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MFI.TO - Q2 2018 Maple Leaf Foods Inc Earnings Call

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## PRESENTATION

### Operator

Good afternoon, ladies and gentlemen. Welcome to the Maple Leaf Foods Second Quarter 2018 Results Conference Call hosted by Mr. Michael McCain. Please be advised that this call is being recorded. (Operator Instructions)

I would now like to turn the meeting over to Mr. Michael McCain. Please go ahead.

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### Michael H. McCain - Maple Leaf Foods Inc. - President, CEO & Director

Thank you, Valerie, and good afternoon, everyone, and thanks for joining our Q2 2018 earnings call. Both Debbie Simpson, our CFO, and I will provide commentary on various aspects of our business and then open the call for your questions. The news release and today's webcast presentation are available at [mapleleaffoods.com](http://mapleleaffoods.com) under the Investors section.

Some of the statements made on this call may constitute forward-looking information, and future results may differ materially from what we discuss. Please refer to our 2017 annual MD&A and other information on our website for a broader description of operations and risk factors that could affect the company's performance.

Turning to Slide #3, the headline for our second quarter is really focused on 3 themes. The first is unveiling of our food renovation in the Canadian markets, as we've discussed now for almost a year with you and which we are very enthusiastic about. Secondly is the somewhat challenging market conditions relative to last year and also 5-year averages. These conditions are driven mostly by trade volatility and its impact on hog production profitability. And finally, in the midst of all this noise, a business portfolio which delivered our 10th consecutive quarter above our strategic margin target of 10%.

As you can see on Slide #3, sales were up 1.1%. Our adjusted EBITDA margin was 10.1% and EPS was \$0.34 per share. Reported sales were impacted by the new IFRS standard and other items that Debbie will be pleased to walk you through.

In addition to these things, we will speak a bit today about our all-important and market-leading sustainability agenda, which continues to advance, plus our recently announced agreement to acquire the assets of Cericola Farms.

Turning to Slide #4. We feel this is a great quarter to speak about the relatively stable and balanced performance of our portfolio today in the context of the last couple of years, since we completed our supply chain conversion. As I said a moment ago, this is our 10th consecutive quarter



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above our strategic target of 10%, and our stability was demonstrated during a fairly high level of surrounding noise. For example, the launch of our food renovation inside the second quarter and some relatively turbulent market conditions, both being very short term and transient in nature, had a combined impact of roughly 200 to 250 basis points on our margins, split evenly between those 2 factors. Of course, now, it would not be accurate to just add that back to our numbers because we'll never have a perfect quarter. But considering this noise, we feel very confident in the portfolio -- of the performance of the portfolio today.

And this is a result of 3 factors: first, the balance across the value chain in our portfolio; second, the high value-added component of our business, representing over 80% of our portfolio; and three, our strong and leading brands.

I want to reiterate what I've said many, many, many times over the last several years, that the natural ebb and flow of our business results will occur inside a bandwidth of roughly plus or minus 100 basis points on a quarterly basis. And as you can see from the chart here, we've been well within that.

Finally, looking beyond the short-term noise, we have a clear path to improve the margin structure in the business to a range of 14% to 16%, and I'm going to speak to that a little later.

With that, I'd like to turn the call over to Debbie, who's going to review the financial highlights and operating commentary before I provide additional color on the quarter and on our business. Debbie?

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### **Deborah K. Simpson** - *Maple Leaf Foods Inc. - CFO*

Thank you, Michael. If I could turn your attention to Slide 5. Our key metrics for the quarter included a reported sales decrease of 1.8% to \$909 million, inclusive of a \$34 million impact of the new IFRS reporting standard. As we discussed in our first quarter call, all listed companies in Canada were required to adopt IFRS 15. The impact for Maple Leaf was reduced sales and cost of sales sold by approximately \$34 million that would previously have been recognized in the quarter. There was no impact to our net earnings, adjusted EBITDA or adjusted operating earnings. Now that we have adopted the standard, we expect a similar ongoing impact each quarter.

Now turning to our other financial metrics for the quarter. We delivered adjusted EBITDA margin of 10.1%, with strong headwinds in the pork complex and execution costs from our food and brand renovation strategy. Adjusted EPS for the quarter was \$0.34 per share, and we have net debt of approximately \$21 million. This is after \$49 million of share repurchases. The strength of our cash generation and balance sheet allows us to continue to reward shareholders through dividends and share buybacks.

