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Q1 2019 Maple Leaf Foods Inc Earnings Call

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen. Welcome to the Maple Leaf Foods First Quarter 2019 Results Conference Call hosted by Mr. Michael McCain. My name is Joanna, and I will be your conference operator today. Please be advised that this call is being recorded. (Operator Instructions) Thank you.

Mr. McCain, you may begin your conference.

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

Thank you and good afternoon, everyone, and thanks for joining our Q1 2019 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 under the Investors section.

Before we start, Slide 2 is a reminder that some of the statements made today on this call may constitute forward-looking information and that future results may differ materially from what we discuss. So please refer to our 2018 annual MD&A and other information on our website for a broader description of operations and for risk factors that could affect the company's performance.

I would like to begin by turning you to Slide #3, please. The first quarter of 2019 is best described as a quarter marked by investments in growth. And we delivered solid top line growth, although we experienced in-quarter margin compression as we invested in that growth. Our sales were up 11% driven by acquisitions and the higher-value sales mix. And from a margin perspective, we incurred higher costs as we made strategic investments to support growth in plant-based protein and added new capacity to meet increased demand in 2 areas, our protein kits and meat pies. Adverse pork markets -- fresh pork markets also continued through the quarter, although I would emphasize that they're expected to improve for the balance of the year. And we never want to deliver results that don't meet expectations and Q1 fell short of the mark for sure. But peeling back the impact of higher costs and market conditions, we feel we made good commercial gains in the quarter, and we're on track to deliver on our structural margin targets.

Turning to Slide #4. Over the next several years, we have a very, very robust plan to drive sales and profit enhancement. That includes building 2 new facilities to secure our market leadership in exciting growth categories. It includes monetizing our investment in food renovation, it includes building our leadership in U.S. expansion in the sustainable meat space and driving significant growth in the exploding category of plant-based protein as well as integrating growth acquisitions that we've completed. And we are investing strategically in expanding markets and in areas that leverage our core competencies. But pursuing an exciting and tangible path to value creation, our plans are ambitious and I would say that, that comes with some quarterly lumpiness, which is normal and to be expected. Having said that, our shareholders and many of our shareholders understand this, but they've made us an ask of us and they've asked us for transparency concerning elements and drivers that impact that lumpiness or the results and a growth -- and the growth trajectory.

So in an effort to be responsive to that feedback and request, on Slide #4, we've laid out what are the key drivers in the quarter that had limited impact on our adjusted EBITDA margin. The first is a short-term dilutive effect of 2 tuck-in acquisitions that we announced in the



fourth quarter, Cericola Farms and VIAU. Both are excellent strategic transactions that provide us additional poultry supply and access to new avenues for attractive growth opportunities. Still in the business combination phase, the dilutive impact of these acquisitions was approximately 70 basis points in the quarter. That said, we expect both of the acquisitions to be accretive in the back half of the year as we complete their integration.

Our investment in startup of new capacity to expand production for protein kits and meat pies, which are relatively small categories but they're important growth categories for us, compressed our EBITDA margin by approximately 50 basis points. These were not substantial capital investments, but they were important to expand capacity in these categories, which do offer growth opportunities for us in the Canadian marketplace. As a result, we experienced near-term startup costs in both of those 2 lines as normally expected, but we don't believe that those are going to extend beyond the quarter -- beyond 1 single quarter. So in fact, the startup costs attached to both of those operations will be complete or are complete by the end of the first quarter. Both protein kits and meat pies are exciting subcategories and they're value-added categories that are very attractive to us and have attractive growth rates.

We've talked a lot about our plans to accelerate our leadership in plant-based protein. As a new frontier of protein, this market is growing at simply incredible rates. And investing to build our share in the future of food is unquestionably capital well spent. In the quarter, we invested in exciting new brand marketing, deepened our U.S. organization's bench strength and launched our new Lightlife Burger lineup. In total, this aggregate investment in the first quarter, which will affect the plant-based protein business over time, impacted the quarter in SG&A by approximately 40 basis points.

We have top brands in that fast-growing refrigerated segment. And we are intent on sustaining and growing our leadership position. We are going at full throttle to support those brands, our products and innovations in plant-based protein. I'll highlight some of the programs we have in place later in the presentation.

And finally, while hog prices spiked in the end of the quarter, the adverse market conditions that persisted through 2018 did affect us in the first quarter and on a year-over-year basis, compressed our margins by approximately 50 basis points.

