Maple Leaf Foods Inc.

Second Quarter 2022 Financial Results Conference Call

Event Date/Time: August 4, 2022 — 8:00 a.m. E.T.

Length: 75 minutes

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to Maple Leaf's Second Quarter 2022 Financial Results Conference Call.

As a reminder, this conference call is being broadcast live on the Internet and recorded. Please note that there will be a question-and-answer session following the formal remarks.

I would now like to turn the conference call over to Mike Rawle, Investor Relations at Maple Leaf Foods.

Please go ahead, Mr. Rawle.

Michael Rawle — Vice President, Investor Relations and Treasury, Maple Leaf Foods Inc.

Thank you, Michelle, 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 second quarter 2022 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 Q2 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 that you might have.

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

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

Thank you, Mike, and good morning, everyone, and welcome to Maple Leaf Foods' second quarter 2022 earnings call.

This past quarter is one of stark contrast: incredibly chaotic operating environment, yet a very sound business that remains, in our view, structurally on target. When we spoke to you last in May, we told you that we expected a significant recovery in our second quarter meat segment margins. I do recall highlighting the caveat that our capacity to predict in this environment is dubious at best, but obviously, this significant recovery did not come to pass. My goal this morning is to clearly and succinctly explain to you why and what we're doing about it.

On a macro level, and I'm seeing this in almost every single sector of the economy, the post-pandemic economy is materially more challenging operationally than even during the pandemic itself. Of course, this is exacerbated by the conflict in Europe in our industry, but the core drivers of extreme labour instability, hyperinflation, and unstable agricultural markets has created an historically unprecedented situation that I've not seen in my 40-plus year career in this industry.

It would be incorrect, incorrect, to ascribe this to normal cycles of our or any other industry. While we've not seen stabilization yet, I personally do not see this environment being with us for long either, so let me be perfectly clear about the factors that impacted our meat protein results in the second quarter. We faced three core obstacles: people, pork, and pricing. I repeat that: people, pork, and pricing.

On people, we traded an absenteeism problem in Q1 for a vacancy problem in Q2. With a severe labour shortage in Canada and the country at essentially full employment, we struggled to fill over 1,500 vacancies. That's over 10 percent of our workforce. The labour shortages, and even worse, the continuous churn in our population, limited our ability to consistently meet demand for our highly valued products; it increased our reliance on overtime and temporary labour; it added cost to our onboarding and turnover; and it weakened our productivity.

On pork, we saw intense disruption in the global agricultural markets due to the ongoing impacts of COVID and the tragic conflict in the Ukraine. There were a confluence of forces at play, including the dramatic rise in feed costs, notably higher in Manitoba than other North American regions; material contractions in the Chinese pork imports that placed pressure on other markets; high meat values, which disproportionately affect the Japanese market, a mainstay for the Canadian industry; a falling Japanese Yen; exploding ocean freight costs; and weak pork packer margins. The fact that any of these occurred is not significant to us. The fact that they all played out at the same time and they all persisted for a considerable time is significant.

On pricing, I want to be crystal clear here. We have the ability to properly price for inflation in our business. We've demonstrated that. We have number one brands and leading-edge revenue management skills, but what we do not have is the ability to increase prices speculatively for things that might happen or speculative cushion, so to speak, certainly in the short term. Our struggle has simply been to keep up with the magnitude of price increases required. We think we've nailed it at one moment only to realize the next wave. The pricing actions that we took in the second quarter successfully covered the inflation we anticipated, but we now know it was inadequate to cover the inflation levels that actually materialized new during the quarter, mostly in freight surcharges and costs, some in packaging ingredients, and various overhead components.

So what actions are we taking? For sure, we’re not standing still hoping, just simply hoping, for a sunnier day, even though we feel this environment is short-term and transitional. For example, we have taken steps to materially increase our hiring capacity. In a challenged people market such as this, the old suite of hiring tactics simply isn't adequate, and we are accelerating our activity. It is getting better, but we have much more work to do.

Number two, while we cannot influence global markets that affect the pork business, we are taking steps to optimize our position inside these markets, including pricing action where it's possible; freight cost optimization; and moving volume to more lucrative opportunities where they can be found.

Number three, we are taking another round of pricing in our prepared meats business in Q3, another round.

Although we have no crystal ball and things are wildly unpredictable, the situation we are seeing is showing early signs of abatement. The global agricultural markets are showing some signs of stabilizing. In June, the economy shed jobs, and we expect this recessionary trend to increase our hiring capacity. To be very clear, a good recession is our friend at Maple Leaf Foods, and our volumes have held up incredibly well under the circumstances. I know we will catch up to a new stable level of inflation. Even though the pricing action that we took has not been enough, it has been very effectively executed and absorbed, and we believe the next round will be also.

In the face of this volatility, as you can see, our meat protein performance fell short this quarter, yet I don't want to lose sight of how successful the underlying strategies have been in our meat protein business over multiple years, including our focus on sustainable meats, our brand development and branded product market shares, and expansion into the U.S. markets.

These strategies are and will continue to drive us towards our meat protein target of 14 percent to 16 percent Adjusted EBITDA margin structurally. It's really important to recognize that from its inception, this target was based on normal market conditions. Since inception, this target was based on normal market conditions, including a pork complex in line with five-year averages. We have not and we will not waver from that target, and we believe that as soon as conditions normalize, we will be on track to that target. While I don't feel it would be responsible to predict when things will normalize and stabilize in these conditions, we do believe that we are seeing early signs of improvement.

