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Maple Leaf Foods, Inc. (MFI.CA)

Q3 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen. Thank you for standing by. Welcome to Maple Leaf's Third 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 instructions for the Q&A following the conclusion of the formal presentation.

I would now like to turn the conference call 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, Jenny, and good morning, everyone. Speaking on the call this morning will be Curtis Frank, President and Chief Executive Officer; Dave Smales, Chief Financial Officer; and Dennis Organ, President, Pork Complex and Incoming CEO of Canada Packers.

Before I begin, I'd like to remind you that some statements made on today's call may constitute forward-looking information, and our future results may differ materially from what we discussed. Please refer to our third quarter 2024 MD&A and other information on our website for a broader description of operations and risk factors that could affect the company's performance. Uploaded our third quarter investor deck to our website, which includes support material for the quarter. As always, the Investor Relations team will be available after the call for any follow-up questions you may have.

And with that, I'll turn the call 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 my comments this morning, I will begin by discussing the progress we are making in executing our strategic priorities and summarizing my thoughts on our Q3 financial and operating performance. I will then turn the call over to Dennis Organ, the President of our Pork Complex, and our Incoming CEO of Canada Packers, who will touch on the performance of the pork business. Following Dennis, you'll hear from Maple Leaf's Chief Financial Officer, David Smales, who will provide a more detailed financial update.

I will then step back in to close the call, offering a clear picture of what lies between us and our 14% to 16% strategic margin target, along with an update on the spin-off of our pork business as we have some materially good news to share. And of course, we will reserve time to open up the line to your questions.

First and foremost, our top priority continues to be driving adjusted EBITDA growth and expanding our adjusted EBITDA margin towards our 14% to 16% strategic target. In this pursuit, I'm pleased to report that our Q3 sales of approximately CAD 1.3 billion were up nearly 2% year-over-year, fueled by over 3% growth in our CPG prepared meats business.

Adjusted EBITDA also grew by over 9% to CAD 141 million in the quarter and has grown by nearly 30% year to date. Additionally, we delivered another quarter of improvement in our adjusted EBITDA margin, which increased by 80 basis points in Q3 to 11.2%, driven by improved pork markets and contributions from our capital projects. This progress was partially offset by higher SG&A year-over-year and the impacts of an inflation-stressed consumer.

Our large-scale capital projects at London Poultry and our Bacon Centre of Excellence continued to ramp-up successfully this quarter. As we mentioned on our last call, we remain confident that we are fully on track to realize the remaining benefits of these projects in Q4 of this year. And as a result, we do expect some level of sequential margin improvement in the fourth quarter of 2024.

As many of you know, the entire North American consumer packaged goods industry continues to face the challenge of navigating an inflation-stressed consumer environment. This environment has a particularly significant impact on a premium portfolio like ours, and I want you to know that we are not sitting still, waiting for the macro environment to recover on its own. Instead, our commercial teams are doing incredible work to adapt our brand strategies to the evolving consumer demand environment, leveraging the depths of our CPG capabilities.

Through this playbook, we are investing in our portfolio of leading brands to drive consumer demand. A great example is our Maple Leaf Natural Negotiators advertising campaign, which this quarter focused on our prime raised without antibiotics and bacon portfolios. We also completed our most successful season as the official hot dog and sausage partner of the Toronto Blue Jays, selling a record-breaking number of hot dogs this season, including over 725,000 of them on Loonie Dog (sic) [Dogs] (00:05:07) nights alone.

We are accelerating the pace of impactful innovation, highlighted by the launch of 22 new SKUs into the market in Q3. This is the most items we have launched at one time, dating back to 2020. We are already seeing great success with these new innovations, particularly with our new Schneiders brand line of breakfast sandwiches and breakfast egg bites, which cater to the growing market for savory, convenient, and protein-packed breakfasts.

We are leveraging our leadership in sustainable meats, which grew at a double-digit pace in Q3, supported by breakthrough advertising campaigns for the Greenfield Natural Meat Company and expanded distribution with customers such as Costco USA, where, in September, we partnered to launch a Greenfield brand club pack lunch kit item. We are expanding our reach into the US market as a source of incremental growth. Here, too, we achieved double-digit sales growth in prepared meats, winning business with new partners, and expanding distribution for our sustainable meats brand, a Greenfield, which saw over 50% sales growth in the US as compared to last year.

We are plugging our unique capabilities into our customer strategies by leveraging new assets like our Bacon Centre of Excellence and the investments we have made at our Walker Drive facility. And we are executing in store and at point of sale, where our field sales team executed displays in over 4,000 Canadian grocery stores in Q3 alone.

Underpinned by the strength of these brand plans and our robust customer partnerships, our prepared meats business demonstrated outstanding resilience this quarter. We achieved our third consecutive quarter of sales growth of 3% or greater and delivered a slight gain in retail market share. In poultry, while overall sales declined slightly year-over-year due to the repatriation of tray-packed volume into the London plants, which as of the start of Q4 is now fully lapped, we delivered 10% growth in the retail channel and grew our retail branded market share of the fresh poultry category.