Before I pass it over to Debbie, turning to Slide #5, I'd like to provide a few comments on African swine fever outbreak in China. While it had no effect on Q1, I would say it's virtually impossible to predict exactly how this will play out as it's beginning to influence global agricultural markets. Let me start by being super clear that African swine fever harms pigs, but there's no impact on human health. But it's swept across the Chinese marketplace where they are the largest producer and consumer of pork. Current estimates are that in China, they've experienced a 25% to 35% loss in hog production. Hog futures in North America have rallied as commodity traders bet that China will buy more North American meat. Rising hog prices are expected to alleviate the margin compression that hog producers have been experiencing for more than a year now. And looking further downstream through our vertically integrated business, we are planning ahead and reviewing potential pricing to mitigate expected higher input costs for prepared meats. The outbreak in China has far-reaching effects across global agricultural sectors. Countries are stepping up their protection efforts as we are in Canada, which already has some of the best biosecurity practices in the world and has increased inspections in the air, sea and land ports.

As for our own operations, we're always vigilant and have comprehensive biosecurity and disease preparedness strategies in place. We have further heightened the precautionary measures in response to ASF.

So with that, I will hand it over to Debbie to further discuss our Q1 results. Debbie?

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

Thank you, Michael.

As shown on Slide 6, our key metrics for the quarter included sales of \$907 million, an increase of 11% or 1.4% excluding acquisition. For the quarter, our core business delivered sales growth in prepared meats, value-added pork and poultry and plant-based protein, all indicators of strength in our business.

Turning to other financial metrics. We delivered an adjusted EBITDA margin for the quarter of 9.3%, which, as Michael mentioned earlier,

reflected investments in growth initiatives. These investments contributed to SG&A expense, which, as a percentage of sales, was 10.8% in the quarter. Driving growth requires our continued investment to support our brands and to build and develop our teams to drive profitable sales.

Adjusted EPS for the quarter was \$0.20 per share, and we closed the quarter in a net debt position of approximately \$384 million.

As most of you know, IFRS 16 - Leases became effective for all public companies this January. The effect on Maple Leaf is primarily related to recording previously classified operating leases on the balance sheet. What was previously recorded as a lease expense is now recorded as depreciation and interest.

During the quarter, we recognized \$8.1 million in depreciation and \$1.8 million in interest related to the adoption of IFRS 16. This geography change had a minimal impact on net earnings.

Taking you to Slide 7. We are pleased with the continued momentum in the underlying commercial performance of the business as we move towards our adjusted EBITDA margin target of 14% to 16%.

During the quarter, each area of our core business made good commercial progress. We saw a benefit from our sustainable meats platform with growth across fresh pork and poultry and continued expansion of the Greenfield brand into the U.S. market. Prepared meats also performed well. We realized positive commercial performance from pricing actions taken in the fourth quarter of 2018 to offset inflationary pressures and favorable sales mix as food renovation behind our flagship brands continue to gain traction. Prepared meats also benefited from lower input costs. And overall, we are pleased with how our prepared meats business performed during the quarter. Fresh pork and poultry also delivered good commercial performance, partially offset by adverse market conditions for both. We continue to grow our value-added offerings and this quarter was no exception. Japan chilled, value-added export pork and value-added poultry all contributed to margin during the quarter. And plant-based protein continued to deliver double-digit sales growth in Q1 while we continue to invest in branding and promotion to support the growth of Lightlife and Field Roast brands.

Turning to Slide 8. Investing in growth is a key component to our strategy to achieve best-in-class margins and to create value for our shareholders. We have made significant progress in laying down the foundational building block to achieve our targets, including established plans to construct 2 new state-of-the-art facilities, the largest value-added poultry processing facility and plant-based protein manufacturing facility in North America. To fund our investments in growth, earlier this week, we announced that we have refinanced our existing debt structure with a new syndicated credit facility providing us with access to \$2 billion in debt funding. This new facility consists of \$1.3 billion of unsecured committed revolving line of credit and 2 unsecured committed term facilities, totaling \$700 million. The new credit facility with its size and unsecured structure provides us with enhanced liquidity, flexibility and capacity to fund our strategic initiatives. It's an important step towards achieving our business goal and maintaining a solid investment-grade balance sheet that supports our longer-term growth plans.

I'll now turn it back to Michael.

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

Thank you, Debbie.

Turning to Slide #9, a quick commentary on our plant-based protein business and securing our leadership in this hyper-growth plant-based protein market.