I also feel it's important today more than ever to focus on the long game here. Our Maple Leaf blueprint continues to create the structural improvement in the business that we aspire to. It continues to be relevant, and we're doing what we can to accelerate and elevate every aspect of this blueprint. Our business grew by 5.6 percent in the meat segment in the first half of 2022, and we produced over $200 million of Adjusted EBITDA. I would encourage you to look at this in these conditions in historical context. Number three, we are entering a new phase of harvesting the returns of several years of aggressive investment. We're extremely proud of the resilience of our business despite an environment under deep stress.

Turning to our plant protein business, we are in full motion as we transition the business model back to one of profitable growth. I'd like to refresh you on the objective of this action.

We used to believe in a transformational category outcome, and we used to believe in a transformational level of sustained growth towards that outcome. We built a business model and an investment plan around that premise. This transformational outcome did not materialize. We now understand why it did not materialize, and we no longer believe that it will materialize, so we are altering our business model and dialing back our investment to reflect the goal of profitable growth and one that is actually in line with our views when we first acquired Lightlife in 2017.

We are transitioning the business into profitable growth, which is essentially a straightforward exercise of sizing the shoe to fit a new foot, plus an overlay of revenue management in response to the current inflationary pressures. There are three aspects to this: right-sizing the SG&A; right-sizing the manufacturing footprint; and normalizing the revenue management, taking into account this inflationary environment.

We plan to have SG&A right sized by the end of this year, 2022 and have already taken steps to achieve that. So far, we decreased advertising and promotional spend to match the projected category growth rates and have reduced the size of the Greenleaf organization by 25 percent already. These actions on their own, these actions on their own, will close the gap on Adjusted EBITDA by $50 million or about 50 percent of the journey that we need to complete.

We expect most of the manufacturing footprint will be in line by the end of the first half of 2023 as we migrate some of the excess capacity we have been holding for Greenleaf to growth opportunities in the meat business, particularly further processed poultry, and we are ramping up the new tempeh facility in Indiana.

Finally, we are systematically making revenue management adjustments over the next 12 months, which gives us the back half of 2023 as a buffer to make fine-tuned adjustments towards the target of Adjusted EBITDA neutral or better. Of course, the category itself has continued to struggle during the quarter, but we feel, along with others, that this is just noise and it will settle into the long-term growth rate of 10 percent to 15 percent, particularly supported by a robust innovation agenda.

We live in interesting times today. Despite the extreme operating conditions across the board, we've remained focused on advancing our strategies and controlling what we can, and maintaining our focus on executing our blueprint to become the most sustainable protein company on Earth.

I'm now going to turn the call over to Curtis and Geert who will unpack our operational and financial performance in more detail.

Curtis Frank — Chief Operating Officer, Maple Leaf Foods Inc.

Thank you, Michael, and good morning, everyone.

As you heard in our opening comments today, our second quarter results were clearly not at the levels we would like to see or expect of our business. However, as Michael pointed out, we do not operate in a vacuum. The transitory volatility of the current operating environment has, without question, impacted our business in the near term in the areas of people, pork, and pricing. As experienced operators, we have faced adversity and volatility in our past and we have persevered, and this time is no different. Our blueprint has proven resilient, we will manage through these turbulent times, and we will, in fact, emerge stronger.

In the near term, our focus is set squarely on optimizing the short-term performance of the business. We are agile; we have adapted; and we will continue to adapt. We have taken decisive actions to offset and to mitigate the impacts of a world that is under extreme pressure. At the same time, we are not losing sight of the importance of executing our long-term strategies, operating targets, or capital investment plans, and we remain completely confident that Maple Leaf Foods is well-positioned to deliver value for the long term. The success of our blueprint to date is the foundation of that very confidence.

In meat protein, the strategy is threefold: continued investment in our market-leading brands while leveraging the sustained benefits of our brand renovation; growing our suite of sustainable meat offerings; and expanding our geographic reach, particularly into the United States. Despite the chaotic environment around us, each one of these three core strategies is delivering and contributing to growth.

Overall, our meat protein business delivered year-over-year revenue growth of 3.8 percent in the quarter, and importantly, this growth was led by our prepared meats business, which grew at over 8 percent. Overall, our packaged goods portfolio continues to perform extremely well in this inflationary environment. Consumer demand for our products remains strong, we are not seeing much evidence of a trade-down effect, and the volume response to our pricing in Q2 has been in line with or better than we had anticipated.

Within prepared meats, we saw market share growth in our flagship Maple Leaf brand, as well as our Mina Halal brand. In poultry, our branded share grew nearly 200 basis points, also led by our Maple Leaf and Mina brands. This is a testament to the strength of not only our brands, but also the efficacy of our revenue management discipline. We also continued to see strong demand and growth across our margin-accretive sustainable meats platform, which contributed positively to our sales mix this past quarter.

As we have shared previously, our sustainable meats business is now generating over $700 million in annual sales, and our sustainable meat sales within prepared meats grew at 17 percent this past quarter. We delivered double-digit growth in the United States led by our Greenfield brand, where sales nearly doubled within the quarter. We continue to see a long runway for growth within this high-margin category as sustainable meats represents only a fraction of the market today and is growing rapidly at double-digit rates in both Canada and the United States.

Lastly, we continued to build on our momentum in making deeper inroads into the U.S. market. In Q2, we grew our meat protein revenue in the U.S. by over 10 percent on a year-over-year basis. Over the past several years, we have steadily grown our business in the U.S., which is a large and lucrative market for us. We continue to grow our product distribution in the U.S. market. Our products are now available in over 18,000 U.S. stores, and our Greenfield brand can also be found in over 13,000 stores in the United States retail market.

