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PRESENTATION

Operator

Good morning, ladies and gentlemen. Thank you for standing by. Welcome to Maple Leaf's Third Quarter 2020 Financial Results Conference Call. As a reminder, this conference call is being broadcasted live on the internet and recorded. (Operator Instructions) I would now like to turn the conference call over to James Allison, Investor Relations at Maple Leaf. Please go ahead, Mr. Allison.

James Allison - *Maple Leaf Foods Inc. - IR Officer*

Thank you, Joanna, and good morning, everyone. Speaking on the call this morning will be Michael McCain, Chief Executive Officer; Curtis Frank, Chief Operating Officer; and Geert Verellen, Chief Financial Officer.

Before we begin, I would like to remind you that some statements made on today's call may constitute forward-looking information, and our future results may differ materially from what we discuss. Please refer to our Q3 2020 MD&A and other information on our website for a broader description of operations and risk factors that could affect the company's performance. We have also uploaded our Q3 investor deck to our website which includes support material for the quarter. As always, the Investor Relations team will be available after the call for any follow-up questions or any detailed modeling questions you might have.

With that, I'll now turn the call over to Michael McCain. Michael?

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

Thank you, James, and good morning, everyone. Thank you for joining Maple Leaf's Third Quarter 2020 Earnings Call. I'm joined today by Curtis Frank, our Chief Operating Officer; and Geert Verellen, our Chief Financial Officer.

On the call, we will discuss the performance of our business during the third quarter as well as the outlook for 2020 and beyond, and then we'll open the call to questions.

We continue to do our best at Maple Leaf through the impacts of the COVID-19 pandemic. It's been devastating for many and life-changing for all of us. And through this, Maple Leaf continues to evolve as an organization, but our purpose and our commitment to shared value remains unchanged. This includes supporting a safe, economically robust and more inclusive society moving forward.

And Maple Leaf remains guided by 3 core principles: first and foremost, protecting our people while we operate our critical infrastructure. Because of our early action in responding to this crisis, we were able to maintain business stability and continuity while implementing procedures and protocols to protect our people. This is really put to a test. It was put to the test this summer when Brandon, Manitoba, the location of our main primary pork processing facility had a significant and sustained community outbreak of COVID-19. We responded immediately to further enhance our COVID-19 measures, including additional testing and contact tracing.

We worked alongside local health officials, our union and the community to flatten and hopefully extinguish the curve. We were able to determine through very careful and comprehensive investigations that throughout this community outbreak, our facility remained a safe working environment, with no evidence of any workplace transmission of the virus. It was absolutely critical to keep our employees safe and it was crucial to maintain operations to fulfill our role as an essential service and keep our operations running and running safely. Unfortunately, some team members testing positive and a new protocol from China restricting importation of food products from facilities that had COVID cases. We voluntarily stopped shipping to China. We also bore the impact of high absenteeism rates for an extended period of time, which commercially impacted our ability to produce the value-added products that drive our business model. We are in the process now of being relisted in China and hope to begin shipping into this important channel, sometime in the near future. Curtis will take us through this in more detail in a few minutes.

The second core principle is maintaining the security and continuity of our supply chain, allowing us to continue fulfilling our essential role in providing food for Canadian and international markets. Building on what I just mentioned with respect to our Brandon, Manitoba facility, our team has been tireless in their efforts to operate with minimal disruption in our Meat Protein business. Protocols, workflow and product mix continue to evolve, and we've seen operations improve as we work through this crisis.

As Curtis will discuss, we did see operational challenges in our Plant Protein business. While most were production issues, including ones that affected our packaging, there was also some operational impact due to the complexity of working in a COVID environment. The team is working around the clock continuing to optimize our operational capacity and performance in that business as well.

Third, we must continue to support the vulnerable communities and our stakeholders through this journey. Throughout the crisis, we remain true to our purpose and our commitment to shared value. We've been actively engaged in providing our communities with emergency food relief donations and supporting frontline health care workers. This quarter, this included free mask distribution to the Brandon community, as well as supporting our hog raising partners who were materially impacted by depressed hog prices due to the COVID market disruptions, which have since recovered.

Turning to the business. Curtis and Geert will review our operational and financial performance, but I want to touch on how we are executing against our blueprint. We often speak of our purposeful journey and our commitment to shared value and long-term sustainable value creation. This has led us to significant advances in our blueprint for success, including becoming the first major food company in the world to be carbon neutral just under a year ago. The journey is also one that is built for and committed to growth. We are focused on profitable growth in our Meat Protein business. The growth strategies that have been -- that we've been executing against, including the expansion of our sustainable meat platform, renovating our core brands and geographic expansion are reflected in our performance. In fact, compared to our CPG peers, we are growing at 9% on a trailing 12-month basis, almost double what our peers top line sales growth has delivered.