This is an important leg on our growth strategy. Hyper growth of plant-based protein is attracting a lot of attention, certainly from new entrants, new investors and consumers alike. In some cases, and I think this is an important point, it appears as if some of the new entrants are running a technology stock playbook, and we need to be cautious not to be constrained by a classic food company playbook. Now winning in this market requires investment, agility and innovation. And that's what we intend to bring to the table. Our Lightlife and Field Roast brands are fully participating in this growth curve, and our job is to provide the scale and resources to enable those brands to lead the way.

Last month, we announced our plan to build the largest plant-based production facility that is unrivaled in the industry, leading the capacity drive as a key enabler. It will secure our market leadership in a growth category, provide us with highly efficient low-cost networks and needed capacity to meet market demand and support -- sustain growth in one of the food sector's most dynamic categories.

Our investment in this space also includes driving innovation behind our brands. We plan to significantly grow our presence in the burger market and launched our new Lightlife Burger early in Q1. You should expect to see it roll out mostly over the second quarter through retail distribution throughout North America. Our pea protein-based burger and family of products have been well received by our retail and foodservice customers.

Our strategy is to build awareness in a big way with a multichannel approach reaching consumers on air, online, experientially and in traditional media as distribution ramps up. We expect to reach target markets with intense frequency and across multiple contact points in a phased campaign. Shareholders should expect to see us build our investment in assets, in brands, in people and in innovation.

Turning finally to Slide #10. We're pursuing an aspirational vision to be the most sustainable protein company in the world. We think ours is a very bold strategy with ambitious plans that will change the makeup of our portfolio and our growth profile.

We're making strategic investments in attractive and growing areas to build on our market leadership as they provide new avenues for growth, and creates value for our shareholders over time. Fundamentals of our business are sound, and we're moving with speed to advance the key drivers that we've identified consistently in the past for structural margin growth. Each of our building blocks are moving ahead and tracking as planned.

Our sustainable meat portfolio continues to expand each quarter, making further inroads. Our Raised Without Antibiotics platform continues to entrench our position as the leading provider of RWA meat while contributing to margin expansion. We've expanded our offering to organic poultry and are very excited to launch our first retail prime organic advertisement in the second quarter of 2019. We've also received the green light to start laying foundations for our new value-added poultry plant in London, Ontario, and we expect to be breaking ground as scheduled. Continued favorable sales mix we've enjoyed towards higher-margin prepared meats categories is a clear testament that our food renovation is working.

Finally, we're making significant investments in plant-based protein to capture growth and share in an incredibly attractive market where we have an established network and customer base to build on.

In sum, we have clear strategies to deliver the next level of profitable growth and create a sustainable enterprise over time based on pursuing an exciting and what we feel is compelling vision.

So with that, I'll open up the floor to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question is from George Doumet.

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

I'd just like to focus a little bit on the ASF. You've obviously have given some color there, and you've called out the lean hog move. And can you just remind us typically of the mechanisms and the lags as it relates to passing through some of that -- some of those prices?

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

So the lean hog futures market and cash market is reflected in our hog production as it's quoted on the cash market daily. The processor spread occurs -- again, quoted daily on a benchmark basis, although some of our portfolio is disconnected with that, particularly our --



the Asian component. But that's also reflected in the marketplace on a daily basis where analysts and shareholders can easily view how that unfolds. One would expect that with a significant demand for meat that the price of hogs would go up. But in due course, the price of meat will go up as well to reflect the protein shortage around the world, which undoubtedly will emerge. And then finally, because the cost of meat is going to go up rapidly over the course of the next few months, we are planning price increases to reflect the increased cost of raw materials in our packaged meats business, and we would expect that those to be -- those to be in the market in the third quarter. So that's roughly how it goes, George.

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

Okay. So we can price -- we can take the price in the third quarter for some of that and then get (inaudible) higher?

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

In packaged meats, yes.

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

Got it. Okay. That's really helpful. Just shifting gears over the plant-based protein, obviously, it's very topical today with the Beyond Meat IPO. So just wondering if you can talk to the cadence of the SG&A investments, is that going to remain for the rest of the year? Is it going to get lower towards the back half? Is it going to be higher? And then the second part of that question is, just wondering, the \$26 million of CapEx that we have invested into that business, is that going to be enough to supply the demand over the next few years?

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

Is the what?

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

Well, the CapEx you invested -- \$26 million of CapEx that we invested in into that business, do you believe that's really enough from a capacity standpoint to supply all this demand?