Our focus for our plant protein category remains no different than our other businesses in that we expect to generate profits. In the third quarter, we continued to make strides toward that goal. Our US dollar sales were relatively flat. Our performance outpaced the overall US refrigerated category and our sustained focus on driving out costs led to a quarter of year-over-year improvement in profitability. Early within Q4, we implemented our plans to integrate the plant protein business as a category within our prepared foods business, marking a very important milestone to set us up for success in 2025 and beyond.

To be clear, while we are very encouraged by our overall prepared foods performance, the higher levels of SG&A and the steps that we have taken to invest in our brands to support volume growth and protect market share are resulting in a short-term margin and slight adjusted EBITDA decline when viewing prepared foods on a standalone basis. However, with inflation easing, interest rates declining and our brand plans taking hold, we are fully confident that this impact will prove to be transitory.

In the Pork Complex, we are thrilled to report that after many quarters of unprecedented market conditions, markets appear to be normalizing. As a result, our financial performance has continued to improve both sequentially and on a year-over-year basis. And in our supporting materials, we estimate a negative market impact of about CAD 14 million or approximately 110 basis points in the third quarter as compared to normal market conditions, most of which is now attributed to Japan margins being below pre-pandemic levels. Restoring these margins, while executing other value-creating levers as it moves forward as a standalone organization, is the top priority for our pork team, which Dennis will discuss momentarily.

So, overall, I think it would be reasonable to say that the quarter unfolded as expected. The financial performance of our business is strengthening year-over-year. We saw a substantial increase in free cash flow generation in the quarter and we accelerated the deleveraging of our balance sheet with net debt to adjusted EBITDA reduced to 3.1 times by the end of the quarter.

With that as strategic context, I will now pass the call over to Dennis to review the Pork Complex performance in the quarter. Dennis?

Dennis Pat Rick Organ

President-Pork Complex, Maple Leaf Foods, Inc.

Thank you, Curtis, and good morning, everyone. In the Pork Complex, the most important takeaway is that our financial results are improving, feed costs have stabilized, and we are focused on driving profitable growth and operational excellence in the business. While revenue is not a key metric for the Pork Complex as we are more focused on EBITDA and optimizing spreads, sales did grow 1.1% as compared to Q3 last year. This was primarily due to increased number of hogs we processed and improved product mix. Adjusted EBITDA margins in the Pork Complex improved both year-over-year and sequentially as our raising costs have normalized and we work to fully leverage our premium sales mix.

Our margins benefited primarily from improvement in our vertically integrated spread, which is the margin we make on the hogs we raise. This margin doubled compared to last year as feed costs continued to decline. In Q3, the average corn price was $3.90 a bushel versus $4.92 last year and year-to-date of $4.23. The price of corn is now pre-2020 levels, which was before the dramatic price increase that occurred that year. We believe we are now at normalized feed cost levels, which will continue to materialize in the form of lower raising costs.

Packer spreads, which is the margin we make on the hogs we buy, were not a meaningful driver of margin expansion in the quarter, as Q3 was largely in line with Q2 of this year and Q3 of last year. While our business will always have a market component, we remain focused on the controllable factors in our business via our three primary strategies, which are lowering our controllable raising costs through focusing on our critical KPIs, maintaining or lowering our manufacturing costs through operational excellence and increased utilization, and maintaining or improving our premium sales mix.

I'm pleased to report that we have had success in all three of these areas. In Q3, we continued the trend of driving costs out of the non-feed aspects of our hog raising operations with improvement in nearly all of our critical KPIs. In our manufacturing facilities, we are able to improve our utilization to offset inflation, but we still have work to do on our operation – on our OpEx initiatives. We anticipate that the number of hog we'll process will continue to grow year-over-year for the next three to four years.

Driving costs out is extremely important, but it is our premium mix that separates us from the industry through multiple specialty programs like RWA, loose sow housing, labor-friendly programs for our North American retail customers, specialty export pack configurations, market-specific quality specs, and multiple other premium programs we truly differentiate ourselves. With feed costs now a tailwind, solid demand for our premium product offerings, and cost reduction initiatives delivering financially, we are extremely enthusiastic about the opportunity to unleash Canada Packers.

With that, I'll pass it over to Dave.

David Smales

Chief Financial Officer, Maple Leaf Foods, Inc.

Thanks, Dennis, and good morning, everyone. Turning to our results this quarter, I'll comment on the company's consolidated results before addressing balance sheet items and discussing the overall outlook for 2024. The key takeaway from our financial performance is how the improving profitability of our business in 2024, including in the third quarter, has generated a substantial increase in free cash flow and delivered a significant improvement to our balance sheet, consistent with our priorities and outlook for 2024 coming into the year.

Total sales in the third quarter were CAD 1.26 billion, an increase of 1.8% compared to last year. Adjusted EBITDA increased by 9.1% to CAD 141 million with an adjusted EBITDA margin of 11.2% compared to 10.4% last year. Earnings for the quarter were CAD 18 million, or CAD 0.14 per basic share, compared to a loss of CAD 4 million, or CAD 0.04 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 0.13 per share last year.

The 1.8% sales growth year-over-year was driven by prepared foods, where sales were up 2% year-over-year. We saw an increase in sales in prepared meats of 3.1% and plant protein of 1.1%, which was partially offset by a slight decline in poultry of 0.9%. Within prepared meats, we saw both higher volumes and improved category mix. And in plant protein, our sales performance was stronger than the overall US refrigerated category performance.