The success of our strategy is also evident in the progress we made in the third quarter in our Meat Protein Group despite the significant disruption caused by the pandemic. We delivered on our strategy of profitable growth in Meat Protein, with strong sales growth, coupled with gross margin and adjusted EBITDA margin expansion. In fact, we delivered the fourth consecutive quarter of adjusted EBITDA margin above 11%. In Q3, we delivered revenue growth of 6.4% and adjusted EBITDA margins of 12.1%. In our Plant Protein business, there's no pulling punches here, we had a very difficult quarter with performance that is unacceptable. There are several factors which impacted that performance and COVID created further complexity. The bottom line is that we had supply chain challenges, and we are laser-focused on resolving them. We've built a strong foundation for Plant Protein by investing for growth and investing to win. And despite these disappointments in our operational performance in the quarter, we are seeing very strong end demand for our products with robust POS growth that is consistent with our long-term sales target. The market continues to be in a high-growth phase and consumers are refining their taste in Plant Protein. Our brand renovation, portfolio of products and our continued investment in brand development makes us extremely well positioned to remain a strong long-term player in this market.

So I'll now turn over the call to Curtis, and he'll discuss some more details in this regard. Curtis, over to you.

Curtis Eugene Frank - *Maple Leaf Foods Inc. - President & COO*

Thank you, Michael, and good morning, everyone. As Michael noted, the challenging backdrop of the global pandemic continues, but so does the confidence we have in our strategies. Our business is built for growth, and despite what were pretty extraordinary circumstances, we delivered exceptional results in Meat Protein, and we saw sustained strong demand for our Plant Protein products.

From an operational perspective, we continue to be focused on executing our blueprint for growth. Within this particular quarter, meeting consumer demands, accelerating product innovation and driving operational efficiencies, all while keeping our people safe, remains front end center. As a result of the successful execution of our blueprint, we have been able to absorb over $40 million in incremental costs associated with COVID-19 on a year-to-date basis. Of course, simply absorbing these costs is not sustainable over the long term. And to the extent that these additional protocols become an ongoing cost, we will take actions to reflect these new inflationary realities into our product costs.

Turning to segment performance and starting with Meat Protein, our performance was very strong, headlined by the continued delivery of key strategic initiatives, which helped us to mitigate the impacts of COVID-19. For example, our sustainable meats platform grew by 25% in the quarter, led by our Greenfield brand, and our strategy to expand our sustainable meats portfolio into the U.S. market continued to deliver strong growth and exceptional results. Additionally, we saw almost 20% growth, along with market share expansion in our retail branded portfolio, reinforcing the strength of our brands, following the success of our brand renovation initiatives.

During the quarter, we also introduced several new innovative products, including Maple Leaf prepped and ready, and new varieties of Schneiders' kits. Despite the complexities and challenges of the pandemic itself, we saw a third consecutive quarter of improved operating efficiencies in the Meat Protein business. While the pork complex remained above 5 year averages, this tailwind was entirely offset by the costs associated with COVID-19. Beyond the incremental costs that we have incurred to protect our people, COVID-19 did create some additional headwinds for us in the quarter. As Michael mentioned, there was a community outbreak in Brandon, Manitoba, where our main pork processing plant is located. For a brief period, heightened absenteeism impacted both our processing capacity within the plant and our mix of products available.

Additionally, China introduced a new protocol in late July that required any plant reporting a COVID-19 positive case to temporarily suspend its exports. Despite no evidence of a transmission within our plant and our continued commitment to the health and safety of our people, we voluntarily halted shipments to China in early August. We are diligently working to obtain reinstatement and we will update you when we are successful in this pursuit.

Turning to Plant Protein. As Michael mentioned, we were clearly unhappy with our performance within the quarter. Supply chain disruptions were amplified by the impact of COVID-19, and together these 2 factors impaired our ability to meet what was strong consumer demand. Our Plant Protein business proved to be more susceptible to the complexities arriving from the pandemic, impacting operations in the short-term as well as adding costs. We took immediate decisive action to address these issues, and we expect to see operational improvements within the fourth quarter.

As we look forward, our confidence in the long-term success of our business model remains unchanged. Not only has the Plant Protein category showing no sign of slowing down, we are seeing strong, consistent growth in demand for our Lightlife and our Field Roast products. Demand for our brands remained strong in the third quarter as IRI data for the U.S. market reflected 29% POS growth for the Lightlife brand and 33% POS growth for the Field Roast brand over the 12 weeks ending October 4.

Our portfolio of brands continue to hold a solid #2 market share position in the lucrative retail channel, and continue to maintain market-leading distribution. Equally important to our position today is how we are setting ourselves up to win tomorrow. As the Plant Protein category evolves, so do consumers' motivations for purchasing our products. This summer, we took a page from our highly successful brand renovation playbook into Plant Protein, while paying careful attention to the unique characteristics of this category. After completing the most extensive consumer research in the history of the U.S. Plant Protein category, we moved to renovate and relaunch our Lightlife brand, focusing on delivering simple and recognizable ingredients. This renovation taps into a growing number of consumers whose desire for natural, healthy alternatives has been largely underserved to date.