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

We feel we've got capacity with the investments we've made to date and intend to make in our 2 existing facilities to take us through to 2020. And the new plant is designed to carry that capacity beyond that. With respect to your SG&A forecast, we -- I would tell you that our intention is to play in this market to win. And we know that the technology playbook that we are witnessing in other parts of food today focuses on revenue growth and terminal value more than they do your SG&A profile. And we intend to do the same thing. So I can't tell you exactly nor would we tell you if I knew precisely because we don't offer forward guidance what exactly that ratio is going to be, but I will tell you when it occurs, what the impact of any additional investments were in the quarter. But our intention is we're playing in this to win.

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

Okay. And just last one, if I may, on that segment. What do you think the ideal kind of mix would that -- would be like foodservice versus retail if you look a year or 2 out?

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

I think we'll be heavily focused to retail, but we are concentrating on foodservice as well. But we -- our certain area of strength is in retail in the first instance, and that's where our brands are leading today and that's where we expect to prevail over time, although we are calling on the trade across the -- across North America in foodservice as well.

Operator

Your next question is from Mark Petrie.



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

I wanted to ask about the brand renovation. And maybe just give a bit more detail in terms of the impact in your business in Q1, the outlook for 2019 and you mentioned some benefits. But is that coming through a lower penetration of promotions? Or is that through the innovation and higher margin on those goods?

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

So the first quarter is a bit of an interesting anomaly because if I told you in aggregate, we had a slight volume decline in the first quarter, which is a real paradox. But when you double-click on that slight volume decline, it actually came in the categories where we had supply chain challenges, which is ever so slight. But we did have supply chain challenges in some of those growth and important categories. So in the broad portfolio, we actually benefited in the quarter. We had good benefit from sales mix improvement. And that sales mix improvement, which is ultimately what our aspiration was when we renovated our brands, was to improve our sales mix in the categories that we operate in, and we started to see that in the first quarter and I think it's continuing on. So we suspect that was a long-term initiative, Mark. But we suspect that as this year unfolds and over the course of the next 5 to 10 years and I emphasize this, that the brand strategies and renovation that we commenced in 2018, we expect we will realize benefit in sales mix, which gives us a modest top line benefit and a decent bottom line benefit will be realized over that period of time. And we started to in the first quarter.

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

Okay. And then just back to that volume decline, is that -- are you speaking specifically about prepared meats? And how did that play out sort of through the quarter?

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

The supply chain challenges we had like, for example, the two startups that we had were in protein kits and meat pies, which are very -- both categories are growing. Both categories we have identified as attractive to us both in terms of market share and growth opportunities. And in both categories, we were tapped out from a capacity perspective, and we invested in lines to start up. Unfortunately, the downside of that is we experienced what was amounted to be 50 basis points of startup problems in the quarter. They're not big -- some big and it's not long-lasting. By the end of the quarter, it was over. But we experienced that. So the volume -- the slight volume gap would all trace to exactly the same issues.

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

Okay. And so what was the volume performance broadly speaking for prepared meats?

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

Well, as I say, it was modestly tiny bit down but traced to those supply chain challenges in a couple of categories.

Operator

Your next question is from Irene Nattel.

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

First of all, I really want to thank you for that, the bridge from -- for the quarterly margin. That's really, really helpful. But moving on for a minute, it sounds as though there was actually some really good sell-through in the branded product, notwithstanding the price increase in Q4. Is that a reasonable statement?

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

We're happy with the -- we are very happy with the underlying fundamentals of the brand renovation that we completed in 2018. Brand renovations are like that. They're not -- they are a game of inches. They're not home runs in the first instance. And we made several inches forward in the underlying brand strength in the quarter. Save -- but for the supply chain challenges in a couple of categories, we were very happy with the sales mix improvement, which was our ambition. So I expect that, that will pick up speed as the year unfolds.



The only complexity as this year unfolds is the impact on -- the impact from price increases in the third quarter as it relates to passing through raw material costs -- but again, we have to tease that out from the -- what's going on in the underlying categories.

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

Absolutely. That's very helpful. And I was very interested in your comments around the whole plant-based protein category and sustainable meat in general. As you look at your portfolio today, are you satisfied with the product lineup? Do you see sort of any areas that you believe that you need to fill in? Or really, it's just a matter of growing the volume in the areas that you're already engaged in?