Looking at Slide 6. From a commercial viewpoint, we made significant progress through this quarter in our supply chain performance. We are pleased with the continuous improvement we are achieving in operating our assets. We also had good commercial improvement in prepared meats, which included margin expansion. We had higher volumes in fresh pork and value-added fresh poultry and favorable mix in prepared meats. Due primarily to execution complexity in the number of SKUs being repositioned as part of our comprehensive food renovation strategy, volumes were slightly lower in prepared meats.

We continue to see volume and sales benefit from our ongoing expansion into the U.S. market. Our sustainable meats portfolio performed well in the U.S., continuing to gain traction with major retailers.

Lastly, Lightlife and Field Roast both continued to perform very well, with both brands enjoying strong double-digit growth due to continued demand from their products.

Overall, our commercial gains in the quarter were more than offset by weaker pork market conditions, primarily in hog production, compared to the high-water mark on processor spreads of last year. We also had costs of approximately \$10 million to support our comprehensive food and brand renovation launch, primarily for production ramp-up, customer promotional activity, reformulation impacts and merchandising and marketing costs. We expect these additional costs will subside moving into the second half of the year.



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I will now turn the call back to Michael.

### **Michael H. McCain** - *Maple Leaf Foods Inc. - President, CEO & Director*

Thank you, Debbie. Turning to Slide #7. I'm going to start by focusing on our food renovation work. I'm immensely proud of our team's work in this strategy, which has the potential to contribute significantly to our growth and profitability for decades to come. As I've described before, our food renovation strategy is the largest initiative we've ever launched in this market and I believe the largest ever in Canada. It is sweeping in its ambition and its scale. 2/3 of the SKUs were converted by quarter end, supported by a massive merchandising and marketing effort. Our marketing campaign for the Maple Leaf brand alone has achieved 75 million impressions, ensuring Canadians coast to coast are hearing about the exciting news coming out of our branded food portfolio.

To put that in context, we are up on close to 600 billboards, between Maple Leaf and Schneiders, across the country. We are in the middle of executing several experiential marketing, digital social campaigns and public relations engagements. We are also airing excellent TV broadcast spots and are executing a very comprehensive in-store execution program.

Debbie described the quarter -- the in-quarter start-up investment, and the costs were significant in the quarter, but extraordinarily modest relative to the enormous potential of this initiative. It's an investment we have conviction will position our brands for continued leadership in the future, helping contribute to category growth.

We're very early in executing this strategy. In fact, I would say we are just past the starting line. The view from this vantage point is that we've had a cadre of tremendously good feedback from customers and consumers, but most of that would be considered anecdotal, and it's way, way too early to calibrate.

For the Maple Leaf brand, it's important to note that this is a significant change to the brand positioning, so it will require materially more time to communicate and embed the full extent of that message, and our consumer narrative will take time to hold. We have great confidence this is the right direction not just for this brand but for the large swath of the food industry.

Schneiders has enjoyed immediate product success in most segments simply because decadent taste can always be quickly identified. And with the Swift brand, our goal and need is to continue building distribution, as it's a relatively new launch in the marketplace for those who are looking for value and convenience that it has to offer.

Overall, we're very excited about how laser targeted the brands are now, positioned to meet specific demand occasions, and the opportunity to build the category in their respective positions. We not only pulled them forward in the marketplace, but we pulled them apart.

Turning to Slide #8. Our plant protein business is another exciting story this quarter and a central component of our long-term growth strategy. Lightlife and Field Roast continue to perform very well, participating in the exciting growth of the plant protein category. They are now the #1 and #2 brands in the high-growth refrigerated plant-based meat alternative category in the United States. Our biggest opportunity is supporting both of these brands to fully participate in the growth cycle, enabling them to meet consumer demand, which includes building the supply chain capabilities for both brands.

Lightlife has also been hard at work bringing its product portfolio to the Canadian market, where it can leverage Maple Leaf's significant relationships and expertise. The brand has achieved listings in every major Canadian retailer as we speak. We are enabling success in these 2 high-growth brands by investing in people, investing in product innovation and investing in these legacy brands.