We doubled down on the Lightlife relaunch in August with our Clean Break campaign, highlighting this innovative brand positioning through our largest marketing effort to date, including national TV, social media, digital advertising and in-store support. This fall, we are also taking steps to renovate our Field Roast brand. We are starting with rolling out refreshed packaging design, which will be followed by a new breakthrough advertising campaign, one that is focused on bold and unique flavors. We are excited to share more on this important initiative with you over the months to come.

Our Plant Protein strategy continues to be rooted in our strong market position in a 3-horse race, and we believe there is room for these players. We continue to have unwavering confidence in our business model, and remain very confident in the long-term goals that we have for the Greenleaf business.

I'll now turn it over to Geert, who will review our financial performance in greater detail. Geert, over to you.

Geert Verellen - *Maple Leaf Foods Inc. - CFO*

Thank you, Curtis, and good morning, everyone. I'll begin today by discussing the company's consolidated performance during the third quarter. I will then turn to a more detailed look at both our Meat and Plant Protein groups. I'll conclude by speaking to some key financial metrics, CapEx and our outlook for the remainder of the year.

Sales for the quarter were approximately $1.1 billion, an increase of 6.2% from the prior year. This increase was driven primarily by strong performance from our Meat Protein operating segment. Adjusted EBITDA for the third quarter was approximately $83 million, a 55% increase from the prior year with strong growth in our Meat Protein Group, partially offset by continued strategic investments in Plant Protein. Total company adjusted EBITDA margin was 7.8% for the quarter, an increase of 240 basis points from the same period last year. Results included the impact of incremental operating costs due to COVID-19 as well as those associated with the disruption resulting from the community outbreak in Brandon, Manitoba that Michael and Curtis already spoke about.

Direct costs associated with COVID-19 totaled $19 million and are largely captured in cost of goods sold. This was slightly higher than our expectations in July due to incremental cost to protect and support our people during the community outbreak in Brandon as well as support for our third-party hog suppliers during a period of severely depressed hog markets, as Michael mentioned. Other costs, including PPE, sanitation, were largely in line. Just like in Q2, we were able to partially mitigate the $19 million in direct costs through SG&A savings in discretionary spend categories, including lower spend on travel and training as well as reduced marketing spend as we continue to evolve our advertising and promo to reflect the current environment. As a result, the net impact of COVID was $12 million in the quarter, which had a dilutive impact to our adjusted EBITDA margin.

Adjusted operating earnings for the quarter were $37 million compared to $10 million in the prior year, primarily due to significant strength in Meat Protein's commercial performance, with an offset from increased strategic investments in Plant Protein and the COVID-19 cost I just discussed. Net earnings for the quarter were $66 million or $0.54 per basic share compared to net earnings of $13 million last year or $0.11 per basic share. Now after removing the impact of non-cash fair value changes in biological assets and derivative contracts for both periods, adjusted earnings per share were $0.17 for the third quarter of this year compared to $0.03 in the prior year.

I'll now turn to a discussion of Maple Leaf's 2 operating segments. Let's start with meat. Meat Protein sales for the third quarter were roughly $1 billion or an increase of 6.4% from the prior year. This improvement was driven by strong demand in the retail channel, growth in branded and sustainable meats as well as higher value-added export sales to the U.S. and Asian markets.

While foodservice volumes remained down versus last year, we did see a sequential improvement compared to the trend in the second quarter. Meat Protein adjusted EBITDA for the third quarter was $123 million, a significant increase of 44% compared to prior year. This growth was mainly due to higher retail volumes, favorable product and channel mix and strong operational performance. These positive drivers more than offset the incremental COVID-19 costs incurred in the quarter. Adjusted EBITDA margin for the meat segment was 12.1%, representing a 310 basis point improvement over the prior year. We continue to benefit from the investments we have made over the last couple of years such as brand repositioning, a focus on sustainable meat, increasing our value-added exports and cost optimization projects. All these elements have supported robust top line growth and consistent adjusted EBITDA expansion. Indeed, this is the fourth quarter in a row of consistent year-over-year margin expansion for meat. 12-month trailing adjusted EBITDA margin now stands at 12%. We are well on our way to achieving our long-term margin target range of 14% to 16% in Meat Protein despite the incremental cost to keep our people safe and our supply chain running.

Turning now to Plant Protein Group, where we continue to invest for growth in a high potential market. Plant Protein sales for the third quarter were $51.4 million, an increase of 9.3% from the prior year or 8.2% in constant currency terms. Sales were impacted by supply chain disruptions, amplified by the complexities related to COVID-19. This resulted in temporarily reducing our ability to meet the growing demand for our products. As Curtis and Michael have mentioned, we have remediated this and expect improvements in the fourth quarter.

While we remain primarily focused on sales growth and brand building, we continue to work on structural improvements in Plant Protein gross margin. Gross margin for the quarter was 6.6%, but it was also severely impacted by the operational challenges I just noted, continued supply chain inefficiencies as well as the costs related to COVID-19. Over the next few quarters, we expect gross margin to continue to be impacted by sales building initiatives. And at the same time, we will continue to improve structural margins, including improvements in transportation and distribution efficiency. SG&A expenses and Plant Protein were $46.5 million, or 90.5% of sales, in line with our plan. We remain on track to reaching our full year investment of about $150 million in advertising, promotion and marketing, organizational capacity and our innovation pipeline.