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

I think we are sufficiently committed to this -- to plant-based protein growth that we want to be in many different categories. We already have the broadest portfolio in the marketplace. We're involved in virtually every segment of that -- of the meat alternative part of that today. But I think we will -- I know we will be investing in growth in those -- that broad portfolio as it stands, but we're also interested in expanding the portfolio. I would rather not highlight where those opportunities are because it might eliminate a competitive playbook, which I'd rather not get into. So -- but we are interested in the plant-based protein category growth in aggregate. One of the more interesting things, Irene, I would say, which I referred to in my annual meeting remarks this morning is that what we -- what we're finding actually in the categories is that -- is the fundamentals of this category are that consumers want to eat more protein. They're digging into plant-based proteins. But so far, there's not much evidence that it's at the expense in total of meat proteins, category-by-category. I mean bacon demand continues to grow. Hot dogs are a little soft, but sausage is very robust. Most of our deli meat categories are robust. So that's a good news story for us, right? So the early signs are this is additive protein consumption, not shift. And that -- and over time, maybe that will change. But I don't see that at this moment.

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

That's really interesting, Michael. And then just only one more question on the brand renovation. Are you recognizing that the Swift brand was always going to take longer to gain traction? Are you pleased with the progress to date relative to plan?

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

On the Swift brand, I'd say mixed. It would be decidedly mixed. We've had some categories where it's been better and some categories where it's not. That's not terribly concerning. We'd rather be better. But whether we service the quick-fix demand space, whether we service that through Swift or some of our portfolio of regional brands, which we've invested very heavily in, brands like Larsen brand in the East or Hygrade in Québec or Mitchell's and Burns in -- the West and Shopsy's in Ontario, they're very strong regional brands. So we've tried to take a more robust approach to the quick-fix segment that involves Swift, as a prizefighter, where we can consolidate, but also utilizing the regional brands. So I would say mixed on the Swift brand. Super excited about what's going on in the Schneiders brand, super excited about what's emerging in the Maple Leaf brand, mixed in the Swift brand.

Operator

Your next question is from Peter Sklar.

Peter Sklar BMO Capital Markets Equity Research - Analyst

On that chart where you showed the various impact on margins, one of the items was the investment launched in meat pie and protein kits. And I'm just wondering, that 50 basis points, was that felt in COGS? Or just -- was that in SG&A?

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

The COGS.

Peter Sklar BMO Capital Markets Equity Research - Analyst

Okay. On the launch and rollout of the Lightlife Burger, can you give us some indication on how broad your distribution is going to be? Like do you have any idea of how many points of distribution? I don't know how you distribute in the U.S. I mean how broad is the distribution going to be?

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

Our ambition is universal. Important to point out that our distribution of the Lightlife brand and the Field Roast brand as a starting point is higher than any other brands in the marketplace in the United States, emerging in Canada. But our intention is to utilize the Maple Leaf platform in Canada to ensure the same thing exists in this marketplace. We've got more feet on the street in Canada than anybody in our space. In fact, there's many as I think there's many as anybody in the food industry and more in terms of presence in retail. So in Canada, I don't worry about distribution so much in retail. I think we've got the capacity to -- and confidence to deliver that relatively quickly. And in the United States, we've got the platform of the two leading brands. So our goal is very universal. What's that?

Peter Sklar *BMO Capital Markets Equity Research - Analyst*

I know that Beyond burger in their IPO prospectus are bragging that they have 30 points of distribution. I guess a -- each grocery store is a point of distribution or a restaurant is a point of distribution. I mean...

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

30 points of distribution -- I have no really -- 30 -- 30,000?

Peter Sklar *BMO Capital Markets Equity Research - Analyst*

3,000 points of distribution, which would mean restaurants and grocery stores. Yes.

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

Yes. That's a function of how you count it. Yes.

Peter Sklar *BMO Capital Markets Equity Research - Analyst*

But do you anticipate that your product will be as broadly distributed as the Beyond burger product?

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

More.

Peter Sklar *BMO Capital Markets Equity Research - Analyst*

Okay. Another question. Why are the acquisitions you referred to, which were a drag in the quarter -- like why are they a drag in the quarter? And what are the dynamics that get them to go to profitability and accretion?