Turning to our plant protein business, after growing sales by just over 5 percent in Q1, we delivered a year-over-year decline of 18 percent in Q2. The refrigerated plant protein category continues to face pressure with POS sales declining at 12.5 percent, impacting our own results. Greenleaf POS sales this past quarter performed nearly exactly in line with the refrigerated category, declining at 12.4 percent.

Since Michael has already provided you with an update on the progress we have made towards achieving our commitment of an Adjusted EBITDA margin of break-even or better in the back half of 2023, I'll simply summarize by echoing Michaels remarks. We are, in fact, on track. With the actions that we have already put in place, we are $50 million, or about halfway complete, on the journey to break-even, and since we last met, we have taken a material step forward toward achieving our goal of profitable growth. Our expectation continues to be that we will achieve our Adjusted EBITDA target in the back half of 2023. Before handing the call over to Geert, I wanted to touch briefly on the progress we have made in advancing two of our most important capital projects so that we ensure we do not lose sight of the transformative benefits that these projects will provide to Maple Leaf Foods and to our shareholders.

Our London Poultry project has progressed tremendously, and we are extremely proud of how this world-class facility is shaping up. The level of planning that goes into a project of this size is nothing short of impressive and we are thrilled to see our organization rally around this important milestone for our Company. The start-up of this plant is now in sight, and our teams are gearing up for the exciting phase of wet testing, which will begin later this summer. Through the combination of the cost reduction that comes with consolidating three facilities into one, creating additional capacity to grow our profitable value-added sales, and investing in world-class technology to drive operational efficiency, the London Poultry project will deliver an annual benefit of approximately $100 million of Adjusted EBITDA, or 200 basis points of EBITDA margin expansion, once fully ramped up, which we expect to be complete by the end of 2023.

Similarly, our Bacon Centre of Excellence is another strategic capital project that is now in the ramping-up phase. With consumers' ever-growing demand for pre-cooked bacon, we have completed the construction of 182,073,000 square foot expansion at our Lagimodiere facility in Winnipeg, Manitoba. This will increase our in-house capacity, improve our operating efficiency, and drive product innovation to allow us to meet growing customer and consumer demand for pre-cooked bacon products. Once fully ramped up in the second half of 2023, our Bacon Centre of Excellence will add an incremental 60 basis points, or $30 million, to Adjusted EBITDA in our meat protein business.

Over the past two and a half years, operating in the COVID-19 pandemic has brought on what is seemingly a never-ending strain of disruption and stress to our operations and to our people. Together, we have faced a confluence of challenges unlike we have seen in our history. I continue to be deeply proud of our team who have been unrelenting in their focus to protect the health and safety of our people, to ensure the continuity of our business, and to contribute to the communities in which we operate. I'll close by thanking and acknowledging the Maple Leaf team who have exhibited enormous resilience, commitment, and creativity as we progress down the path toward becoming the most sustainable protein company on Earth.

With that, I'll turn things over to Geert.

Geert Verellen — Chief Financial Officer, Maple Leaf Foods Inc.

Thank you, Curtis, and good morning, everyone.

I will begin by discussing the Company's consolidated performance during the second quarter. I will then turn to a more detailed look at both our meat and plant protein groups, and I will conclude by speaking to some key financial metrics, capital expenditures, and our outlook for the remainder of 2022.

Sales in the quarter were $1.2 billion, an increase of 3.1 percent from last year, as favourable pricing and mix in the meat business were partially offset by lower hog volumes processed and lower plant protein sales. Pricing actions implemented at the beginning of the quarter to mitigate inflation more than offset lower volumes.

Adjusted EBITDA was $74.1 million, a decrease of $31.6 million from last year. This decrease was driven by market headwinds, rising labour and production expenses due to inflation, lower gross profit in our plant business, and higher feed costs, partly offset by price increases. The Adjusted EBITDA margin was 6.2 percent, a decrease of 292 basis points from last year.

Net earnings in the quarter were a loss of $54.6 million or a loss of $0.44 per basic share compared to earnings of $8.8 million or earnings of $0.07 per basic share last year. I would like to unpack this net loss for a second, as it is driven by a number of factors that we believe are not reflective of our underlying business, and that we therefore exclude from adjusted metrics when talking about financial performance.

First and most notable is a $50 million non-cash decrease in the value of our biological assets in the meat business resulting from a decrease of hog prices in the quarter. These bio assets are mostly comprised of our hog stock and their value is based on the fair market value of similar hogs. As these markets go up and down, so does the value of our bio assets.

Second is a $19 million restructuring charge in our plant protein business, of which $16 million is a non-cash asset impairment and $3 million is severance and other related costs. These are the result of the actions we are taking to turn the plant protein business to profitability.

Thirdly, we incurred startup expenses of $11.3 million from the ramp-up of our newest capital projects in London, Winnipeg, and Indiana, which are progressing smoothly. As mentioned in prior quarters, these startup expenses are part of the respective solid business cases for each of these projects, and they are temporary in nature.

Finally, and partially offsetting the charges that I mentioned, is an unrealized gain on (inaudible) derivatives of about $11 million. We would like to point to Section 20 in our MD&A - non-IFRS measures - for a summary of these elements.

After adjusting for all of these elements, adjusted earnings were $0.00 per share for the quarter as opposed to the loss per share of $0.44.

I'll now turn to a discussion of Maple Leaf's two operating segments.

As Curtis mentioned, sales in the meat protein segment increased 3.8 percent to $1.2 billion in the quarter. The increase was driven by pricing action implemented in prior quarters to mitigate inflation and structural cost increases, and a favourable mix shift, including growth and sustainable meats, partially offset by lower volumes in price-sensitive categories.

