Maple Leaf Foods Inc.

Fourth Quarter and Full-year 2022 Financial Results Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to Maple Leaf's Fourth Quarter and Full Year 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 Hilda Maraachlian, Investor Relations at Maple Leaf Foods. Please go ahead, Ms. Maraachlian.

Hilda Maraachlian — Investor Relations, Maple Leaf Foods Inc.

Thank you, Michelle and good morning everyone.

Speaking on the call this morning will be Michael McCain, Executive Chair and Chief Executive Officer; Curtis Frank, President and 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 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 Q4 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 will now turn the call over to Michael McCain. Michael?

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

Thank you, Hilda. Good morning everybody.

We achieved many critical milestones in our business in 2022 and we advanced very important initiatives, yet our fourth quarter capped off a challenging year with more of the same: hyperinflation, inefficiencies in supply chain due to labor shortages, the worst market conditions in recent memory, all compounded by a cyber incident which was extremely disruptive to our operations and more costly than we anticipated when we last spoke.

All told these factors negatively impacted our reported results by a challenging 730 basis points. None of this, however, belies the underlying fact that we are at an important inflection point in our business. I won't bury the lead. Here are the key issues and challenges that we faced in Q4.

First, this was clearly the cyber quarter. The cyber incident was insidious, impacting our business in multiple ways. In real time we had to pivot the business from a highly efficient network of operations, one that is highly automated from orders to manufacturing planning to inventory picking receipts and payment, to a business that had to run entirely on a manual basis. The cyber incident impacted our

Adjusted EBITDA by at least $23 million or 200 basis points and further knock-on effects in delaying the resolution of the many supply chain inefficiencies that we have been facing and are working to stabilize.

Second, we are at 10-year lows in global pork market conditions. For those of you that have access to this, I'd turn your attention to the most relevant single chart in the deck that we circulated this morning, which shows that there's really only one profit in a pig. The chart illustrates the difference in the cost to raise that pig over the past 10 years, which is as far back as we went, compared to the meat values over that same period of time. I would urge you to notice how unprecedented this is and how deep the disconnect is in the short term.

Our industry is increasingly vertically integrated in primary processing, and this is the single chart that matters. Here are my takeaways from that chart. Number one, we have a clear view on what is taking place and the impact on not just us but the entire industry. Number two, we have a hypothesis on why it has happened, and there are many broad factors but you can distill it down to mostly a China story.

Number three, while this is painful in the moment, I have been around long enough to know that markets correct; they always do. I repeat that, they always do, and we are seeing the green shoots of this occur now. The outcome you see in this chart is simply nonsensical, and we can say with 100% certainty that these conditions, while with us now and certainly into the first quarter, will not last.

Our double impact here is in Japan, which compounds the effect to Maple Leaf since we over-indexed in that Japanese market, but that's improving as we speak also. The green shoots are very important here. Everyone understands, of course, that we cannot predict future global markets, but we can identify the factors which do change markets in time.

They include things like, it's a China story and China's rebounding. For example, China has increased pork imports by 44% in December 2022 compared to just one year ago. Our Brandon plant, for example, has recently been re-listed to ship to China, which is reflective of this China story. There's industry-wide poor performance continuing into the first quarter of 2023. I’d urge you to check any available data point and you will see these extreme outcomes.

Paradoxically, this is actually a very good leading indicator. There are many domestic and international data points of supply contractions that are taking place in both hogs and processing capacity. For example, Canadian industry contractions are in the news. Eurostat is forecasting hog production to fall 7% in the second quarter, compared to a year ago in the EU, and I would remind you that Europe has been the number one exporter to China.

These factors are working in concert and will eventually re-establish demand and supply equilibrium in the market, but in the interim, we and our peers are certainly facing more challenging market headwinds than we have in over a decade.

In pricing for inflation, we have been relentless in this regard and we have made very strong progress. In poultry, however, the inflationary pressures in the fourth quarter were greater than we expected, resulting in a 70-basis point margin impact in the quarter, and we are taking action to close that gap in April of 2023. I would highlight that while we have mostly caught up to inflation, the inflationary dynamic is not over. In the course of normal business operations, we would expect to take accelerated pricing action in the first half of 2023.