Turning to Slide #9. I'd like to touch on the announcement that we made a short time ago in reaching an agreement to purchase the value-added poultry plants and their associated supply from Cericola Farms. They are a leader in fresh air-chilled, value-added retail-ready product, and this planned acquisition is positioned to expand our RWA portfolio and give us new capabilities in organic poultry. These 2 plants have significant capabilities and capacity for processing value-added air-chilled chicken, including RWA and organic.

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As part of our agreement, we will also secure 100% of the primary processing production from a third Cericola facility, with an option to buy that facility within 3 years. Chicken is the fastest-growing meat protein, and RWA and organic chicken is leading the pace within the value-added poultry space. So this move is directly on target strategically for Maple Leaf.

Turning to Slide #10. We just published our 2017 sustainability report, which is an annual milestone in our sustainability journey. We report to the global reporting initiative standards, which is global best practice. I would encourage you all to visit our website and spend some time with the content. The progress it represents reflects years of investments and efforts that are truly positioning Maple Leaf as a sustainability leader in creating competitive advantage that responds directly to consumer and customer needs.

To illustrate a few of our accomplishments, we are ahead of target on our environmental footprint reduction goals. A great example of that is progress that we're making in installing LED facility lighting, which is a large electrical energy consumer. Making progress on our footprint will come from thousands of projects just like this. We've now transitioned 38,000 sows to enhanced open housing, achieving leadership in both the scale and innovative approach that we use. We have several technology partners influencing our digital future that also support our sustainability agenda. An example of that is a partnership with Microsoft that is developing a digital livestock transport management system, delivering very important animal care outcome benefits.

And finally, we've become a member of the World Economic Forum Climate Action Alliance, a group of leading companies around the world focused on actionable solutions to the pressing issues of climate change. Collectively, these milestones demonstrate both commercial and societal value, which in our belief system is central to ensure competitive differentiation and success in the long term.

To wrap it up, on Slide #11. Last November, at our investor conference, we outlined a path to significantly build upon our structural margin and the strategies that we are pursuing to get there. In the context of quarterly market noise, things like some trade volatility or the start-up of significant new food or brand offerings, they can be very distracting. But I want to assure investors that while we are actively managing this, of course -- that's our job to do that -- we are relentlessly pursuing what really matters long term. In fact, to put a finer point on it, let me highlight 5 things that we are intensely focused on, which I am confident will make this company worth considerably more over the next 5 years than it is today for all our stakeholders, and delivering at least our next strategic financial milestone of 14% to 16% adjusted EBITDA margin. Those are: number one, our sustainability agenda, and of course, the financial driver in the middle of that is growth in sustainable meat sales; number two, the return on investment in our poultry assets, just as it was in the fresh pork and prepared meats assets; number three, our food renovation, which we expect will drive top line and margin improvement; number four, the substantial growth we expect in our plant-based protein business, which will also be accretive to margins; and finally, number five, our cost culture operationally and with how we operate our assets. These are the things that really matter.

In summary, the quarter was challenging, but actually quite satisfactory under these conditions. But we're mostly focused on the prize and not on the noise.

With that, I'll open it up to questions.

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question is from Irene Nattel.

### Irene Ora Nattel - RBC Capital Markets, LLC, Research Division - MD of Global Equity Research

I just wanted to focus on the brand renovation for a moment, please. Michael, you mentioned that we're really only at the beginning of it. But can you walk us through what the next steps are and how you expect the whole process to unfold as we move through, let's say, the next 6, 12, 18 months?

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**Michael H. McCain** - Maple Leaf Foods Inc. - President, CEO & Director

Sure. I mean, first of all, we have to complete our work. And we have, I think, 2/3 of the SKUs are converted and in the marketplace. And then we have another 1/3 to complete. That will occur over the course of the next quarter into the early part of the fourth quarter. The second part, the second component is we -- and now the most important is our investment behind the brand message. The message -- the Schneiders message around product is a relatively easy one to communicate, and it's an easy one to experience in the store and at home. The Maple Leaf one is a much more radical message, a radical message that I believe actually the whole food industry should pay attention to, but it is a radical message reflecting the real food movement. And we need to continuously and deliberately and systematically get that message into the consumer's psyche to modify their shopping and buying behaviors attached to that brand. The Swift brand is a distribution game. We've -- obviously, launching that in the context of this food renovation, if -- the distribution would be, by quarter's end, was less than 20% in total and will continuously develop over the course of the next 6 months. So I see us unfolding really a concentrated messaging behind the brand strategies, continuing to build on the distribution of portions of that. And then finally, Irene, I would say that these brand strategies are not one event of a food renovation in the second quarter. They're brand strategies that are enduring and will define our innovation agenda for years to come. So we're already thinking through future waves of innovation that will fit inside those brand strategies and brand portfolios for future development.