Meat protein Adjusted EBITDA was $104.1 million compared to $131.2 million in the prior year, representing a decrease of $27.1 million. This decrease was driven by market headwinds, labour and materials inflation and availability, and higher feed costs, partially offset by pricing action. Adjusted EBITDA margin for the meat segment was 9 percent, a 277-basis point decrease from last year.

Turning to plant protein, sales were $40.8 million, a decrease of 18.4 percent in constant currency compared to the same quarter a year ago. The decrease was driven by lower retail volumes as consumers adjust to higher prices, partially offset by higher foodservice volumes, as well as pricing action to offset inflation.

Plant protein gross margin was a negative 24.7 percent in the quarter as a result of low sales volumes, low-capacity utilization, raw material inflation, and startup expenses. As we mentioned in previous quarters, gross margin continues to be heavily impacted by the capacity investments we have made ahead of anticipated growth. Gross profit for the quarter also included startup expenses of $2.3

million associated with construction capital projects related to our Indianapolis tempeh facility, which are excluded in the calculation of adjusted operating earnings, as we just mentioned.

SG&A expenses in plant protein were $26.3 million, a decrease of approximately $3.5 million from a year ago, driven by lower advertising and promotional expenses, partially offset by higher consulting and people costs.

Turning to the balance sheet now. On the balance sheet, net debt increased to approximately $1.4 billion. This debt primarily relates to the over $1 billion in fixed assets we have invested in our Bacon Centre of Excellence, Winnipeg, the new tempeh facility, Indianapolis, and of course, the new poultry facility in London. Winnipeg and Indianapolis are in startup mode and London will start testing later this summer. In short, after years of investing funded with debt, we are confident we will start to see the cash flow benefits of these projects drive down leverage levels once again.

During the quarter, we invested another $90 million in capital expenditures. This investment included about $52 million in construction capital primarily related to the almost completed construction of the London poultry facility.

Our outlook regarding our big capital projects remains unchanged from the prior quarter. We expect the London Poultry facility to be completed by the second half of 2022, and when fully ramped up by the end of 2023, this facility is expected to contribute incremental Adjusted EBITDA of about $100 million annually. This state-of-the-art facility will increase our processing capacity for value-added, higher-margin poultry products. It would also add operating efficiencies through lower costs and consolidation of three subscale plants into one at-scale facility. The plant construction is going as planned, and wet testing, as Curtis mentioned, is scheduled to begin later this summer.

The Winnipeg Bacon Centre of Excellence expansion started producing salable product early this year. Once the ramp-up is completed, which we anticipate in the second half of 2023, we expect this plant will begin to add incremental Adjusted EBITDA of about $30 million each year. The benefits will come primarily from improved operating efficiency and incremental capacity to meet the growing demand for pre-cooked bacon.

During the quarter, we renewed our NCIB to repurchase up to 10 percent of the public float of up to 7.5 million shares through May 2024. We view share repurchases as an important way to return capital to shareholders, and we will be opportunistic in our buyback program.

I'll wrap up with an outlook for our business for 2022. Our expectations are based on certain assumptions, primarily normal market conditions, including a pork complex in line with the five-year average.

In meat protein, we expect mid-to-high single digit sales growth driven by continued momentum in sustainable meats, brand leadership, and growth into the U.S. market.

In addition, we now expect to achieve Adjusted EBITDA margin expansion to a 14 percent to 16 percent target range once markets normalize.

Our CAPEX expectations for 2022 remain unchanged at a range from $400 million to $500 million. Approximately 50 percent will be construction capital, mainly related to the London facility and other projects to add growth and capacity in the prepared meats business.

I will now turn the call back to Michael.

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

Well, thank you very much, Curtis and Geert.

Clearly, as you can see, we are living in very uncertain times where the ability to predict and anticipate is next to impossible, but we are agile, I think excellent operators, and we're doing everything we can to mitigate the short-term impacts of this current environment without, certainly, impacting our focus and our long-term commitment to the Maple Leaf blueprint and our success that that drives.

On our meat protein strategy, which continues to be relevant and robust, we are executing and seeking to improve our underlying business to deliver best-in-class growth in Adjusted EBITDA, and in the plant-based business, we've made the decisions and are taking the necessary actions to achieve a break-even in the back half of '23, so we're confident in the structural health of our business and remain committed to the blueprint of shared value creation and our vision to be the most sustainable protein company on Earth.

With that, I'll open the line to your questions. Operator?

Q & A

Operator

Thank you, sir.

Your first question comes from Irene Nattel. Please go ahead.

Irene Nattel — Analyst, RBC Capital Markets

Thanks, and good morning, everyone.

That was a very comprehensive and fulsome review of the quarter. I was wondering if you could talk about the relative contribution of the three factors that you cited in terms of the pressure on profitability in meat, and how much of those can be mitigated by self-help measures?

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

Good morning, Irene.

Of the three components - people, pork, and pricing - I would argue the vast majority, if not all of that, is to some degree connected and interdependent on market conditions.

Certainly, we’re not the only organization in our society that's struggling with people availability. I'm sure you've traveled recently or been to an emergency room recently and you see exactly the same thing. We are taking steps to improve our hiring capacity, but the ability to predict the timelines attached to that are challenging. I would take you solely to the point that, in our business, oddly, recession is our best friend, particularly in our ability to hire people and staff our supply chains.