In poultry, as we've seen all year, London has allowed us to improve our mix by increasing our tray pack capacity, replacing third-party source tray packs, allowing us to reduce lower value and volatile industrial channel volume, resulting in the slight decline in poultry sales in the quarter year-over-year, but improved mix and margin performance.

Pork sales were also slightly higher at 1.1% growth year-over-year, on improved product mix and favorable movements in FX, partially offset by lower market prices for byproducts. As I just mentioned, adjusted EBITDA continued to improve, growing to CAD 141 million, a 9.1% increase compared to the third quarter of last year.

In 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 to right-size of the business and drive costs down. As Curtis noted, we did see some offsetting pressure on margins in our prepared meats business this year, as we continue to invest to support volumes and protect market share in a more dynamic consumer environment.

Pork markets were also a tailwind to our year-over-year results, as market conditions have improved, but continue to operate below what we define as normal. Q3 adjusted EBITDA was negatively impacted by CAD 14 million, or 110 basis points, relative to what we view as normal market conditions. SG&A was at CAD 14 million compared to last year, which created a headwind to our adjusted EBITDA performance this quarter. Most of the increase here was due to variable compensation, including adjustments in Q3 of last year that reduced the comparable period significantly. Our SG&A rate is typically between 8.5% and 9% of sales, and we are operating within that range.

Adjusted EBITDA margin came in at 11.2%, up 80 basis points from the previous year and in line with our second quarter result. In total, during the quarter, we invested CAD 26 million in capital expenditures compared to CAD 51 million in Q3 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 of 2024 to approximately CAD 100 million based on our current spending levels. We've continued to recalibrate our current year maintenance capital requirements, primarily related to completion of major capital projects and related closure of legacy poultry plants.

We've also introduced our outlook for capital expenditures for 2025, which we expect to be between CAD 175 million to CAD 200 million, primarily focused on maintenance capital as well as growth capital related to capacity optimization and cost efficiency initiatives. Free cash flow improved year-over-year to CAD 155 million, up CAD 65 million as we continue to see the year-over-year benefit of improved earnings and lower maintenance capital requirements. This quarterly improvement contributed to a year-to-date increase in free cash flow of CAD 230 million.

On the balance sheet, net debt was down CAD 126 million during the quarter to just under CAD 1.6 billion. In line with our stated priorities, we have seen a significant improvement in leverage ratios over the past year, with a net debt to trailing 12 months adjusted EBITDA ratio of 3.1 times at the end of the third quarter of 2024, compared to 4.9 times at the end of the third quarter last year, and 3.4 times at the end of last quarter.

As the profitability of the business continues to improve and our capital requirements have receded following completion of our large capital projects, we expect this deleveraging trend to continue through the end of 2024. With the exception of cooling down our capital spend for 2024 and introducing a 2025 capital forecast, our outlook is unchanged from our expectations at the end of the second quarter. We continue to expect low-single-digit sales growth in 2024 versus 2023 and we continue to expect to see growth in adjusted EBITDA margin in 2024 over 2023, progressing toward our 14% to 16% adjusted EBITDA strategic margin target.

I will 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 summarize our collective comments today by reaffirming our commitment to achieving our 14% to 16% adjusted EBITDA strategic margin target for our consolidated business. This is not merely an aspirational goal, it is an imperative one, given the capital that we have deployed. We are clearly making progress, as evidenced by an adjusted EBITDA margin that has improved by 240 basis points year-to-date, a CAD 230 million improvement in our free cash flow year-to-date, and a rapidly deleveraging balance sheet. The very same time, we recognize and fully embrace that there is still more work yet to be done. Delivering on this commitment remains our most pressing short-term priority and we fully accept your desire to hold us accountable.

To achieve our strategic goals, we are focused on the execution of five key levers that will drive us forward toward our 14% to 16% target. The first, finishing our capital playbook, where we are expecting to deliver the full operational benefits of our projects in Q4 this year. A second, as I outlined earlier, we are adapting our brand strategies to the inflation-stressed consumer. Although consumers remain under pressure today, we expect that the conditions will progressively improve as inflation stabilizes, interest rates decline, and our brand plans continue to take hold.

A third includes the recovery of pork markets, where integrated margins have significantly improved sand are approaching pre-pandemic levels, while Japan remains an area of opportunity. A fourth, we are committed to consistently delivering a profit in the plant protein business, with plans in place to achieve profitability in 2025. And finally, we are continuing to evolve our cost focus and competitive edge. This includes the recent completion of a procurement project aimed at leveraging our purchasing scale.

And this month, we made a series of organizational changes that will sharpen our cost competitiveness, enhance our operational effectiveness, and increase our customer alignment. These changes include simplifying the business, improving our execution focus, creating clear lines of sight to accountabilities with KPIs assigned to each role, and accelerating the speed of decision-making by removing layers within the organization.

Before I wrap up the call, I just wanted to touch on the next steps for the spin-off of our pork business, where our transaction team is working diligently on all the work required to separate the businesses and successfully launch Canada Packers as a new public company. As I mentioned at the beginning of the call, we have some good news to share. We have been making great strides at preparing for the separation, and at the same time, we've continued to advance the work on the transaction structure to see if we could achieve a more tax-efficient outcome, and I'm happy to share that we have indeed found that path.