**Irene Ora Nattel** - RBC Capital Markets, LLC, Research Division - MD of Global Equity Research

That's really helpful, Michael. And that last bit is particularly interesting because, I guess, it really will define on a go-forward basis the types of products that you introduce and the brands under which you introduce them.

**Michael H. McCain** - Maple Leaf Foods Inc. - President, CEO & Director

Exactly. 100%. That's why the important -- the DNA of this brand strategy is not what's it going to do for the next quarter or 2. I mean, we won't get a good bead on how well this takes hold for probably a year. But the more important point is how this defines the -- everything about the brand development and the market development and the innovation agenda for the next decade.

**Irene Ora Nattel** - RBC Capital Markets, LLC, Research Division - MD of Global Equity Research

That's really interesting. Much appreciate it. Can you also talk a little bit about the market response within the U.S., particularly on the part of your clients, your customers, as you extend the reach of the plant-based proteins?

**Michael H. McCain** - Maple Leaf Foods Inc. - President, CEO & Director

You have to help me with your question. Describe the customers' response?

**Irene Ora Nattel** - RBC Capital Markets, LLC, Research Division - MD of Global Equity Research

Well, yes. I mean, as you go in -- as you, Maple Leaf Foods, go into the U.S. retailers and the foodservice and certainly against the backdrop of increasing demand for these products. And now you're presenting a broader brand portfolio. Are you sensing sort of a real eagerness? Are they encouraging you to even broaden the product line? What's the sort of the conversation around? And what's your sense around the growth as we look out, again, 1, 2, 3 years?

**Michael H. McCain** - Maple Leaf Foods Inc. - President, CEO & Director

So when we acquired those 2 businesses, Irene, we acquired them and they had high growth. Since we have acquired them, they've migrated from high growth to hyper growth. And we acquired businesses that had platforms already in place, and we have integrated those 2 platforms, Lightlife

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and Field Roast, into one operating business. We don't go to market as Maple Leaf, in fact. We go to market as Lightlife and Field Roast, under 2 separate brands. So really, the existence of Maple Leaf is really not known to consumers or customers. We're not -- it's not unknown, but it's not widely known. The organization in the United States would not view us as Canadians coming into this market to develop a business. They would view it as Lightlife and Field Roast headquartered in Chicago, Illinois, which is where the head office is for those businesses. And they would respond to it as a great, hyper-growing, plant-based meat alternative business that happens to have the #1 and #2 brands in the category and are supportive accordingly. In terms of what it means for us over the course of the next 5 years is when you get into a market like this, I learned a long time ago that there's only one answer, and that's riding the wave. And that's exactly what we're doing. We're going to ride that wave with making sure that we've got the capacity to service our customers as the demand grows, ride the wave by feeding it with innovation consistent with the brand platforms of Lightlife and Field Roast, being true to the brand strategies of those individual brands. We'll ride it with additional people resources as the business grows because it's going to take more people and different types of people as the business scales up rapidly. So in short, we're very excited about the future of the plant protein business. It's smallish today, but with the kind of organic growth rates that they're experiencing and our market shares in the U.S., I think 5 years from now will be a different story.

### Operator

Our next question is from George Doumet.

### George Doumet - Scotiabank Global Banking and Markets, Research Division - Analyst

Michael, I believe on the last conference call, you had mentioned that the industry models point for, I guess, a 1 year or so requirement to absorb all that extra capacity coming online. I know this is a tough question, and I know a lot has changed since, but in light of all that, can you maybe give us your assessment in terms of how long it will take for that capacity to normalize?