In the case of the pork markets, they're all to some degree uncontrollable, but I do think that there are things that we can and are doing to optimize it within that, within the pork markets, things like negotiating different freight architectures, and we are seeing ocean freight rates and freight rates in general start to normalize and dial back. Trying to optimize where we tap into the most lucrative markets in the world is part of the optimization, but the pork market conditions, whether it's feed cost, the meat values, the Japanese Yen weakening by over 20 percent, all of these factors, Irene, are out of our control.

In the case of the pricing, I'm pretty confident we're going to get it sooner or later. We can't price ahead of inflation but we can price for inflation. We clearly got it wrong the last quarter in that we didn't price enough for what actually occurred, but we're executing another round of pricing in the third quarter and that will catch up, whether it's this quarter—I believe—I will always tell you I believe we've gotten enough. I'll always answer the question, yes, I believe we have gotten enough from what we see today, but what happens in the next quarter from an inflationary perspective could be different.

Now, most economic reports that I read, particularly those that are calling for some recessionary trend, are also suggesting an abatement in that inflationary pressure, so I believe that we'll catch up on that one. So teasing out the difference between these—between the—is very challenging because they're all so interdependent, Irene, and it would be misleading for us to try to tease it out (inaudible), but they're all, all three of them are connected singularly to the environment that we operate in.

Irene Nattel — Analyst, RBC Capital Markets

Understood, so let me try and get at this a different way. This is two quarters in which you've had a 9 percent margin. We understand that structurally you should still be able to achieve the 14 percent margin. Unfortunately, we're in the position where we need to forecast your trajectory from here to there, so based on what you're saying, it sounds as though probably not much easing in Q3; maybe, hopefully, a little bit in Q4. But we're sort of pushing—let's say we're pushing out the 14 percent by a year. Is that the best way to think about it? And again, Michael, I understand the challenge, but this is what we need to get our minds around.

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

Well, I know, and Irene, I totally am empathetic to your challenge. We felt that it would be irresponsible for us to offer predictions for you in this environment. I know that you have financial models that you need to try and make those predictions in but our predictive capacity is fully impaired at the moment. I just feel that whatever I tell you is going to be wrong, and we felt that that was irresponsible to offer that up. So we're very confident that when the conditions that underpin this in the pork markets, in the broader economy normalize, we are structurally on track in our margins. It's very challenging for me to provide that predictive ability right now, and I know that's frustrating for you. I understand that. I'm empathetic to that, but I'm going to resist offering an answer to that question.

Irene Nattel — Analyst, RBC Capital Markets

Okay. Thank you, Michael. I'll let someone else take over now.

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

Okay. Thanks.

Operator

Your next question comes from Mark Petrie. Please go ahead.

Mark Petrie — Analyst, CIBC World Markets

Good morning.

Maybe, Michael, we could just hear a bit more about the volume trends in meat protein in Q2. Any details you can share, and also, just perspectives about how shoppers are adjusting their purchase patterns and trading down amidst the elevated inflation.

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

Great question, Mark, and it's one that gives us really good confidence in the steps that we're taking.

We did see some volume contraction in the second quarter. When you can imagine the magnitude of the pricing that we took, there's always an immediate volume implication in the short term. We saw that occur in our primary pork business for different reasons, actually. The supply chain implications in the quarter affected our ability to process all of the hogs that we expected to, so we had a hog supply restriction in the quarter which impacted our volumes in pork, but in our core central packaged meats business, we did see some modest single-digit, low single-digit volume contraction in the quarter, but interestingly so far in the third quarter and late into the second quarter, and what we're experiencing now in the third quarter, is that's been fully recovered. In fact, coming into the mid-summer regions, we actually saw a tiny bit of growth, which gives us great optimism at the market's ability to absorb the price levels. I think that's a reflection of the macro environment where these inflation rates are existing everywhere so our relative value proposition hasn't changed.

Mark Petrie — Analyst, CIBC World Markets

Can you comment at all about the volume trends with regards to between brand and private label? I know you're struggling in all parts of the category.

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

Yes, it’s the same. The brands have very much—we're seeing no trade-down.

Mark Petrie — Analyst, CIBC World Markets

Okay, thanks, and then also just with regards to the plans for the price increases, any commentary about how these vary across categories, and if you anticipate any difference in the reaction versus the other moves you've made over the last 18 months?

Curtis Frank — Chief Operating Officer, Maple Leaf Foods Inc.

Good morning, Mark. It's Curtis. I'll maybe take that one.

In terms of execution in the marketplace, as Michael said earlier in his comments, we fully executed the pricing in line with our expectations in the second quarter and earlier in the year, and we don't expect any materially different outcome in the third quarter. Pricing's moving forward. We’re having the appropriate discussions with our retail partners, as we always do from an execution point of view, and fully expect that by September, we’ll have implemented all of the pricing into the market that we had anticipated and pushed forward.

Mark Petrie — Analyst, CIBC World Markets

Okay. I appreciate all the comments, guys, and I wish you all the best. Thank you.

Curtis Frank — Chief Operating Officer, Maple Leaf Foods Inc.

Thank you.

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

Thanks.

Operator

Your next question comes from Mike Van Aelst. Please go ahead.

Michael Van Aelst — Analyst, TD Securities

Yes. Thank you.

Just on the last pricing question, can you just clarify what the price increase was in meat at the beginning of Q2, and then what you’re pricing in September?

Curtis Frank — Chief Operating Officer, Maple Leaf Foods Inc.

It was in and around 5 percent in the second quarter, in April, Mike, and just under 4 percent in Q3.

Michael Van Aelst — Analyst, TD Securities

Perfect. All right.