Specifically, we are now working to advance a tax-free butterfly reorganization that we would implement through a plan of arrangement. Under the proposed new structure, Maple Leaf Foods will retain a slightly lower ownership interest in Canada Packers, roughly 16% to 17%, as compared to 19.9%, and we've aligned with McCain Capital on a set of representations and covenants related to the applicable tax rules, which is typical for a butterfly transaction with a more than 10% shareholder.

With this structure, we will need to get an advanced tax ruling from the CRA, which we think will take up to nine months. So, this now becomes the long pole in the tent, moving our target closing out a little further than we originally anticipated, although we still remain confident that we will close in 2025. Many more details will come when we file our information circular, which we are currently targeting for Q1 of 2025.

And with that, operator, we can now turn the call over to questions, please.

QUESTION AND ANSWER SECTION

Operator: Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. [Operator Instructions] Your first question is from Irene Nattel from RBC Capital Markets. Your line is now open.

Irene Nattel
Analyst, RBC Capital Markets

Q

Thanks and good morning, everyone. Thank you for the comprehensive review. A question for me really is around the core Maple Leaf business ex-Canada Packers. If we look at sort of – if you do the arithmetic, EBITDA year-to-date is relatively flat, sort of plus or minus about CAD 5 million in any given quarter. So, can you please walk us through what the different puts and takes have been year-to-date and what the factors are that are moderating the gains and how we – as a result of the capital? And how we should be expecting things to unfold as we move through late 2024 and into 2025?

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

A

Yeah. Good morning, Irene. Thank you for your question. I'll walk through the kind of the moving parts. I think you're referencing the kind of the pro forma Maple Leaf business excluding the pork business. In that particular case, you would have seen as part of our materials the financials that we provided where we held our margins in the kind of the pro forma prepared foods business relatively flat. And as you mentioned, we did have a slight decline in adjusted EBITDA for the prepared foods business within the quarter – or within the LTM, sorry.

The moving parts, as you referenced, there are three of them that I think are important to note. The first is that our capital projects have continued to contribute and deliver right in line with our expectations. So, that was a help within the last quarter. It's been a help on an LTM basis and we believe we'll complete the operational benefits of that work in Q4, right in line with what we would have expected. So, the capital projects are contributing, I think, is important point number one. That's being offset by two factors, points number two and three.

Number one, an uptick in our SG&A, and in the third quarter, that was fairly material just given the timing of variable compensation on a year-over-year basis. So, that would have been, certainly within the quarter, the most material factor. But at a strategic level, as you and the market are fully aware, we're certainly seeing the transitory impacts of an inflation-stressed consumer environment play through our business.

On one hand, I'm really pleased and happy with the top-line performance in the business in particular. We saw 2% growth this past quarter in our prepared foods business. It was driven by over 3% growth in our prepared meats business. We had volume growth in prepared meats, which in this consumer environment, relative to other North American consumer packaged goods companies, was a really great outcome. And we had market share growth in prepared meats, in poultry and in our plant protein business. So, I think those are all good and important indicators in the business.

Offsetting that, the consumer does – in the moment is seeking more value. So, we are seeing more trade [ph] down (00:28:01) than we would like, and we are making more investments to grow our volume and protect our market share than we would like in the moment. But again, we believe that those impacts will prove to be transitory, as they have been over the course of history.

I outlined in my comments, Irene, the notion that we're not sitting still. I think as a brand-led consumer packaged goods company, we're obligated in an environment like this to lead. And there are a number of areas where we're stepping up to lead through the ambiguity of the current consumer demand environment. Things like investing in our brands to drive demand, things like launching 22 new items within the quarter from an innovation perspective. Our sustainable meats business continues to grow, which we were pleased with.

We have the benefits of a US market that can provide a level of growth in our business that's supportive, and of course, plugging into our customer strategies, which continues to be deeply important to us. So, I'd summarize by saying three things: capital projects contributing, headwinds in SG&A quarter-over-quarter tied to variable compensation changes, and the transitory headwinds of a consumer-stressed environment.

Irene Nattel
Analyst, RBC Capital Markets

Q

That's really helpful. Thank you, Curtis. And a follow-on question from that, please, which is, you talked about investing in brands. I assume that means vendor support and premium products. What about at the other end of the market? If consumers are looking for value in your product introductions, have you included anything that really would address more that value-seeking behavior?

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

A

Actually, that's a [ph] – what (00:29:47) a great question, Irene. So, we have some really great examples in our frozen further processed poultry portfolio, whereas the poultry business for us, given its very much premium position, has been disrupted, even with the mix between sustainable meats and the conventional parts of our portfolio. So, we launched a number of frozen offerings that are meant to – and ethnic offerings, actually, that are meant to bring value to the frozen poultry category, would be a great example of how we're kind of pivoting within our portfolio to meet the consumer demand in the short term for value-seeking behaviors, while at the same time protecting the market share in our premium portfolio of brands, knowing that the consumer environment will change over the course of time.