### Michael H. McCain - Maple Leaf Foods Inc. - President, CEO & Director

One of the dynamics coming into this fall, there are 2 dynamics in the market today that are affecting that side of the business. The most important actually, interestingly, George, is not the supply and demand of new capacity actually. The most important is the volatility introduced to the market in the last 90 days by global trade policies that everybody is aware of. Specifically, though, to your question around the trade -- the supply and demand of new capacity, the interesting development over the course of the last 6 months is that the hog production has at least caught up to that capacity. And in fact, some of that capacity is delayed coming on stream so that the back half of this year, actually, there will probably be more hogs than there is capacity to process it. They have 2 struggles in the U.S. capacity today -- in the U.S. industry. One is bringing that new capacity online, and the second is labor availability in -- with their current environment. So that dimension of this -- that dimension really is not playing out in a material way. What is playing out is the trade dynamic, and that trade dynamic does impact the domestic markets. It impacts it because of the supply of meat that's available, the amount of hogs, the pressure on hog price. Our market influence today, for example, George, is being felt in hog production, significantly in hog production, and not as much today. 6 months -- over the next 6 months, that may be different. But today, it's really -- and in the second quarter, was impacted in hog production as reflected in hog markets that used to be worth \$60 and now are, say, \$45 to \$48, in some cases, in the back half of this year, high 40s, all of which is the -- reflected in the recent announcements in the United States to bolster that agricultural impact with direct subsidies. So a lot of moving parts, George. The specific component that you described today, I think, is playing out in a more positive tone than what we would have thought a year ago -- or 6 months ago.

### George Doumet - Scotiabank Global Banking and Markets, Research Division - Analyst

Michael, that's helpful. And just one last one, if I may. In your prepared remarks, you guys called out, I think, 200 to 250 basis points of an impact from the food renovation from the pork volatility. Can you maybe break those out a little bit, maybe more granular there? And also just on that 1.1% organic growth number, just wondering if that was at all impacted by the food renovation program as well.



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**Michael H. McCain** - *Maple Leaf Foods Inc. - President, CEO & Director*

I'll take your second question first. Yes, the -- our volume was directly impacted in the quarter by the disruption of the food renovation directly. That was one of the contributors. Not the only one, but it was one of several. So to your question about the composition of the 200 to 250 basis points, it was about, as Debbie said, about \$10 million estimate, roughly. Right? \$10 million. I would probably describe it as \$9 million to \$11 million, but roughly \$10 million of impact due to the food renovation, and then the balance in the -- in basically the market conditions. And I would trace that to hog production primary processing. In the food renovation, there were basically 3 different drivers inside that: volume, which we've spoken to, and you've identified that. That's largely traced to customer promotional activity in a very disruptive state of transition when you're transitioning that many SKUs. And the disruption to the customer promotional activity and pushing back that promotional activity or missing that promotional activity in the quarter was the lion's share of that. There was significant supply chain implications, mostly traced to SKU startups, because you have that many items, every SKU is effectively a new item start-up. And so you have, in manufacturing speak, warranty periods for the first month or 2 in processing a new SKU, and your performance is not optimized. And then finally, higher-than-normal initial merchandising and advertising costs. So if you add that all up and you look at the 200 to 250 basis points, George, it was probably split, roughly speaking, half and half.

**Operator**

Our next question is from Mark Petrie.

**Mark Robert Petrie** - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Research Analyst*

I just wanted to follow up, actually, on those topics, and specifically related to the spending around the brand renovation. You mentioned that, that's going to continue into the coming quarters, but could you give us a sense of sort of the trajectory from here into Q3 and Q4 relative to Q2?

**Michael H. McCain** - *Maple Leaf Foods Inc. - President, CEO & Director*

Yes. The trajectory -- we think that the lion's share of that will be done in the third quarter. There might be some trailing -- trailer in the fourth. But there'll be some more costs, probably not quite as intense, but some costs in the third quarter and a dramatic tail off in the fourth.

**Mark Robert Petrie** - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Research Analyst*

Okay. And the impact on prepared meat volume as a result of the brand renovation. Was that in line with your expectations? And then what are you sort of expecting, not for the business overall necessarily, but in terms of the specific impact from the brand work. What are you expecting in terms of the impact on prepared meat volumes in Q3 or Q4?

**Michael H. McCain** - *Maple Leaf Foods Inc. - President, CEO & Director*

So, was the impact of transition more or less than I was expecting? I'm a natural optimist, so I go into these things always hoping for the best. So probably it'd be fair to say it was less than what was -- probably a greater impact than what I expected just because of my natural optimism. But I think I discussed this in each remark over the last 2 quarters as we got together and discussed this prospectively, I said it was disruptive, and it was -- for sure, it was not going to go as planned. How -- whether it was going to be better, worse, on target, who knows? These are very large disruptions in the marketplace when you're transitioning total portfolios like this. So having said that, I would -- for any investor and analyst, I would encourage people to just really focus on the fact that this is a very, very strategic and significant move that will endure for decades on success. And that kind of impact in the quarter is truly noise, just noise.