The leverage ratio with three quarters of kind of tough earnings and continued CAPEX, your leverage ratio looks like it's around 4.8, I believe. Can you help us understand where your covenants are and how your lenders are reacting to this and the less certain short-term outlook, and are you going to need some waivers to get through the next few quarters?

Geert Verellen — Chief Financial Officer, Maple Leaf Foods Inc.

Good morning, Mike. It's Geert.

The short answer to that is no. The leverage ratio depends on what EBITDA you're using. That's number one. Number two is we are in compliance with all the covenants, so we’re not worried about that. Number three, I would say is the confidence of the lenders is evidenced in the fact that we have extended our credit facility just last month, so that's one thing.

Looking ahead, as we have mentioned a couple of times, our cash flow profile is going to change substantially. If you think about the heavy CAPEX projects and CAPEX project years that we've gone through over the last couple of years, that is going to go away and then it’s going to be exchanged for the cash flow that will be generated by those projects as they come online. So we look at that with a lot of confidence, and there's no need for a waivers or anything else that you mentioned.

Michael Van Aelst — Analyst, TD Securities

Okay, and just (multiple speakers).

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

Michael, the only colour that I would add to reinforce what—because I'm not worried about it a bit—our covenant today, which you're aware of, is net debt to capitalization, and has another leverage ratio, so that's an important fact.

Number two is from a relative risk perspective, the debt that we have on the balance sheet, the vast majority of that debt is related to currently unproductive assets that are just in start-up mode. It's not structural debt that you would think of in a normal context of an operating business that is realizing its EBITDA potential against a structural debt load. The vast majority of that debt is connected to construction capital, which, by most risk managers' lens, is a significantly lower risk profile than the normal structural debt. So, well within our covenants, and it's important to understand the interpretation of that debt.

Michael Van Aelst — Analyst, TD Securities

Okay. No, I understand where the debt is and what the outlook is for the margins. I'm not overly concerned about that part. I just don't know exactly what your covenant is and what parts they look through.

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

Yes, we're very comfortable, very comfortable with that.

Michael Van Aelst — Analyst, TD Securities

Okay. I'll follow up after if there's some details, hopefully.

On the labour situation, have you seen any progress since the end of Q2? When you talk about accelerating your activity and your efforts, what exactly are you doing, and then what's the long-term solution to this if—yes, an economic slowdown could help you, but then when the economy recovers, maybe you get that coming—those labour—those employees leaving again to greener pastures, so can you give us a bit more on your labour strategy?

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

The labour strategy is to improve our hiring capacity. Hiring capacity is the critical unlock here. We have a team that is fully dedicated to accomplishing this. For example, for the first time ever in our history, actually, we launched in the first week of August a very aggressive communication strategy to simply communicate broadly in the marketplace what a great place Maple Leaf is to work, so it's active public recruiting for employment, something we've never done before in my entire history. We are working on a range of access strategies like transportation systems, busing, things of that nature, Michael. We've ramped up our foreign temporary worker programs and access to those programs.

Those are a few examples, but there's hundreds of very local initiatives as well that are being brought to bear, so the focus of effort is increasing our hiring capacity in these conditions, I think, and you and others in your industry, Michael, would probably be better at this than I, but I believe that most economists are anticipating some relief in a recessionary trend over the course of the next 12 months. As I said in my comments, we saw some initial signs of that in the month of June when the economy actually shed jobs, and so there's obviously a lag time in our ability to react to that.

I think whether you looked at it from a travel industry perspective or healthcare industry or quick service industry or food industry, I think everybody would hope that we would return to some kind of a normalized economy in that regard sooner rather than later. I hope that we would not conclude that this is the world that we know forever. Again, I would hope that's not the conclusion. And finally, I would tell you that we are making some progress. I think, empirically, we've closed about 30 percent of the gap, 30 percent as we speak, but we still have got more work to do.

Michael Van Aelst — Analyst, TD Securities

Just to clarify, when you say improve your hiring capacity, are you just talking about the amount of people in HR that actually have to process applications and to onboard them, or...

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

Correct. All of the above. That's part of it, but hiring capacity is just like—historically, we had people show up at the door and we hired them. In the new world, you have to go out and actively recruit people and find them, and then make it easy for them to access your facility, and educate them as to why this is a great, long-term place to work, so it's a bit of a different environment in the near term, Michael.

Michael Van Aelst — Analyst, TD Securities

All right. I'll get back in the queue. Thank you.

Operator

Your next question comes from Peter Sklar. Please go ahead.

Peter Sklar — Analyst, BMO Capital Markets

Good morning.

Michael, in your discussion, you outlined the major factors, the agricultural market factors that are having a negative impact. I'm just wondering if you could go through the major ones and explain fundamentally what's your interpretation of what's happening in markets to cause these issues and where we stand today. Have things improved or are they similar to where they were in Q2? And when I talk about the major factors you highlighted feed prices which is having an impact on hog prices and I guess the packer margin, so if you could just review those and give us your thoughts on where you think we're going and where we're at now.

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

Sure. Well, I'll start with the core drivers: the post-pandemic economy compounded by the war in Ukraine.

The impact of the Russian invasion in the Ukraine on the grain complex, Peter, has been profound, particularly through the second quarter. Those two factors are the core drivers. So what are the consequences of that? Number one, dramatic rise in the feed complex, all the grain complex that you've seen in the second quarter. It was exacerbated in Manitoba. The local markets in Manitoba were worse than the rest of North America, and so that's the front end of that value chain. On meat markets, the U.S. market, which defines the world economy in meat, is an exporting nation. Exports into globally, exports into China in the second quarter were down over 65 percent. The aggregate net exports of the U.S. industry were down over 25 percent, so you have feed costs ballooning, inflation ballooning, and a U.S. industry that is an exporting industry down 25 percent in their net exports.