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

Most of that occurred with the poultry acquisition, actually. And there are two drivers of that. Number one was a very, very significant underutilization of their investment in sustainable meat, or RWA, and specifically organic. And the very dramatic underutilization affects the economics of that initiative dramatically. And when we went into it, we saw that as a bit of an opportunity because we have the marketing capability to correct that relatively quickly. This was I think 75% of the gap is actually in that commercial proposition. One of the most important things that you will see is the launch of Maple Leaf Prime organic, and we are launching Prime organic in the second quarter with various retailers across the country. We are also expanding our RWA offering to take advantage of that utilization that will happen in the second quarter and will impact the operation in the back half of 2019. But it's a pretty good example because of our expertise in brands and market expertise, we can fix those commercial shortcomings relatively quickly. We expect that to be sort of basically in line and accretive in the back half of this year. But it's -- Peter, it's commercially-driven based on the utilization of the sustainable meat, both RWA and organic. The other 25% was in labor efficiency where, frankly, I think not -- this is not meant to be humorous, but I think we're pretty good operators. And the productivity levels and efficiency levels were not up to our standards, and we expect to have that corrected very quickly.

Peter Sklar *BMO Capital Markets Equity Research - Analyst*

Okay. And then just my last question on the impact of ASF and the impact that's had on your -- on pork markets and your margin during the quarter. And Michael, you're optimistic that that's going to improve as we proceed through the year. What is underlying that optimism? Is it the price increases that you anticipate will be passed through in the third quarter?

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

Well, I'll turn you to Slide #5, Peter. Turn to Slide 5. You see that CME hog price in the bottom left-hand side?

Peter Sklar *BMO Capital Markets Equity Research - Analyst*

Yes.

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

You see the hockey stick?

Peter Sklar *BMO Capital Markets Equity Research - Analyst*

Yes.

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

That occurred in late March. That was the driver of the margin compression that we've experienced the last year in hog production. So I think -- I'm just reacting to that chart.

Peter Sklar *BMO Capital Markets Equity Research - Analyst*

I know. But you've purchased externally 60% of your hogs, I believe.

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

We do. But that -- on the assumption that the spread, the processing spread maintains its position, which I think because it's -- what's going on is rooted in the protein shortage, it's very hard to predict. But I think that's a reasonable prediction. I think it's reasonable that, that will maintain the processor spread. But this, the compression of the hog price, which I spoke about two or three quarters ago, is what was driving our margin compression. And this little hockey stick that you see on that chart normalizes that. So when you have an isolated factor that's driving your compression and that goes away, you can say with some confidence that you might not have compression like we've had going forward. Now I would -- the only caveat and health warning to all of that is this -- the ASF situation is quite fluid. So it's a week-to-week situation. But generally speaking, right now, we're on the right side of it.

Operator

Your next question is from Derek Dley.

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

Just shifting back to the plant-based protein. Can you guys -- I mean you mentioned that you're the #1 player, but can you give us just some color in terms of where your market share is at in the U.S.?

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

I think it's in the -- we have lost some share to Beyond Meat because of their growth in burgers. I mean that's the -- the harsh reality is that they've had our competitor. And new entrants had some growth in burgers. But I think we're still -- I think we're sustaining in the 40s. We're in that range, something like that. Over the last 12, it's in the -- somewhere in the 40% to 45% range.

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

Okay. And who would -- can you name some of who your big retail partners are in the U.S.?

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

We have distribution in almost every retailer in America in some way. So we are calling on and have positions with virtually -- with Lightlife and Field Roast on almost every retailer in America. That's how we've got the market shares that we do. So now we're going to the same retail customers and say, we now have a burger, we're just launching the burger, now it will start to roll out into retail distribution over the course of the next 90 days, so to speak. But we're just now in distribution in retail, but we -- the Lightlife brand and the Field Roast brand has -- I think our distribution levels, ACV, would be well over 90% in America.



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

Okay. That's great. The -- Beyond Meat did mention a couple of things that were catalysts for their growth. One was getting into the QSR channel. I mean do -- are you guys having those discussions? Or is there a strategy to get into some QSRs? And then number two, was actually selling their products in the meat case, not necessarily in the plant-based protein section of the retailer. Is that a strategy you guys are pursuing as well?

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

Yes. We do have active discussions with all foodservice customers. I'm not going to name exactly which ones. I don't think that the history would show that putting one's brand on a QSR menu is really a great long-term proposition for the QSR industry. They've typically not done that, although we've seen certain competitors of having certain places been able to leverage that. The QSR muscle players would probably be -- not be our long suit. We have a probably bigger distribution and bigger presence in retail with our brands historically. And certainly, that's where we're going to leverage our strength. But that doesn't mean that we're not calling on particularly because we have significant available, and we'll have in the future, available capacity in a very efficient supply chain, which is attractive to the QSR industry long term. So we're selling to every channel, Derek, and that's what we've always done and that's what we'll continue to do, although I'm not going to name individual customers and never have.