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**Mark Robert Petrie** - CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Research Analyst

Yes. Got it. Appreciate that. And then just on the Cericola acquisition, how do those plants and that capacity sort of fit in with your plans to -- or potentially impact your plans to overhaul your poultry processing assets?

**Michael H. McCain** - Maple Leaf Foods Inc. - President, CEO & Director

That fits in very, very well, actually, because their business is focused on specialty categories like organic that we don't see in any overhaul of our asset base. So we don't see that level of segregation where we would take a large-scale investment in poultry processing and overlay an organic program in the middle of that. So I think actually it fits very well. Plus, this is -- it's really important to note that any time we add scale, we improve our opportunity to scale up our assets at the same time. And finally, important to note that poultry is the only growing asset -- sorry, growing segment of meat supply today that -- and it has seen tremendous growth inside the meat complex over the course of the last 5 years. And layered on top of that, our branded portfolio of -- value-added branded portfolio, including Maple Leaf Prime, Mina, the RWA offerings, have all outpaced the industry growth. So we actually really need that supply, and it's completely consistent with our operating strategies.

**Mark Robert Petrie** - CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Research Analyst

Okay. And I guess, just following up on that quickly, can you give us any sense in terms of the impact of the Cericola business on your P&L in terms of revenue impact or profitability?

**Michael H. McCain** - Maple Leaf Foods Inc. - President, CEO & Director

We haven't put that into the market at this stage, so I think I'm going to avoid that question.

**Deborah K. Simpson** - Maple Leaf Foods Inc. - CFO

Yes, Mark. You'll get some information. So we expect to be closing towards the end of August. And then as part of our financial reporting in Q3, we'll be obliged to share that information with you. But because the deal is structured with a private company, we've kind of given an obligation not to disclose it until then.

**Operator**

Our next question is from Peter Sklar.

**Peter Sklar** - BMO Capital Markets Equity Research - Analyst

Michael, will these -- this headwind you're experiencing from pork market conditions, or what you call the pork complex, can you just explain a little bit more about how Maple Leaf, like how that impacts you? Is it in the primary processing spread? And on what side of the equation are you feeling the pressure? Is it the input or the output?

**Michael H. McCain** - Maple Leaf Foods Inc. - President, CEO & Director

It's in the -- so I will speak relative to 5-year averages, Peter, not relative to last year. The numbers are actually greater than last -- if I spoke to last year, because last year, as we discussed then, the numbers were higher than the 5-year average. So to break it down, the impact that these market conditions have is showing up fully and very negatively in hog production, not in primary processing. Relative to 5-year average, it's relatively neutral, so to speak, over the -- over this period and likely expected coming into the back half of this year, although there are other influences that are at play. The negativity here in margin is in hog production. And I would encourage you to pull up a chart, the lean hog chart or the lean hog

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contracts through the summer period and into this fall, and you will get a sense of the cliff that they fell off largely early on in the second quarter. And most anybody in the industry would correlate that to the sheer unpredictable volatility in trade relationships globally today.

**Peter Sklar** - *BMO Capital Markets Equity Research - Analyst*

But aren't all your hogs used internally for primary processing?

**Michael H. McCain** - *Maple Leaf Foods Inc. - President, CEO & Director*

They are. But when you have a primary -- when you have a -- that -- your assumption is true. But what happens in the spread, the cutout comes down with the hog cost. So we do get a positive offset in our portfolio, but not in primary processing. We get that positive offset not in the short term it takes -- by the time you've churned through inventories; it takes a quarter or 2 sometimes to realize this. But the positive offset that we get is in processed meats, actually, where you're -- basically the lower cost of the meat block as a result of the lower cost of hogs, which translates into the lower cost of meat, which is an input to processed meats. I mean, but to be clear, Peter, and if you want to tease out the impact of the market conditions, there's a wealth of publicly available data to do just that relative to 5-year averages and relative to last year. If you teased out that market impact, you could easily get to numbers -- if you include hog production and pork markets, you'd get a number that would be 300 basis points. Right? You'd get a number of 300 basis points. So we delivered 11.2% last year. Take 300 basis points off it, and you'd have a number that wouldn't be that pretty. But we were nowhere close to that. We were -- if you adjust for the start-up of the core renovation, which is basically 100 basis points, we were roughly flat. We were within 20 basis points of last year's number. Why? For the reasons I articulated. One, we have a balanced portfolio; two, we have a very high proportion of value-added products; and number three, we have some categories, like RWA and Other in global markets that are very lucrative for us and much more stable.