The combination of that unstable agricultural market, the hyperinflation, and the labour instability was what we saw. So your final question is what's the outlook on those, and as I said to Irene and others, we have an impaired ability to predict in these conditions. I believe the labour instability will normalize as the economy normalizes, a.k.a. recession. We are seeing some signs of abatement in the inflationary environment. Just look at the charts on grain complexes and you'll see a big portion of that, and most people are reporting signs of inflationary abatement in other sectors of the economy.

China actually is coming back into the market, this summer, actually. We've seen some improvement in the export market conditions as this summer unfolded. The local feed implications in

Manitoba, whole new crop, whole new market conditions on a relative basis starting in September. These are all as I said early signs of abatement, but how they all come together, Peter, is very challenging for me to piece together.

Peter Sklar — Analyst, BMO Capital Markets

How are you experiencing then—you would know—the packer margin in the current quarter to date?

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

The packer margin, as one of those ingredients—and it's only one of those ingredients—that packer margin started to show signs of improvement in July.

Peter Sklar — Analyst, BMO Capital Markets

Okay. I just have a couple of other questions. I'll move on.

Just going to the plant-based, so I believe that your sales were down 14 percent in local currency and as you said, you've cut your marketing and promotional spend, so aren't you concerned that there's not going to be enough marketing support? With the higher level of marketing spend, you experienced the 14 percent decline, so how do you know where the right balance is, and how do you know that now that you've withdrawn the marketing promotional support, that you won't experience revenue declines that are even more severe?

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

Most of that was brand development-focused activity as opposed to short-term consumer promotional activity, and the advertising and promotion calculus is a relative game, Peter. Everybody's dialing it back, and so relatively speaking, what marketing speak would describe as share of voice as opposed to absolute spend, in the case of share of voice, with everybody dialing it back, it doesn't give me great cause for concern.

Of course, the category didn't perform well in the quarter. Really, really important not to pass judgment in the middle of all of this noise. Some people may want to pass judgment in the middle of the noise. We don't believe that's the right thing to do. There was a tremendous amount of noise in the quarter and the first half of this year. That related to the inflationary environment, the impact that that has on this category and other categories, and how consumers react in that category at the moment.

Our actions, Peter, are to size the shoe to fit. Of course, the obvious question is, well, what if it's a different foot? Well, if it is, then we get a different shoe, and we’re perfectly capable of doing that. I can make any size business profitable, any. I just need to stabilize it at that size level. We’re confident in the long-term hypothesis of 10 percent to 15 percent growth rates. Once the conditions normalize, the consumers normalize, the extreme inflationary environment has sort of passed, we’re confident in that. If it's different, if we’re wrong, we resize the shoe to fit a different foot.

Peter Sklar — Analyst, BMO Capital Markets

Okay, and then, Geert, just have a financial question for you. You're taking these ramp losses at the three facilities that you're ramping as an adjustment. Can you tell us kind of what is the duration and what is the magnitude? How are these ramp losses going to unfold?

Geert Verellen — Chief Financial Officer, Maple Leaf Foods Inc.

Sure. Peter, there's a bit more disclosure on this I think in Q1 of this year or in Q4 of this year. These ramp-up losses, or start-up expenses as we call them, they will continue until the factory is fully ramped-up, and we have earlier disclosed for London, for example, roughly a magnitude of $100 million that we will incur before the plant is fully operational. That's the biggest one. Around $40 million for the Bacon facility, and since they're transitory, since they're one-off and not for us a part of how we measure the underlying performance, that's why we take them out of adjusted earnings, as you can see in the reconciliations in all our documents.

Peter Sklar — Analyst, BMO Capital Markets

Yes, and what's the number for the tempeh plant?

Geert Verellen — Chief Financial Officer, Maple Leaf Foods Inc.

For the tempeh plant, we had CA$2.3 million in this quarter, and we had CA$2.2 million in the quarter before, so roughly, let's say, CA$5 million year to date.

Peter Sklar — Analyst, BMO Capital Markets

Okay. Thank you. That's everything I have.

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

For emphasis, Peter, even though those things come through the income statement, we fully build in these numbers in our investment decision-making, so this is investment strategy in plan, so it's very planned. It's part of our investment thesis, and it's included in our return on net asset calculations in making the investment.

Peter Sklar — Analyst, BMO Capital Markets

Okay. Oh, and sorry, one last thing. I can't recall, the 14 percent to 16 percent target under normal ag market conditions, is that on a consolidated basis or is that for the meat protein segment?

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

Meat protein.

Peter Sklar — Analyst, BMO Capital Markets

Okay. Thank you.

Operator

Your next question comes from George Doumet. Please go ahead.

George Doumet — Analyst, Scotiabank

Hey. Morning, guys.

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

Good morning.

George Doumet — Analyst, Scotiabank

I want to get a little bit of clarity on these higher feed prices in Manitoba versus North America. Can you maybe talk a little bit about what's going on, and I guess more importantly, your outlook on maybe when you expect that gap to normalize?

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

We expect that gap to normalize in the back half of 2022, actually. New crop. All grain markets, there's a macro context and then there's a local basis, and the local basis in Manitoba, which is just defined by the very localized supply and demand environment. Clearly, there were markets around the world, particularly coming into the second quarter of 2022, that impaired the supply and demand locally in Manitoba, and we have an historically high basis. It's, I think, four to five times what the five-year average is is the basis of feed costs in Manitoba, but that basis component...