Let's now turn to our balance sheet. Maple Leaf's balance sheet remained strong with $535 million in net debt and $1.3 billion in undrawn committed credit. While the company has a financial flexibility necessary to complete near-term capital projects, we remain focused on deploying this capital in an efficient and balanced manner with the goal of maximizing shareholder value. During the third quarter, we invested $104 million in CapEx, including construction capital of $72 million. These expenditures were primarily related to the construction of our new poultry facility in London, Ontario. And year-to-date CapEx is just over $300 million, now including about $192 million in construction capital. This is behind the pace and timing that we anticipated, largely due to an overall slowdown in work and spend as a result of the pandemic, we already talked about that in the second quarter as well.

Turning now to our outlook. Please note that our expectations are based on certain assumptions regarding the future of our markets. And as expected, the onset of COVID-19 has introduced a degree of uncertainty here. This includes potential volatility in the pork and poultry commodity and currency markets that remain elevated in the phase of COVID-19. We have outlined the known and unknown factors including the above, for the balance of 2020 in our slide deck that is available on our website. While we deal with the challenges created by the pandemic, we maintain our strategic focus on profitable growth in the Meat Protein Group and investing to grow in our Plant Protein Group. Our underlying business continues to advance, and we expect to continue to see heightened but somewhat stabilized demand from the retail channel with lower sales from foodservice. We expect that incremental COVID related expenses, such as personal protection equipment and increased sanitation will be approximately $15 million in the fourth quarter, which will bring the amount to approximately $57 million for the full year. And just like in the previous quarters, we will continue to look for ways to reduce expenditures in other areas to mitigate some of these incremental expenses.

Factoring in Maple Leaf's financial performance for the year-to-date as well as our estimate for the incremental COVID-19 costs, our expectations for the full year 2020 include: first and foremost, mid- to high single-digit sales in Meat Protein, led by sustainable meats and higher sales to the U.S. and Asian markets. We expect this to be coupled with gross margin expansion and cost efficiencies, resulting in significant Meat Protein adjusted EBITDA margin expansion for 2020 and solidly progressing towards our goal of 14% to 16% by 2022.

Second, in the Plant Protein Group, we remain committed to a business model that drives 30% revenue growth and gradually improving gross margin towards 30% long term. Due to supply chain and COVID-19 disruptions largely experienced in Q3, we expect revenue growth in 2020 will be slightly below our strategic 30% target, while gross margin is expected to be below 2019 levels, driven by similar factors as well as other inherent inefficiencies in building a high-growth business.

Thirdly, we continue to anticipate SG&A expenses in the Plant Protein Group of roughly $150 million or USD 110 million, assuming no further material change to foreign exchange rates. The rationale for these investments remains unchanged, consisting of advertising, promotion and marketing and items related to building scale within the business.

And finally, capital expenditures. Incorporating our spend year-to-date as well as other factors, including the continued impact of COVID-19 on the pace and timing of construction and facility improvements, we now estimate total CapEx for the year between $450 million and $500 million. The bulk of this continues to consist of construction capital, primarily related to the construction of the London poultry facility.

I would also like to highlight a couple of updates to our 2 large construction projects, our London poultry facility and our proposed Plant Protein facility in Shelbyville. Starting with our London facility. We recently completed a full assessment of the impact of COVID-19 and other events have had of the timing and cost of construction. Through careful planning, we continue to expect completion and start-up to commence by mid-[2022] (corrected by company after the call). However, due to the robust construction economy in Ontario and complexities associated with the pandemic, certain material costs have exceeded our initial expectations. And while we have been successful at mitigating some of this through engineering and design work, we now expect total construction cost to be approximately $720 million, up from $660 million as we announced back in late 2018. With regards to building capacity to support our high-growth Plant Protein business, we have been purposeful in executing our multi-tiered strategy, focused on capital efficiency. We continue to find ways to leverage the capacity of our existing Plant Protein manufacturing assets while successfully utilizing footprint in the rest of our network.

We now expect these efforts to meet the capacity needs of the business beyond 2022, providing greater flexibility to extend the development horizon of the Shelbyville facility.

With that, I'll conclude with saying how impressed I am with the continued strength of our business despite the challenging operating environment. We believe, we are well-positioned for the future and remain committed to and confident in our longer-term targets. Michael, back to you.

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

Thank you, Curtis, and Geert, for that comprehensive review. Our strength at Maple Leaf in consumer packaged goods, our brand development, product positioning and manufacturing have been built over decades in this industry. And we've been measured and extremely strategic in our approach to how we build Maple Leaf for the long-term growth.

Our experience in the Meat Protein industry has taught us that building brands and operational capacity and efficiencies can take time, and can have some twists and turns along the way if you're focused on the long term. I'm confident that our quick recovery from the operational issues experienced in Q3 in our Plant Protein business, as well as the underlying consumer demand for our products will result in continued growth meeting our long-term targets.