**Peter Sklar** - *BMO Capital Markets Equity Research - Analyst*

Okay. Can I just...

**Michael H. McCain** - *Maple Leaf Foods Inc. - President, CEO & Director*

My point is that I think if there's any quarter to tease out the fact that we have a very different model than the commodity model, this is the quarter to do it.

**Peter Sklar** - *BMO Capital Markets Equity Research - Analyst*

Okay. I just have one other question. Back to the repositioning of the Maple Leaf brand, could you just reiterate in your mind where you're positioning the Maple Leaf brand? And I just don't understand why you characterize that as a new radical messaging that you're bringing across.

**Michael H. McCain** - *Maple Leaf Foods Inc. - President, CEO & Director*

To the best of my knowledge -- if you look at the reformulation of our products, and the best illustration of this would be to take a before and an after on the ingredients deck. I'd be happy to, if I could find it here handy, to read you the before and after of the ingredient deck on a Maple Leaf package. The reformulation that's attached to this real food movement, where we've taken out all of the ingredients that consumers have -- this particular consumer set, not all consumers. The responsible parent consumers, if you look at the -- all of the ingredients that we've taken out and then reformulate it with just pantry ingredients -- ingredients you can pronounce, ingredients that are known to you. They're ingredients that are familiar with you. Plain pantry ingredients. That is a very radical move in the food industry. We don't know of anybody to that extent, that has gone to -- that has done this to the extent that we've done this anywhere in the North American food industry. So yes, I think it ticks the box of pretty radical and pretty leading edge. Having said that, that message, from a consumer perspective, recognizing that brand and brand positioning and



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brand messages like that take years to embed, years. Not to think that you throw 75 million impressions and everybody just gets it. Consumers have very busy lives. They're bombarded with messaging on everything in their lives, and it takes a long time, with much repetition, to embed that message. So consumers that have just bought Maple Leaf habitually, some of them for reasons we like, some of them for reasons we don't like, it takes some time to convert that brand positioning. And we will -- when you do that, when you change the brand positioning like that, Peter, there are some consumers you shed, and there are some consumers you gain. And there's a transitional process in those consumers over a period of time. But it's really important to look at it through that lens.

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### Operator

Our next question is from Derek Dley.

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### Derek Dley - Canaccord Genuity Limited, Research Division - MD & Consumer Products Analyst

Just a couple of quick ones for me. Last quarter, you commented that the PED virus had reduced some of your hog herd. Did any of that spill over into Q2? Or has that situation been rectified?

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### Michael H. McCain - Maple Leaf Foods Inc. - President, CEO & Director

It did not spill over into Q2.

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### Derek Dley - Canaccord Genuity Limited, Research Division - MD & Consumer Products Analyst

Okay. And then actually just the last one, just on working capital. Typically, with Maple Leaf, we see a drawdown of working capital in the front half of the year, and then it comes back in the back half. Should we expect the same this year? Is there anything different given the brand repositioning and product reformulation?

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### Deborah K. Simpson - Maple Leaf Foods Inc. - CFO

I'm not expecting anything too different, Derek. We'll have a little bit of a build over the summer in inventory, but that's just normal as we prepare for back to school. Don't see anything too different from our normal trends.

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### Operator

(Operator Instructions) Our next question is from Mike Van Aelst.

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### Michael Van Aelst - TD Securities Equity Research - Research Analyst

I guess I'll start with Cericola. Can you give us an idea of what you plan on doing with the brands? Do you plan on keeping them separate? Or do you convert it to Maple Leaf Prime?

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### Michael H. McCain - Maple Leaf Foods Inc. - President, CEO & Director

Most of that is undecided at this stage, but a big chunk of their business was done through private label and unbranded.



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**Michael Van Aelst** - TD Securities Equity Research - Research Analyst

Okay. And does Maple Leaf currently do a lot of private label in Canada?