Irene Nattel
Analyst, RBC Capital Markets

Q

That's great. Thank you. And just one final housekeeping question, if I may. You mentioned something that the process can take up to nine months on the spin, post the filing. The clock started when on that process? I guess, what I'm really trying to say is if we're thinking about like is this nine months from now, so mid-2025? Is it – just to give us a better idea?

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

A

Yeah, yeah, plus – mid-2025 is a very much a reasonable timeline, plus or minus a couple of months here or there, Irene. I mean the CRA ruling is outside of our direct control, obviously, so that will be dependent on their timeline. And we'll continue to give you updates along the way. Q1 will be an important milestone because we'll file our prospectus information, but I think mid next year, plus or minus a couple of months here and there, depending on how CRA decision plays out, is a reasonable expectation at this stage.

Irene Nattel
Analyst, RBC Capital Markets

Q

That's great. Thank you.

Operator: Thank you. Your next question is from Michael Van Aelst from TD Cowen. Your line is now open.

Michael Van Aelst
Analyst, TD Cowen

Q

Good morning. Thanks for giving those five levers to your 14% to 16% goal. But are you able to quantify or at least kind of give us some benchmarks as to how important each one of those are and is this everything that's needed to get into that 14% to 16% range?

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

A

Good morning, Mike. The second part of your question I'll answer first, which is a yes. I mean, the sands have obviously shifted to a certain extent over the last number of years from wildly dislocated pork market conditions in a post-pandemic economy to the consumer demand environment we're seeing in the short term. But yes, those are the five factors that I think are clearly going to position us into that 14% to 16% range. I'm going to resist the temptation to quantify each and every one of them, so I won't do that.

But what I will do is – one of them is certainly quantifiable because we've outlined it in our slide presentation that we provided earlier this morning, which is the 110 basis points in pork market conditions from where we are today. And what I would tell you is the combination of the balance of them, put them – the other four put us squarely at – or depending on overarching market conditions, I think it would put us squarely operating consistently in that range, and I feel really good about that.

Michael Van Aelst
Analyst, TD Cowen

Q

Okay. So, is it fair to say that the pork market improvement, particularly in the Japan, as you mentioned, of 110 basis points, that that would be the biggest of the five?

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

A

Yeah, I think, yes, that would be one of the largest ones. The second one that, I think, is material is the consumer environment. It's pretty material, Mike, as well. And the capital project benefits, you should see, as we indicated, continue to improve and take shape in the fourth quarter, and that's why we've indicated that we do expect a sequential uptick here in the fourth quarter of some magnitude, just given the capital benefits coming to full fruition.

Michael Van Aelst
Analyst, TD Cowen

Q

Thank you. And then, as far as the situation in Japan is concerned, in the past, whenever you've gone offside – or not offside, that's probably the wrong word, but whenever you've felt headwinds in Japan or pressures in Japan, it's tended to take upwards of four quarters to get back to some – like to get all that back. Is that still the case? And what is it that you're doing to get to try and [ph] seek that for you (00:34:41)?

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

A

Well, one thing – and Dennis could talk about this as well, but the one thing I admire about the way Dennis is operating the business today is he's identified a series of levers that have the potential to create significant value in his business, in the event that that does not happen fast enough, Mike. Do I expect it's going to take four quarters? I don't know. I don't have a crystal ball. So, I think it would be maybe even irresponsible for me to put a precise timing on that. But what I would say is that the overarching conditions are moving in the right direction. The dislocation that we saw in market conditions and the impact of products flowing into Japan, it's certainly easing. Oversupplied markets are easing. That's causing less disruption in Japan, and it makes the commercial terms of doing business in Japan much more favorable, so that's positive.

The currency impact has been problematic with the devaluation of the yen, as you know, and that's, I don't think, materially changed over the course of the last short little while. And so, we're positioned well commercially. We've added customer relationships in Japan, so new sources of growth in the Japanese market. So, the volumes are actually improving. We did see an improvement in our profitability in Japan. We don't break it out, obviously, but we did see an improvement in our profitability in Japan in the third quarter. And I'm pretty confident that getting back to the levels of profitability we would expect in Japan is very much on the horizon. And if it doesn't turn out that way, Dennis and his team have a number of contingencies in place from an operational perspective that can help to mitigate any risk that exists.

So, through the combination of those two things, I think getting back to the level of profitability that we would have expected pre-pandemic is well within reach here.

Michael Van Aelst
Analyst, TD Cowen

Q

Okay. You said the debt – I think you said debt was down CAD 126 million, net debt. I haven't checked the calculation. But now that your balance sheet leverage is down close to 3 times, do your priorities change at all for the next 12 months as to how you want to allocate your free cash flow?

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

A

David will maybe step in here, Mike, and give you perspective.

David Smales
Chief Financial Officer, Maple Leaf Foods, Inc.

A

Yeah. Hi, Mike. So, obviously, that debt reduction and reduction in leverage has been ongoing for a while now. As we noted in our comments, free cash flow generation has been increasing. We expect those trends to continue into 2025, which gives us the option to look at a number of alternatives, including investing in the business. We've talked about opportunities to look at our network optimization, cost reduction initiatives. So, being able to invest in those kind of projects is important. Obviously, we'll look at – as we move through the year and we get into a range from a leverage perspective that is comfortably in the investment-grade category, what that means for us at that point in terms of other opportunities to deploy capital, including return of capital, but that will evolve as we move through 2025.