As we exit 2020 and enter 2021, COVID-19 remains ever present. We have to assume that we'll be operating in this type of environment for many months to come. I'm confident that we have the organizational capabilities and the management expertise to navigate through this. While staying true to our values in our purposeful journey.

I'd like to conclude by expressing my profound gratitude to our frontline team members who come to work each and every day to make the food on which we all depend.

I'm humbled and I'm grateful for your commitment and inspired by the dedication of all our people, persevere and succeed in this difficult environment.

So with that, operator, we'll turn it over to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from Mark Petrie.

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

I just want to ask you about the current level of productivity at your plants. You called out the issues regarding absenteeism at Brandon. And then also on the plant-based side. Could you just comment about the relative sort of run rate capacity, both in Brandon, in plant-based as it stands today?

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

Yes. It's a great question, Mark, and good morning. In Brandon, when they -- during the period in which there was a community outbreak, notwithstanding the fact that we had no evidence of any workplace transmission, there were higher levels of absenteeism, which affected our ability to produce at the normal rates, and particularly our ability to produce the value-added product mix that is fundamental to our business model. But that occurred during the period of the community outbreak and has since recovered. The balance of our Meat Protein network is operating under the very strict and robust protocols that we put in place, but at full efficiency and productivity levels.

In the case of Plant Protein, where, as you know, in the United States, the pandemic has a much more severe impact than it does here and has had implications to both our ability to launch innovation and our ability to meet current production needs due to those impacts. That has -- we have seen some improvement more recently, but there is a bit of -- there is some more sustaining implications there than here. But we've taken, as Curtis had mentioned, we've taken steps to mitigate that, and we think we'll see a substantial improvement into the fourth quarter.

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

Okay. And I know you don't give sort of specific guidance with regards to Q4 or sort of the commentary about the performance so far. But just kind of trying to think through how these production issues in plant-based are going to affect the POS trends in Q4? Obviously, you were able to keep POS trends very strong in Q3, despite the production issues, but how should we think about the impact on Q4?

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

I think just because of the lag time in POS that you will see some lagging softness in POS and some strengthening impact in factory shipments. That's logical to assume, right? And that's probably the best information that I can give you. As both Geert and Curtis articulated, we do expect to see a significant recovery in the fourth quarter. There would definitely be some bleed over of the supply chain implications into the fourth quarter, but we're starting to see some significant recovery of that because of the mitigating actions that we've taken. I think, though, the most of -- and I would really, really encourage Mark and all the others on this call, to put this quarter into perspective. The first perspective is that, yes, we lost $8 million or $10 million in top line growth in the quarter out of $1 billion of sales portfolio, it's about $8 million or $10 million. So it's really not that significant. We sometimes get obsessed by the growth rate. But our more important metric is what is the underlying consumer demand telling us. And as Curtis highlighted, it's been very robust. In fact, what's evolved in the market, Mark, is basically a 3-horse race. It was a 2-horse race, and now it's sort of a 3-horse race.

And interestingly, as the third horse came into the retail market, the vast majority of their gains came from the #1 player, and our performance was remarkably stable and consistent without much impact to our base business and our performance. We view that and the continuity of our demand strength to be really, really good signals. In addition, as Curtis highlighted, we just, in the third quarter, launched our new brand renovations in these categories, which I think takes us into the next phase of brand development in the plant-based meat alternatives segment. And I am really excited about the products, the innovation pipeline and particularly the brand strategies that we've locked into. So I know that we sometimes obsess about a quarterly percentage, but I will tell you quite confidently that I'm not obsessed by that at all. We had some supply chain issues. They were driven by a number of factors, not the least of which is COVID. And we press on. And the underlying actions that we're taking to strengthen our long-term proposition behind the brands is more solid today than it's ever been.

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

Okay. I appreciate that comment, Michael. And just the last one for me. Curtis, you highlighted the materiality of the pandemic-related costs that you're -- the business has absorbed. Michael, you commented about sort of how the pandemic has kind of brought about a new normal, I guess, in some respects, with regards to operating costs or constraints. And then the potential for this all to be reflected in your price structure over the course of time. Just sort of curious about how you're thinking about the timing in that evaluation and how you think that plays out?

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

Curtis, over to you?

Curtis Eugene Frank - *Maple Leaf Foods Inc. - President & COO*

Yes, thank you. I think I would start by saying the review of our inflationary and including commodities and other general inflationary business is an ongoing practice that we obviously have in our pricing discipline. When it comes to COVID-19 specifically, which I think was your question, there's essentially 2 types of costs, or at least certainly the way we think about it. Those that are onetime in nature and those that are structural, and that we believe we'll have to enter over the long term. From a onetime perspective, it's been clear you see in our results and our disclosures that we've absorbed those costs on a year-to-date basis. When it comes to the structural components, we will move to, where required and only those that are structural, we will move to embedding in our cost structure, as you mentioned. And we would expect those to be reflected as we move through the fourth quarter here, begin to be reflected in the market as we move through the fourth quarter.