With respect to location in the store, it's an interesting dilemma because the history of this category is with vegans and vegetarians who, to be brutally frank, refuse to shop in the meat case. We've been in dialogue with our customer base for years about finding more productive locations in the store in the meat case or otherwise to expand the consumer's beyond vegetarianism or veganism into what we've described many times -- you heard me quote this -- described it as flexitarians. And those flexitarian indeed want to buy in the meat case, and our burgers are being offered in the meat case. So the -- where it's rolled out -- where it's in distribution right now are on the photographs that I have. We've got beautiful displays. The packaging is stunning and stands out beautifully in the shelf. And we're commanding great shelf presence in the meat case. But we're also supporting the traditional vegan and vegetarian consumers with presence in the produce section as well. So retailers are trying to figure out where the optimal location in the store is, and we intend to be in all of those places.

Operator

Your next question is from Michael Van Aelst.

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

Just to stay on plant-based. Can you give us an idea of the size of the retail versus the foodservice market for plant-based?

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

I can't actually right now. I don't know that off the top of my head. I can tell you what -- retail is typically about 55% of the shared stomach and foodservice is 45%. So that's about -- that's a 60-40 -- in and around 60-40 split between retail and foodservice, I think, ish. I think a little more foodservice in the United States, a little less in Canada, I think. From -- and I'm going from memory on that, Michael. But I don't -- I can't answer that in plant-based.

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

So -- okay. And then can you just talk to us a bit about the process in getting the product in -- getting the burger and the sausages into the existing point of distribution for -- of Lightlife? Like what does it take to get the product onto the shelves? Is it a battle at all? Or are they just opening -- welcoming you with open arms?

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

I've been selling to the retail industry since 1979. I'm trying to remember a single product line or a single year when they welcomed us with open arms. I don't think it's ever happened once, even if they did. So we're quite schooled in the selling process, Michael. We have the brands and the platform and the distribution system. It's important to know we do have that distribution system because we can plug into that. But the process is -- very simply, we have the brands. We leverage our brand. We block the brands in the planograms. We get



into a shelf set with a particular customer. We get through all the gyrations of negotiating the terms of entry with each individual customer. We get a listing. We celebrate the listing. We ship the first product. Then our sales organization ensures that the retail position is optimized, and away we go. Honestly, that's been the same process for 40 years.

Michael Van Aelst TD Securities Equity Research - Research Analyst

So you're saying that you already have it in some -- you already have the burgers in some retail locations now in U.S.?

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

Yes. For sure.

Michael Van Aelst TD Securities Equity Research - Research Analyst

Okay.

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

For sure. Totally. I get a raft of picture, photographs, of new distribution just last night. We suspect it will come in or hopeful, it will be coming in fast and furious over the course of the next 90 to 180 days.

Michael Van Aelst TD Securities Equity Research - Research Analyst

And Canada, the next 90 days as well?

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

Yes. We've got great support across Canada.

Michael Van Aelst TD Securities Equity Research - Research Analyst

Okay. On the -- getting back to like the pork complex and all that, how much forward buying and hedges do you actually have in place? Like what's your lead time? Because I mean we see the hockey stick price, and I think what people are trying to get at when they're asking about the pressures is obviously the rising hog -- the impact of the rising cost of hogs and pork on -- for the 60% that you're buying. How much of your forward buys are -- like how much time do you have before you need to raise prices or before you start feeling pressure on margins?

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

From packaged meat?

Michael Van Aelst TD Securities Equity Research - Research Analyst

Yes.

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

We're in the market right now speaking to customers, and we expect to execute pricing and we'll execute pricing in Q3 or early part of Q3.

Michael Van Aelst TD Securities Equity Research - Research Analyst

Right. But -- so did that mean Q2, you get pressured? Or do you have forward buying in inventories that...

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

There's some inventories and some forward buying that's attached to that. So there might be a little bit of pressure in there. But having said that, it's offset by, we also have some benefits in our hog production. So in total -- I think in total, if you look at it in aggregate, I don't think -- right now, it's a -- this is a -- some very fluid global agricultural event. Right now, Michael, I don't believe in aggregate that we will experience the margin compression that we have in the last year.

Michael Van Aelst TD Securities Equity Research - Research Analyst

The acquisitions that you said were dilutive in the quarter, you're talking into margins obviously. I'd assume they did produce profits, right?

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

In aggregate, yes.

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

Okay. But I'd assume that if you just do the math, they have to -- they couldn't have contributed much if they were 70% -- 70 basis points dilutive to overall margins.

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

Correct.