Michael Van Aelst
Analyst, TD Cowen

Q

So, an NCIB is possible at some point during this year?

David Smales
Chief Financial Officer, Maple Leaf Foods, Inc.

A

Sorry, say that again, Mike. I missed that.

Michael Van Aelst
Analyst, TD Cowen

Q

Like a buyback is possible at some point in 2025?

David Smales
Chief Financial Officer, Maple Leaf Foods, Inc.

A

Well, I'm not going to predict what we will or won't do, but obviously, historically, that has been a focus for us. We have invested significant efforts to return capital through NCIB historically. It's still very much part of the playbook, and in the right conditions, would be something we would definitely be looking at. But I'm not going to predict how or when that will materialize.

Michael Van Aelst
Analyst, TD Cowen

Q

Thank you. And last question. Is there anything to explain – or what does explain that CAD 5 million increase in depreciation from Q2 to Q3, like an 8% increase?

David Smales
Chief Financial Officer, Maple Leaf Foods, Inc.

A

Sorry, in depreciation?

Michael Van Aelst
Analyst, TD Cowen

Q

Yeah.

David Smales
Chief Financial Officer, Maple Leaf Foods, Inc.

A

Nothing specific. It's just the run rate and the capital that came on over the last number of years, but there's no one specific factor influencing that.

Michael Van Aelst
Analyst, TD Cowen

Q

Because it seems like a big jump from one quarter to the next one. And I don't think any new plans opened up. Anyways, I'll follow-up offline. Thank you.

David Smales
Chief Financial Officer, Maple Leaf Foods, Inc.

A

Okay.

Operator: Thank you. The next question is from Mark Petrie from CIBC. Your line is now open.

Mark Petrie
Analyst, CIBC World Markets, Inc.

Q

Yeah. Thanks and good morning. I wanted to just follow up specifically on Japan. And so, it's fair to say then that you've taken the actions that you feel like you need to in order to get to a restored profitability there and then the other sort of factors are largely out of your control, whether they be competitive, or supply, or FX. Is that a fair summary?

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

A

Yes, I wouldn't want to leave you with the out of our control sound bite, though, Mark, that's accurate. We're taking the actions commercially at a pace that – as fast as we can in Japan, respecting in Japan, nothing moves at lightning speed, consistent with many markets. So, commercially, we are taking the steps and making progress, and that shows up for us financially, making progress.

Mark Petrie
Analyst, CIBC World Markets, Inc.

Q

Yeah.

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

A

On the market conditions and currency that you're describing as out of our control, that's fair and that's reasonable. And that's why I very much represented the view for Dennis and his team of if it proves to be out of our control and does not normalize in a way that we're satisfied with, there are other levers that we can backfill that gap with. And I think that that's a strength that Dennis has brought in his leadership of the team and his experiences and I think will benefit the pork business not only today, but moving forward.

Mark Petrie
Analyst, CIBC World Markets, Inc.

Q

Yeah. Okay. Understood. And I wanted to actually just go into that side of things a little bit. You talked about sort of the premium side of the hog business and how important that is and what a differentiator it is. Could you just talk about some of the drivers of demand for those sort of different pockets of the business that you described?

Curtis E. Frank
President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.
A

Yeah. Sure, Mark. I'll pass this one over to Dennis. [ph] I know (00:41:55) it's a good opportunity for him to give you an update.

Dennis Pat Rick Organ
President-Pork Complex, Maple Leaf Foods, Inc.
A

Yeah. I think the way I would describe it is the way we differentiate ourselves is through specialty programs, all the way down – up and down the spectrum. So, you've heard about our RWA, sustainable meats, our loose sow housing, all of those attribute programs that require a premium. So, that's one way we differentiate ourselves. But there's also other areas that are things that we do that other people either don't do at the same level or don't do at all. And the way I described it in my comments were retail-friendly packs for North American customers. So, think about all of the retailers struggling getting labor in the stores. We have ability to prepackage things like single-piece ribs and pork butts and things like that, so the grocery stores then just put them out on the shelf. They're sort of shelf-ready.

They have an endless supply of specialty package – pack size for specialty items for different export markets like the way that we layer pack some things so that they're easy to be frozen and broken out individually. And also specs. We have almost – we have about nine different specialty home programs that run through our plant which have [ph] specialty (00:43:13) quality needs that are required from different customers from obviously Japan, things from China, but even South Korea and the Philippines and things in Mexico. So, I've been talking a lot about [ph] costs (00:43:27), because I feel like those are some of the levers that we need to get caught up with where the industry is at. But we will always be a house of premium offerings, that always will differentiate us.

And so, what Curtis was saying even earlier about Japan, we're really comfortable in the pro forma we put together. We have multiple ways that we can get there. And the only thing that tends to send us offside is when the raising cost for our hogs is inflated. Now that that's normalized, you have multiple paths to the CAD 190 million to CAD 200 million worth of EBITDA.

Mark Petrie
Analyst, CIBC World Markets, Inc.
Q

Yeah. Okay. That's helpful. Thank you very much. And I guess, actually...

Dennis Pat Rick Organ
President-Pork Complex, Maple Leaf Foods, Inc.
A

Yeah.