Operator

The next question comes from Irene Nattel.

Irene Ora Nattel - *RBC Capital Markets, Research Division - MD of Global Equity Research & Senior Equity Analyst*

A couple of follow-up questions, please. If we could start with the -- sort of the discussion around the COVID cost and I completely understand the onetime versus the structural. But can you give us an idea of what you might estimate, let's call it, the structural cost to be? And when you say that they'll be reflected in the market as you move through Q4? Are what you say -- are you saying that you will try and implement price increases in Q4 to cover those costs?

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

We -- as part of our normal rhythm, execute in the fall of every year price adjustments to reflect inflationary changes. And we estimated our structural costs attached to a new operating environment that we believe the entire industry will be adopting. And included that in our inflationary pricing adjustments that we do each and every year at this time of the year. So I hope that's helpful, Irene.

Irene Ora Nattel - *RBC Capital Markets, Research Division - MD of Global Equity Research & Senior Equity Analyst*

Yes. Could you give us an idea of the order of magnitude?

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

No. No, we can't. It's hard to tease out those elements versus our normal inflationary costs.

Irene Ora Nattel - *RBC Capital Markets, Research Division - MD of Global Equity Research & Senior Equity Analyst*

Okay. But can you give us an idea of what order of magnitude you might be sort of pointing toward in terms of pricing to...

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

No. No.

Irene Ora Nattel - *RBC Capital Markets, Research Division - MD of Global Equity Research & Senior Equity Analyst*

Okay. Okay. Got it. If we think about sort of the plant-based segment, as we look towards 2021, you're entirely confident that you will have enough capacity to meet what will hopefully be the 30-ish percent level of top line growth?

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

Yes. I do believe that we will be able to meet that strategic target in 2021 from a capacity perspective. We are -- we work constantly, constantly to find more efficiency and more effectiveness and therefore, more capacity out of our existing network, both plant and meat. And as was highlighted, we are now producing significant portions of our plant-based portfolio in our meat facilities. But I would tell you, our hope would be is that we could overachieve those numbers. And the more we overachieve them, maybe there'll be some stresses. But yes, the base strategic target, we're confident you can meet that.

Irene Ora Nattel - *RBC Capital Markets, Research Division - MD of Global Equity Research & Senior Equity Analyst*

That's great. And I'm also trying to understand the language around Shelbyville. So if I'm reading this correctly, you now believe that you have enough capacity because of the innovations or because of the progress you've made, to not require the capacity of Shelbyville until some point beyond 2022. So when we're thinking ahead, should we be factoring the Shelbyville CapEx into our -- like if we're building models out to '22, let's say, do we -- we don't need to think about Shelbyville, like at what point do we need to start thinking about Shelbyville in terms of the capital requirements, I guess, is what I'm really asking?

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

Geert, do you want to take that one?

Geert Verellen - *Maple Leaf Foods Inc. - CFO*

Sure. So Irene, what we've tried to articulate is that, just as Michael said, with the capacity that we find in our existing plant network and existing meat, we can get safely through the next year, definitely, and 2022. So that's the reason why we do not today want to start forking out a lot of capital and building something that we can deliver in terms of capacity in the rest of our network. Now all of that depends on how the market evolves. And so we continue to fine-tune our plans in that sense, which is exactly what we've been doing all through this year, and we're very happy that we found other ways to serve that capacity. Now if you want to think longer term, I think the rule of thumb that we have always used is that you should model for roughly $1 of capital for every $2 of revenue. So as you start to model into that sales growth number, I would continue to use that. Today, we have not made any further, I would say, very, very detailed plans on that, but that's the rule of thumb I would use going forward.

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

Irene, the only thing I would add for you and for others on the call is because we have a multi-tiered supply chain strategy in our plant-based business, what Geert just articulated is very, very good news for the shareowners here because it says that we are going to manage capital risk and exposure very carefully by sweating the assets that we currently have and maximizing the performance of our existing assets before we commit to new capital. And the more we can do that, that pushes out that new, more expensive new capital, the better off it is while still meeting the demand. So our view is that this is a very good news story.

Operator

The next question comes from Michael Van Aelst.

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

First of all, a quick follow-up on the price increase here. So if you institute the price increase in Q4, when does it actually take effect usually?

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

Curtis?

Curtis Eugene Frank - *Maple Leaf Foods Inc. - President & COO*

Michael, we've instituted for execution early in the fourth quarter, and we'll start -- we'll see the benefits of that pricing take effect throughout the fourth quarter, but safe to say, early in the fourth quarter and transitioning as the quarter progresses.

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

Okay. So we should get some of it earlier in Q4 and get most of it by the end of the Q4?

Curtis Eugene Frank - *Maple Leaf Foods Inc. - President & COO*

That's exactly right. Yes.

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

Keep in mind, Michael, please, that this is -- these are normal pricing rhythms to offset the inflation, the natural inflation that exists in our business.

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

Right. But that natural inflation includes some of the COVID costs that you think will stick around?

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

Yes.