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

Okay. So when you're talking it's going to be accretive in the second half, you're talking about to the overall margin?

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

Yes.

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

Okay. All right.

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

Which I think is an important point here, Michael. And I -- we've been specifically asked by shareholders to provide quarterly insights if we're going to have lumpiness, be transparent about what's driving that lumpiness. And in this case, as much as I -- who loves lumpiness? Certainly not any of us. But at the end of the day, if you look at it, they're all very focused with good reasons for it. These acquisitions are superb acquisitions. The fact that they compressed our margins by 70 basis points, honestly, it's just -- it's not that relevant to the overall value of the business. The startup of a couple of lines, again, they're growth opportunities. We're happy to experience -- we're not happy but we're happy. If you know what I mean, that's sort of a paradox. But they're good categories. Investing in the -- investing in growth in the plant-based protein, to the question that was posed earlier, we are going to invest and we're going to stay with the party in that business. And while I can't give you a forecast on it, I expect to try and highlight quarter-to-quarter any negative impact that, that might have had so that -- so shareholders will understand what's driving that. But clearly, the other entrants in the plant-based protein, they're not playing it for short-term profits. I know you've read this in detail. They're playing it for top line and terminal value. That's what they're playing it for. And if we're going to -- we're not going to sit here five years from now and say, "Boy, I wish we had been in that game so we could have played for terminal value and growth but oh, my goodness, we had to maintain a margin target." Nobody would want that of us. So we are going to play according to the rules of growth on that business. Period, full stop.

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

So you do -- maintaining the 14% to 16% margin target, but you've got IFRS that benefits you by 100 basis points on that margin. Does that mean you're going to -- you're expecting to -- that you might be able to invest up to 100 basis points? Or are you going to move...

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

No. I don't know. I honestly don't know. I'm just saying is that we're going to stay with the party to invest in the top line growth and protect our business. I -- do I believe that that's going to impair our 2022 target? Not at all. Not in -- not a bit. You're talking 2, 3 years from now. But I'm in the here and the now. When you're fighting for distribution and buzz and share of voice on the airwaves and innovation in the here and the now, we're in. We're all in.

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

But that -- Debbie, are you changing your 14% to 16% target based on the -- are you raising it by the -- or adjusting it for IFRS 16?



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

We haven't -- I mean I'll answer. Debbie can -- I'll tell but we -- that's the topic we talked about before this call, Michael. We just haven't addressed that question. So maybe we should. There's no downside to it. We just haven't addressed it. So you have to cut us a little bit of slack on that one, please. Well, maybe we'll come back to you on that. We just have not looked at whether that's appropriate or inappropriate in the impact in 2015. Logic would suggest that we should. And I get that. The -- so that's a good placeholder in there, Michael, until we've turned our attention to it. But we just have not -- that's been the -- of all the things we've had to think about, that's the last on our list.

Michael Van Aelst TD Securities Equity Research - Research Analyst

Okay. Just last question. By not focusing on the foodservice side with plant-based...

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

I didn't say we weren't focusing on that, Michael. I said that we -- our strength is in retail. We are in the foodservice trade. And we don't count victories on the basis of our ability to get a brand name leading-edge QSR person to put it on the menu. That's not how we count victories.

Michael Van Aelst TD Securities Equity Research - Research Analyst

No. But does that -- do you think that, that provides any brand recognition? I mean everybody seems to know about Beyond Meat now because it's -- everybody's calling it the Beyond burger at the restaurants, so now you see it in the store and people recognize it. So I mean is there any value to doing that with Lightlife?

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

You'll probably see examples of that. But I'm not -- that's -- in my experience, that's not the best way to build a brand. But it's a way to build a brand, but it's not the only way. It's not necessarily the big and the best way. I want to be associated with the attributes of my product, not its existence of somebody else's menu.

Operator

There are no further questions at this time. I will now turn the call back over to Mr. McCain for closing remarks.

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

Okay. Well, thank you very much, and I look forward to the next quarter. We live in interesting times. We've got a lot in the go. I'm super happy with how our company is positioned today in this very volatile and disruptive world. And I think we are positioned extraordinarily well. That doesn't mean that we won't have challenges along the way. Of course, we will. But we're in fighting shape and ready to go. And I think we're well positioned. So I look forward to updating you on the next quarter. I do hope that shareholders appreciated the transparency that we're trying to provide in our outcomes, and we'll continue to aspire to do that. So I look forward to the next quarter, and thank you very much for your attention. Have a good day.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating, and we ask that you please disconnect your lines.

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