Mark Petrie
Analyst, CIBC World Markets, Inc.
Q

...just sort of related to that, there was a call out that you processed more hogs in Q3 and you expect that to continue to rise. What are the drivers there? And I know further capital investment is sort of required to kind of fully unlock that efficiency and volume opportunity. But what are the drivers of the increase so far and how much could that increase in the next year or [ph] two (00:44:35)?

Dennis Pat Rick Organ
President-Pork Complex, Maple Leaf Foods, Inc.
A

Yeah. So, I've mentioned that there's two ways that – well, actually three things that we think about in our manufacturing facilities. Number one is utilization. The biggest thing that we need to get working in our favor is that we have some processing capacity in Brandon. What I would say happened last year and continues to happen this year is opportunistically acquiring hogs from growers. What we've been working on now that you will start to see in our numbers in 2026, and it may take two or three years after that to actually fully fill up the plant, is we're building strategic relationships with folks that can do things on a larger scale. This will not require CapEx from us. There will be a little CapEx we have to put in the plant, but I would say it's going to fall more in the – it would be what you would consider normal for our capital expenditures there. So, utilization is a big deal.

The other thing that we've talked about is our opportunity to automate the plant. We have some easy-to-install, sort of not overly complex equipment that we're a little bit behind in the industry. I like these investments because they're manageable, CAD 1 million, or CAD 2 million, CAD 3 million projects at a time, not significant, so we have that coming. And then the last one, which is most critical – Curtis mentioned it, too, reiterate [ph] it from my (00:45:55) operational excellence, whether it's raising a pig, processing a pig, or actions to sell a pig, we just have to get better at executing the things that we do. So, those three things together will lower our cost base, but continue to help us sell at a premium.

Mark Petrie
Analyst, CIBC World Markets, Inc.

Q

Okay. Thanks for that. And I just wanted to confirm, just with regards to the Winnipeg bacon facility, so that volume has come into that facility and you're expecting the full run rate for Q4, is that fair?

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

A

Yeah, we are, Mark. That's fully accurate, yeah.

Mark Petrie
Analyst, CIBC World Markets, Inc.

Q

Yeah, okay. Okay. Thanks for all the comments. All the best.

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

A

Thank you.

Operator: Thank you. Your next question is from Vishal Shreedhar from National Bank. Your line is now open. Well, Vishal, can you please check if you're on mute. Your line is now open.

Vishal Shreedhar
Analyst, National Bank Financial, Inc.

Q

Hi. Thanks for taking my questions. With respect to the sequential improvement in Q4 relative to Q3, should we expect the majority of that to relate to the onboarding of the customer in the bacon facility? And can you help us understand what that benefit would be in terms of the number or for us to better model that benefit?

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

A

Good morning, Vishal. Thanks. Thank you for your question. I'm going to stay disciplined and not provide quarterly guidance in line with kind of our normal practice. And I know that may be frustrating, but I'm going to resist that temptation as well, if that's okay. But I will give you some context. So, we are saying we're expecting a sequential improvement in Q4, and I think that's totally appropriate, given for a long period of time we've been saying our capital projects will achieve their full operational benefits in the fourth quarter. And it's not just the Pre-Cooked Bacon Centre of Excellence, it's also the last of the remaining work to do within London Poultry as well. So, in those two instances, our two most significant and largest capital projects, we're now into Q4, and I think we're confident to say that they'll contribute within the quarter.

Outside of that, I think – [ph] annual one (00:48:12), we're seeing more normalized market conditions in pork continue into the fourth quarter. So, those two things in and of themselves give us confidence in making a statement that we expect a level of sequential improvement, but I think I don't want to get further ahead of myself than that, if that's okay.

Vishal Shreedhar
Analyst, National Bank Financial, Inc.
Q

Related to the benefits from the two larger facilities, London and bacon, do you expect it's going to be the full or substantially the full run rate of benefits achieved in Q4, or will you expect that to build again into Q1?

Curtis E. Frank
President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.
A

No, I would expect we'll see the full operational benefits in Q4. And then, as I mentioned in my comments, Vishal, I mean, these things – operationally, we're in a wonderful place in both of these startups, wonderful. Again, expecting to be fully on track is a great milestone for our team and one that we'll celebrate for certain in the fourth quarter. The commercial components are lots of moving parts, as I indicated earlier, in both poultry and prepared meats, getting the sales mix that we expect on those assets now is the primary area of focus. That's going incredibly well in pre-cooked bacon. And in the poultry, in the fresh poultry category, our focus is obviously on reestablishing and reigniting the level of growth that we've historically seen in our sustainable meats business, in particular in [ph] not raised with on (00:49:41) antibiotics. So, I think next year will be all about accelerating commercial performance. In the fourth quarter of this year, I expect we'll have the full operational benefits put to bed.

Vishal Shreedhar
Analyst, National Bank Financial, Inc.
Q

Okay. In Q3, the contribution sequentially from the large capital investments was flattish quarter-over-quarter, as I understand, but you also had more volumes and you onboarded a customer in the Bacon facility in Q3. So, I would have anticipated at least some operating leverage and benefit in Q3 sequentially. Why wasn't there any?