Curtis Frank — Chief Operating Officer, Maple Leaf Foods Inc.

Corrects every new crop.

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

I think weather conditions in Western Canada are very favourable to a bumper crop, actually.

George Doumet — Analyst, Scotiabank

Okay. I think Walmart the other day, they called out a trading down effect of private label in some categories like bacon, deli, lunch. I know you haven't really seen that in a meaningful way, but just wondering when you layer in additional pricing that you're taking in Q3, maybe your outlook on maybe that actually potentially happening or your views there.

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

We haven't seen it to date. Many of the CPG brands in North America have taken between five and seven price increases in a single year. Think about that: five to seven price increases in a single year, most CPG brands in North America, and we’re not an exception to that. I'm sure there are markets and categories where there might be some evidence of some trade-down. We’re not experiencing that to date. If that experience to date is any indicator, then I would say that I wouldn't anticipate that going forward, but in the Canadian marketplace, we've got great brands. I am hugely grateful for the work that we did in 2017 to invest in the strength of our brand strategies. That has served us incredibly well since that time, and we continue to earn the confidence of Canadian consumers, All I can tell you factually, George, is that we've not experienced it to date, and I have no reason to believe it'll be any different in the next round.

George Doumet — Analyst, Scotiabank

Okay.

Moving over to the plant, is there a baseline level of revenue that we would need to maybe generate in order to obtain those 30 percent gross margin levels?

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

We have a $150 million business today. We acquired Lightlife at a $40 million business, so it was a quarter of the size, and we had those margins then when it was a $40 million business; actually, higher. I think our margins when we acquired Lightlife in 2017 were in the mid-30s, so structurally, that's where that category—and there's a whole bunch of financial reasons why that's so, but structurally, that's why that margin rate is both reasonable and expected for that category. The reason it's not there today is because we overbuilt the capacity and the size of the organization. We were expecting transformational growth. It didn't materialize. Now we've got to resize the shoe to fit a new hypothesis.

George Doumet — Analyst, Scotiabank

Okay, and just one last one for me, maybe to Geert. Can you share a preliminary CAPEX number for next year, please?

Geert Verellen — Chief Financial Officer, Maple Leaf Foods Inc.

We've not completed our planning there, George, so what I would say is what I said in previous quarters, is that we would be at a significantly lower level than what we had in the last couple of years, so let's say roughly $300 million to $400 million at the max, at the max, but still going through the planning phases, so it's too early to knock off on that, but you will see a substantial shift from the past years of investment, clearly.

George Doumet — Analyst, Scotiabank

All right. I'll queue back up. Thanks, guys.

Operator

Your next question comes from Derek Dley. Please go ahead.

Derek Dley — Analyst, Canaccord Genuity Inc.

Yes. Hi. Thanks. Just a quick one for me.

You mentioned the price increases of 5 percent in Q2 for roughly 4 percent in Q3. Can you just comment on what you saw in terms of inflation within your input costs? What was the magnitude of that? And then secondly, as it relates to labour shortages, I think last quarter, you quantified it at, in some cases, about a third of your employees were away due to vacancies. What was that number like in Q2?

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

I don't know what the third. Our total employment base at full capacity is 13,500 people, and we had a peak, we were over 1,500. In fact, I think it peaked out at about 1,800 people in terms of vacancies in Q2, which is not a dissimilar number to what we experienced, but for different reasons, in the first quarter. The first quarter was mostly absenteeism related to—kind of pandemic-related effect as opposed to post-pandemic kind of economy effect in Q2. So I'm not sure where the 30 percent number came from, Derek. I'd have to go back and reflect on that. I don't know where that came from, but it's roughly the same number, but very different root cause.

Clearly, absenteeism is one problem area to deal with. It's unplanned in the marketplace. The vacancies that we’re seeing today have a particularly challenging aspect to it in that it's not just vacancies, but it's also churn, so you're constantly training, retraining, filling in and so on and so forth, so that's the structural difference between the two.

I am reminded by one of my colleagues here that the 30 percent number was a—some plants at its peak up to 30 percent, so it's not across the total Company at 30 percent. Some plants at its peak, they had absenteeism levels of 30 percent.

Derek Dley — Analyst, Canaccord Genuity Inc.

Got it.

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

So just a different metric.

Derek Dley — Analyst, Canaccord Genuity Inc.

Okay. That's helpful on the labour front.

Just on the inflation, do you have a number of what you saw for your input inflation during the quarter?

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

I don't have the number at my fingertips, Derek. Obviously, it was higher than the 5 percent that we priced, so it was higher, but I haven't pieced that out.

Derek Dley — Analyst, Canaccord Genuity Inc.

Okay. Maybe we can follow up on that. Thank you very much.

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

Yes.

Operator

Ladies and gentlemen, that's all the time we have today for questions. I would now like to turn the conference back to Mr. McCain for closing remarks.

Michael H. McCain — Chief Executive Officer, Maple Leaf Foods Inc.

Okay. Well, thank you very much. Obviously, these are chaotic times. We don't pass any judgment on our strategies or our business or our people in the middle of this chaos, and we're confident that this too will pass. We are obviously coveting stable waters ahead, but we're not going to offer predictive capacity to tell you when exactly that will occur. Appreciate your patience. Certainly we are, and we're focused on the long ball in our organization and achieving the targets that we expected, so thank you for your participation today, your patience, and we'll look forward to connecting and updating you in the next quarter.

Have a good day.

Operator

Ladies and gentlemen, this does conclude the conference call for this morning. We would like to thank you all for your participation and ask that you please disconnect your lines.