

...interpreted that quite a bit. Is it too early to see any improving trends over recent weeks as the yen is strengthened?

A

David Smales

Chief Financial Officer, Maple Leaf Foods, Inc.

Yeah. I think a bit. I mean, that's positive long-term, obviously, Mike. And you've characterized the two issues in Japan. I mean, we saw what happened in the Pork Complex in Q2 as the vertically integrated margin improved and pretty substantially. The packer or processor margin in picker terminology came off slightly and there was pressure on the Japanese market and the why behind there was pressure on the Japanese market is exactly what you described, the implication of a rising cut out, which always pressures the Japanese margins and the implications of the yen relative to historical or normal market conditions.

A

The yen has improved slightly in the last little while so that over time that will be helpful, but it's far too early to describe that to be a positive impact in terms of a key driver in the pork business. And the only thing I would add on top of that, which is not overly material, but we haven't talked about for a while, is the market in China continues to be weak, did have a slight year-over-year impact, so I think it's worth calling out, not necessarily material to the business what we continue to see weakness in the revenues in the Chinese market.

Michael Van Aelst

Analyst, TD Cowen

Okay. So, what have to happen for Japan to see improvement over the next several quarters?

Q

Curtis E. Frank

President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.

The combination – actually Dennis, maybe you'd add a little bit of context on this.

A

Dennis Pat Rick Organ

President-Pork Complex, Maple Leaf Foods, Inc.

Yeah. Again, for Japan to normalize the way we're classifying it is meat values have to come down. So, again, we keep trying to draw your attention to the story is in the vertically integrated spread are raising costs continue to normalize and then everything else will have sort of counterbalancing effect. So, Japan will go up if meat values come down.

A

Curtis E. Frank

President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.

I think the important point to make is, if we continue to see the cut out where it is today or strengthened, we'll continue to see pressure on the Japanese market until there's a reversal of cut off values.

A

Michael Van Aelst

Analyst, TD Cowen

Q

Okay. So, Dennis, if you have a – if you need lower cutout values yen, for the Japanese business to normalize, is it – do you see the feed costs coming down enough to allow both the Japanese business to improve, but also not to impact your North American pork markets?

Dennis Pat Rick Organ

President-Pork Complex, Maple Leaf Foods, Inc.

A

Yeah. I guess the way I would answer that is, just you look at the feed markets. If you look at using corn as a proxy, look at what it did from 2015 through 2020, the increase and then where it is today and what futures are pointing to in the future.

Michael Van Aelst

Analyst, TD Cowen

Q

Okay. Perfect. Thank you.

Operator: [Operator Instructions] The next question comes from Luke Hannan. Please go ahead.

Luke Hannan

Analyst, Canaccord Genuity Corp.

Q

Thanks. Good morning. I'll start off with a quick one here on the plant side. Maybe I missed it in the materials, but can you quantify what the actual EBITDA loss was in plant this quarter?

David Smales

Chief Financial Officer, Maple Leaf Foods, Inc.

A

We didn't break it out separately. Probably, we're not going to move it forward, Luke. But what I would say is, we had a slight loss in the plant protein business, which simply means our meat protein performance was even stronger than what it might look like on the surface. The important context, I think, is, number one, we've made great strides in rightsizing the cost structure and the operations improvements that we've made, including supply chain.

Two, we continue to expect that the plant protein business will be a profitable and that defined as not only EBITDA neutral or greater, but equal to or greater than the balance of the Maple Leaf portfolio. There's no reason over the course of time that that can't happen. The story in the quarter was really one of our ad and promo increased sequentially in Q2 from Q1, which is normal from a seasonality point of view and our sales declined at 2.5%. We do need some level of sales growth in the plant protein business to be profitable, which we've been clear on, and that we're now going to turn to making further cost efficiency improvements in the business to "size the shoe to fit."

The positive news probably in the plant protein business could take it as, you never like to be the leader in a declining category. But the refrigerated category in the US declined at over 10%. We declined a 2.5% Canadian, about 5.2% in US dollars and the gain market share in a declining segment. So, I mean, it's very clear that there's still more work to do. Our focus is also equally clear, which is on reigniting growth and driving continuous cost savings to shape the profitability of the business.

Luke Hannan

Analyst, Canaccord Genuity Corp.

Q

Okay. Thanks. And then for my follow up here, extending on the earlier discussion on the market conditions, I think it impacted the quarter by 125 basis points. And if I heard you correctly, Japan was included in that. Is it possible to strip out what the impact of Japan was from that headwind?

David Smales

Chief Financial Officer, Maple Leaf Foods, Inc.

A

No, we've been very consistent in our market definition of having three components. The combination of the vertically integrated margin, the industry margin with respect to pork processing margin and Japan. And I think my preference at this stage would be to stick with that definition, which is really important. So, the combination of the vertically integrated margin, the packer margin or processor margin and the Japanese markets. And the headline, I think in our materials, look, you would see the vertically integrated margin improved very significantly in the second quarter. The pork processing margin came down from Q1 and as we've talked Japan was a headwind given the run up in capital values.

Luke Hannan

Analyst, Canaccord Genuity Corp.

Q

Okay. Thank you.

Curtis E. Frank

President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.

A

Okay.

Operator: There are no more questions at this time. I would now like to turn the conference back over to Curtis for any closing remarks.

Curtis E. Frank

President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.

Okay. Great. Just like to extend a thank you for joining us today where, again, I'll reiterate the fact that we felt that we delivered a very solid quarter in the context of the current environment. Adjusted EBITDA growing 37% year-over-year, a very solid and sound growth in our prepared meats business of 3.2%, a Pork Complex that's clearly seeing and benefiting from improving market conditions and equal or maybe more importance the strengthening of our balance sheet. So, we're very pleased with the outcome for the second quarter and we're very much focused on the execution of our core priorities moving forward. And we also look forward to connecting with you next quarter as well. So, thank you for your time today.

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

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