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

All right. As just going back to the plant-based operational challenges, can you -- you talk about being laser-focused on resolving them. Can you walk us through the changes that are being made so far and what else still has to be done?

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

Curtis, do you want to take that one?

Curtis Eugene Frank - *Maple Leaf Foods Inc. - President & COO*

Yes, sure. Well, there are a couple of factors, obviously, that contributed to supply chain challenges that we saw in the business. One was service level-related predominantly in our Turners Falls facility. And that was directly linked to a packaging disruption that we have, that we feel is now resolved. Obviously, it's going to take some time, as we discussed earlier, to fill the pipeline heading into the quarter here. But for the most part, we feel that, that's resolved. The other complexities that we've experienced have been related predominantly to labor efficiency, which again is obviously related to the COVID-19 situation. And the leading indicators that we're seeing in the business suggest that the corrective actions that we've taken swiftly have contributed to positive results, and we're already seeing improvements. That will, to Michael's point, somewhat bleed into the fourth quarter, but we also expect will be fully resolved in the fourth quarter.

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

Okay. Great. And considering that you are sweating the assets. And it seems to be creating some stress in getting product out at a time when you do have these issues at 1 plant, you don't have much room to adapt. Is there any thought of using more third-party co-packers so that you have a backup in these situations?

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

Having -- using co-packers as a backup strategy on a short-term situation like this, Michael, it's just nearly impossible to execute in that time horizon. And it's very difficult, if not prohibitively expensive to keep it on reserve when you don't need it.

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

No, my question was more, could you have -- use it for 20% of your production, but with some -- an accordion kind of where you can wrap it up to 25% or 30%, if you need to, in certain periods.

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

As Geert articulated, we do have a multi-tiered strategy. And to the extent that we do need additional demand that can't be -- or supply that can't be covered by our network, we do use and seek out co-packers today. So the answer to that is where we can, the answer is yes. But it's -- when you've got a short-term disruption like this of the nature of COVID, it's virtually impossible to just react quickly and get a co-pack supply in place, particularly in some products like tempeh, for example, which is significantly impacted in the quarter. Look nobody produces tempeh like we do. There are no co-packers available. So the short -- so I think in summary, the answer is yes, where we can, but it's not something you can pivot on a dime.

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

Okay. And I guess a similar question for the advertising component. I don't know what percentage of advertising was of your kind of $150 million annual SG&A. But I mean, is it did you give any thought or were you unable to cutting back temporarily when it was clearly that you wouldn't be able to supply all and restock the shelves just quickly?

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

We could have. I think, given the fact that we were launching brands in the quarter, Michael, I think it would have been highly inappropriate in the long term, it might have helped a quarterly number, but it would have been completely inappropriate in terms of brand development in the quarter. So could have, but I think it would have been a bad decision to do so.

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

Okay. And then on the exports to China, can you explain what the process is in terms of getting it back and what stage you are?

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

First of all, the process is very opaque. The decisions are not made in a process that is -- that anybody, anybody in the world is fully aware of. But we've made all of our appropriate submissions. The facility is operating under the protocols that we have in place and successfully, and we continue to work with all of the regulatory and government officials to try and get that done as quickly as possible. To put a time frame on that it's just not something that we can -- we're hopeful it will be soon, but it's just not something that we either control or can transparently or have enough transparency to be able to describe to you exactly what that looks like.

Operator

The next question comes from George Doumet.

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

Just a follow-up on the plant side of things. Outside of packaging and COVID-related inefficiencies, were there any other issues there on the production side? And can you maybe share with us the growth number exiting the quarter?

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

The which number, George?

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

The growth, like how much was the growth? Like -- you guys gave like an average for the quarter, but how much was it like exiting the quarter? Just kind of, if you can share that to see the level of improvement.

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

Curtis, do you want to take that one?

Curtis Eugene Frank - *Maple Leaf Foods Inc. - President & COO*

Yes, George. So in terms of -- I think we've covered -- your first part of your question was have we covered the full implications of what we experienced in the supply chain. I think we -- I think to a large extent, I think we've covered those. The -- exiting the quarter, I don't have the numbers in front of me, sorry. And Geert if you have them, happy to have you jump in. So I'm not going to answer your question correctly, but only because I don't have period numbers right in front of me. But I would say it was a very similar situation throughout the quarter, and we typically don't disclose the phasing of growth by month. I think what's most important is, at least from my perspective, maybe a couple of points. Number one, we committed that our perspective on growth in this category would be 30% over the long term. We shared that we knew it would not be linear, and we would have quarters that were under and over that expectation. Q2 was certainly over, and Q3 was challenged, and we accept the fact that we need to be better. What hasn't changed is our confidence and long-term ability to be at the 30% growth level. And I think what's most important in Q3 is to look to the POS data, more importantly than the phasing by week or month, which clearly indicates the demand for the brand remains strong. So I think that is what we're most pleased with, and we know that throughout Q4, we will resolve to a significant -- to a very significant extent the supply chain issues. So that's where we're focused.