**Michael H. McCain** - Maple Leaf Foods Inc. - President, CEO & Director

In this premium private label, yes. We are a large provider of fresh, owned label on the premium RWA offerings in the country.

**Michael Van Aelst** - TD Securities Equity Research - Research Analyst

All right. And then does Cericola then create an additional source of RWA poultry that you can now use to bring the Maple Leaf Prime brand into Western Canada with RWA? Because I believe you've talked in the past about having converted it in the East, but having -- looking for capacity for the West.

**Michael H. McCain** - Maple Leaf Foods Inc. - President, CEO & Director

Not as much, Michael. The transportation from East to West is onerous. And so we are developing our RWA supply lines in the U.S. -- sorry, in the West, but that will have to be sourced out of our Western facility.

**Michael Van Aelst** - TD Securities Equity Research - Research Analyst

Okay. And then on the spending for the core brand renovation. If the messaging takes a lot longer than you would expect to get across, would the spend stay above normal for an extended period of time? Or does that just start coming out of your regular advertising budget at some point?

**Michael H. McCain** - Maple Leaf Foods Inc. - President, CEO & Director

We see that coming out of our regular advertising budget.

**Michael Van Aelst** - TD Securities Equity Research - Research Analyst

Okay. You mentioned the brand reformulations. Is there any impact on shelf life?

**Michael H. McCain** - Maple Leaf Foods Inc. - President, CEO & Director

A modest impact on a few SKUs, but not that would make any material difference.

**Michael Van Aelst** - TD Securities Equity Research - Research Analyst

Okay. And then RWA capacity for pork, is there -- are you having any troubles keeping up the -- with the demand through your own farms or through third parties?

**Michael H. McCain** - Maple Leaf Foods Inc. - President, CEO & Director

The demand is still quite robust. So I would say no, we're keeping up with demand, but we're growing at the same time. So our supply is growing, but the demand is growing as well, so I think we're reasonably in balance there.



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**Michael Van Aelst** - *TD Securities Equity Research - Research Analyst*

Okay. And just a final question. On the Swift, I think you said that you had 20% distribution only. Can you talk about the challenges to getting distribution for a new product, particularly one that, I don't know, I'd assume it must be displacing private label in some areas, at least from a sales perspective if not from a shelf space perspective. So what are the challenges? And what are you doing to overcome those?

**Michael H. McCain** - *Maple Leaf Foods Inc. - President, CEO & Director*

So we're -- so there's getting distribution or achieving distribution in a very crowded shelf space -- shelf set is always an issue, and this is a full lineup of a new brand in the category. So that just takes time to build, Michael. I don't think that that's -- I don't see any huge obstacles to that, but it will take some time. The message in the Swift brand is around a proposition or a demand space that is, as we've described it, quick fix, is -- where value is -- plays a bigger role. But interestingly, our message is value plays a bigger role, but it's not the only role. And the packaging and the product, actually, while they represent a great value, they're not necessarily perceived as cheap. And I think that's where the -- the role that they can play in the category. Because those consumers, while they want value, they don't necessarily want cheap. So I'd say -- so how do we mitigate against that? We're selling like hell, and we're going to continue to sell like hell. It's a basic category management story, where you convince our retail partners about the dynamic of customer trade-offs and customer and the role that various brands play in that category and how they can maximize their performance in the category by having all consumer demand states represented.

**Operator**

Thank you. There are no further questions registered at this time. I would like to turn the meeting back over to you, Mr. McCain.

**Michael H. McCain** - *Maple Leaf Foods Inc. - President, CEO & Director*

Okay. Well, thank you very much. And I am -- I have the utmost of respect that people have a desire, as we have a desire, to always understand the short term, and as I've described it, the noise that exists in our business. But I'm also really focused and we, as a team, are very focused on the material value creators over time, which are so much more important than the noise around us. And I'm reiterating for all of our shareholders and stakeholders the 5 that we've articulated -- our leadership and sustainability, our investing in poultry assets, our food renovation, the substantial growth that we have in plant proteins ahead of us and our cost culture. We think those are the things that really matter, notwithstanding the noise, and that's what we're focused on. So thank you for your support, and we look forward to chatting and updating you next quarter with more exciting news, particularly on these items that really count. Thank you, and have a great day.

**Operator**

Thank you. The conference has now ended. Please disconnect your lines at this time, and we thank you for your participation.



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