Curtis E. Frank
President, Chief Executive Officer & Director, Maple Leaf Foods, Inc.
A

Well, I don't necessarily see it the same way. When we were here at this particular moment a quarter ago, talking about our Q2 results, we indicated we expected very similar conditions in the third quarter. And that's exactly, in fairness, how things played out. So, I said in my opening comments, it was a quarter that was in line with our expectations – acknowledging that we have more work to do, but it was a quarter that was in line with our expectations.

When you look at our volumetric growth of 3% in prepared meats in particular, which is where the Bacon Centre of Excellence sits, and you think about pre-cooked bacon being, if it's a retail package, 65 grams a package, it takes a lot of those packages to move the needle on a volume. But from a profitability point of view, they make a very material impact in our business. And of course, you see that on the revenue line where prepared meats grew at 3.1%. And those products certainly would have contributed.

Vishal Shreedhar
Analyst, National Bank Financial, Inc.

Q

Okay. And just lastly, with respect to the 14% to 16% target, management has indicated there's some factors out of your control, and you said there are plans to address that if you deem certain conditions to persist. So, with respect to the 14% to 16%, how should the market contemplate the timeline that management believes it can achieve it with all its initiatives? As you know, a target without a timeline is difficult for many to contemplate. So, what would you say to the market as we reflect upon the 14% to 16% and the timeline needed for management's initiatives to possibly counteract some of these unexpected and unfavorable market variances?

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

A

Well, I wish I could give you a precise date, I personally would love that for myself as well, that we'll arrive at the destination. What we said this year is that we would continue to make progress in moving forward toward that target. And I think we had 240 basis points of margin expansion on a year-to-date basis, which is material. So, we've made progress. It hasn't been perfect, but we've made progress. So, we haven't established a guidance for 2025 at this point outside of the capital range that we provided. And we thought that was important because we didn't want you to be misled by the CAD 100 million of capital this year, which kind of would be a misleading number to utilize for 2025. So, we wanted to get ahead of that.

I think our normal practice, Vishal, is to give a bit more of a clearer outlook for 2025 along with our Q4 earnings. And you can expect that we'll do that in the next quarter. I doubt it will provide what you're looking for, which is a precise moment in time at which we'll arrive in the range. That would require us to predict the exact timing of a full restoration of conditions in Japan and predict the consumer environment full recovery to a moment in time. We know those things are headed in the right direction. We're seeing positive momentum in Japan. And through the combination of stabilizing inflation, interest rates coming off, and the brand plans we have in place, we're very confident that we'll make headway on the consumer side as well. So, do we expect to be in that range in 2025? Yes, we do, but I don't want to give you an exact date.

Vishal Shreedhar
Analyst, National Bank Financial, Inc.

Q

Thank you for that color.

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

A

Thank you.

Operator: Thank you. The next question is from Luke Hannan from Canaccord Genuity. Your line is now open.

Luke Hannan
Analyst, Canaccord Genuity Corp.

Q

Thanks. Good morning, and thanks for all the commentary thus far. I wanted to go back to – I think you mentioned in your prepared remarks that you saw 50% growth in Greenfield in the US. How much of that is you capturing higher share of shelf at your existing customers versus just expanding into new customers? And then if you think about the whitespace that you have in the US going forward, how much is predicated on the one capturing more share of shelf than existing customers versus the other being expanding into new customers?

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

A

Yeah, that's an excellent question. Now, the short answer is it was both in the last quarter. I did have an opportunity to dig into that data, so it was both. We saw both an increase in velocities, which is always good to see, again, particularly in the consumer demand environment, which is a little different in the United States than it is in Canada, in its current state. So, we saw an increase in velocities and we expanded distribution at the same time.

The one thing I'm not insecure about is the headspace that exists to continue to broaden our distribution and expand our product portfolio in the United States. Like, I just feel great about the capabilities we have on the ground. We now have manufacturing plants in the US, an office, an Innovation Center in Chicago, an organizational structure that's aligned geographically to Canada and the US uniquely, and just a wonderful team of people on the ground in the United States with strong and growing customer relationships.

And the fact that we're distributing products to every one of the top-10 retailers is amazing. The number of products, though, that we have at each one of those customers as compared to the Canadian market pales in comparison. And we're still such a very small share of the US market that there's just an enormous opportunity for growth for us in the US. So, both contributed, velocity and expansion of distribution. And I fully, fully, fully expect that that will continue to be the case moving forward.

Luke Hannan
Analyst, Canaccord Genuity Corp.

Q

Okay. Great. That's all for me. Thanks.

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

A

Thank you.

Operator: Thank you. There are no further questions at this time. I will now hand the call back to Mr. Curtis Frank for closing remarks.

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

Okay. Thank you, everyone, for joining us today. It was clearly another quarter of progress. That would be evidenced by an adjusted EBITDA margin that's improved, as I said earlier, 240 basis points a year-to-date, a CAD 230 million improvement in our free cash flow year-to-date, and the rapid deleveraging of our balance sheet. So, we're very positive on the quarter in terms of it unfolding as we had expected and very much look forward to speaking with you again at the end of our fourth quarter here in due course. So, thank you for joining us here today.

Operator: Thank you. Ladies and gentlemen, the conference has now ended. Thank you, all for joining. You may all disconnect your lines.