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

Okay. And in the absence of Shelbyville being built, how should we think of the margin profile for plants? Can we get to gross margins of 2019 levels next year?

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

Geert, do you want to take that one?

Geert Verellen - *Maple Leaf Foods Inc. - CFO*

Yes. George, I would really like to stay away from giving any guidance for next year at this point. That's, I think, far too early to say. It is -- what is important is that we remain committed to getting both the sales growth profile and the margin profile up and gradually get in line with what we believe the long-term one is. And we've been very vocal in our belief, in repeating our belief that we can get to that 30% sales growth, we can get to that 30%-ish margin. But it is going to take time. And as this year has showed, it's going to be with ups and downs from quarter-to-quarter. So this is really 1 where we need to take the longer-term lens and not go from quarter-to-quarter because with a business, the scale that we have right now and with the high-pressure that we put on growth, there is going to be inherent pressure from quarter-to-quarter on the gross margin. And we're going to have to grow our way into this. I think what you should take away from this call is the confidence that we have in whatever we have put in place to remediate the actions or the events of Q3. And the team's diligence in finding ways to either to improve the ingredient deck or improve the productivity of the plants and the distribution capabilities that we have. And we've got a lot of confidence in that. So you'll see a sequential improvement, but it's going to take a while before we get to the 30%.

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

Okay. And just one last one, if I may, on the meat side of the equation. Can you maybe quantify the dollar we spent for support of the third-party hog suppliers? And Michael, do you see yourself adopting a cutout value system like some of your competitors?

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

No, we -- I can -- first of all, the first part of your question, George. Thank you for that question. It's an important one. We are not breaking out the cost of different components of our COVID costs, that would include the hog producer payment. As far as the cutout-based contract, as we've told all of our producer partners today, and they're aware -- they're very well aware of that, is that because we indexed our contracts to the CME in

Chicago, the CME contract as an index price, the CME is estimated by the industry to include roughly 35% cutout component. So we do have in our -- and have had for years in our existing contract position, a significant cutout component has been in our contracts to date, and we expect that will continue.

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

Okay. So no change to that formula there?

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

No.

Operator

The next question comes from Derek Dley.

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

Just a couple of quick ones just on the plant based business. Can you -- just putting that 30% long-term gross margin target, I guess, in context and understanding that the business is rapidly evolved. But can you just remind us what the gross margin was in that business in Lightlife when you acquired it?

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

Yes, it was a great question, Derek. It was in the mid-30s.

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

Okay, mid-30s. And can you comment on the EBITDA margin as well.

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

It was -- it bounced around a bit, but it was low 20s, high teens.

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

Okay. Great. That's helpful. And then I'm just trying to sort of calculate that the POS growth that you guys referenced, that 31% that you saw in Q3. And then obviously, the weaker growth, the 9% that you saw in the shipments. Should -- like should we not expect a catch-up between those 2 or at least the convergence between those 2 in Q4 as you backfill some of that inventory?

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

Well, as I said, I think the logic would suggest that you'll see some weakening in the POS data, simply because the supply chain inability to produce the demand signal for a short -- for a very short window of time. I think -- but then simultaneously, you'll see some strengthening in the factory shipments. So -- but yes, those 2 numbers, what you'll see them go in opposite direction probably just by virtue of the fact that, that's just -- it's just a timing issue. But yes, should they converge? Yes, so I think they should converge, probably near the end of the quarter or something in that nature. But yes, those are natural lag effects.

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

Yes. Okay. Makes sense. And then just switching to the meat business. Can you talk about sort of -- I mean, you guys have had really, really strong top line growth here over the last few quarters. And I get -- you mentioned sustainable meat is up 25%. But just, I guess, more broadly, can you talk about -- is it more volume growth? Is it pricing growth? Or should I say maybe lack of promotions given what we've seen in COVID, what's really driving that growth?

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

That's the vast majority of it's volume growth.

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

Volume growth. Okay.

Operator

Ladies and gentlemen, that is all the time we have today for questions. I will now turn the call back over to Michael McCain for closing remarks.

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

Well, thank you very much. I appreciate everybody's time today. I hope all of you stay focused on the same things that we are focused on, the big rocks in the Maple Leaf story. We've built a business for growth. We're delivering higher levels of growth than anybody in the CPG industry that I'm aware of as peers in our meat business, and we obviously have invested heavily in the high-growth plant-based business. Long term, we're very excited about the returns that will generate, but we're equally excited about our very purposeful journey to do so in a sustainable fashion.

These are very challenging times. We've tried to focus on our -- both the long-term interest of our strategy, but also the near-term challenges that all the stakeholders are experiencing and to be very balanced in our commitment to shared value creation through these stressful times. So I'm very proud of our people, as we've persevered through this. And incredibly, incredibly proud of how resilient and high-performing our business has been through such challenging times.

So I look forward to the next quarter, we'll have an opportunity to update all of you. But as we come into 2021, let's all hope and pray that we have more stable conditions than what we've experienced this year in spite of that resilience. So thank you for your time and look forward to chatting next quarter.

Operator

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