Finally, we did not make progress in our supply chain stabilization in Q4, singularly due to the cyber incident, but we are making progress now. We expect that, that should show up in Q2, one quarter later than we originally thought.

All this said, I think it's important to focus on the good things with an equal amount of intensity. This is what creates in our view the investment inflection point.

1. Our supply chain is improving and we expect full normalization by the end of the first half of 2023.

2. The London poultry start-up, a massive investment, is on-track and actually going quite well. Our largest consolidation into that facility will take place in March and April, and the other two major start-ups are going similarly well.

3. We are on-track in our plant-based business model shift to achieve Adjusted EBITDA neutral or better in the latter half of 2023. We have already closed 50% of the gap towards that goal, and we have a clear path to close the remaining gap in the back half of this year.

4. Brandon, as I said earlier, is now shipping to China once again.

5. We've mostly caught up to inflation, although there is more to follow.

6. We have exceptional brand performance and resilience in these market conditions within our prepared foods business.

7. We have continued growth in sustainable meat, demonstrating that our vision to be the most sustainable protein company on Earth is both appropriate and impactful for all our stakeholders.

Consider the inflection point. I believe that 2023 as a year will mark the year where we go from COVID and supply chain instability, rapidly rising inflation, sustained period of investing over a billion dollars, and global market conditions that are ending at 10-year lows to 2023 supply chain stabilized by the end of the first half, stabilized inflation in the first half, harvesting investments fully by the end of the year, and global pork markets normalized when these green shoots show up throughout the year.

In opening this call, I wanted to make sure that you had a very strong and clear sense of the market environment and the challenges that we faced in the fourth quarter. I wanted to affirm the continued strength of our underlying business and our operations, and I wanted to affirm the material returns that we see as a result of our prudent capital investments. Bridging these terrible conditions to what our structural Adjusted EBITDA margin expectations have been for over five years now is really clear to us, and in fact gives us great comfort. The facts are illustrated clearly in the materials that we circulated.

With that, I'll turn it over to Curtis and Geert, who will unpack our operational and financial performance in more detail. Curtis?

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

Thank you. Good morning everyone.

As you heard from Michael, extraordinary market conditions along with the impacts of a cyber attack materially impacted our fourth quarter results and most certainly delayed the progress that we had expected to make relative to our quarter three. At the very same time, our confidence in the underlying health of the business remains unwavering as we look forward to more normal market conditions in our future.

Adjusted EBITDA margin as reported for the fourth quarter was 6.6% in the Meat Protein business, which is obviously below what we had set as an expectation when we were last together following our third quarter results. Heading into Q4, we had anticipated a sequential rebound in our margins, and we were in fact making good progress early in the quarter with respect to executing on the actions that are within our control when our progress stalled abruptly on November 4, the day we were attacked by a group of cyber criminals.

It is important to start by recognising that we are immensely proud of how our team responded in the face of this crisis. In less than 48-hours, we were able to pivot our organisation to operate in a fully manual process, basically going back to paper and pencils. With remarkable pace, in approximately one week, our Information Systems Team cleaned, rebooted, and restored our systems, allowing us to start back on the road to recovery. All that said, as you heard from Michael, the consequences of the cyber attack were harsh, an impact of at least $23 million or 200 basis points in the quarter.

On top of the economic impact, the fact that all of our attention was centered in on cyber meant that we did not make the progress in closing the efficiency gaps in our supply chain that we had identified in the third quarter. You will recall that at the end of the last quarter, we communicated that there were four transient external forces that were pressuring near-term margins, and those four forces were standing between us and operating at the lower end of our 14% to 16% Adjusted EBITDA target. Those were pricing, supply chain headlined by people, Japan pork market conditions, and overall pork market conditions. These very same factors played a role in Q4 and were obviously complicated by the cyber attack.

Michael took you through most of the detail already, so maybe just a few key points here that I would like to add starting with pricing. We have and we will continue to manage price to reflect inflation in our business. In Poultry, where we fell short within the quarter, we have already taken steps to initiate a price increase that is effective for the beginning of April, and we expect based on everything that we know today, that this will be sufficient to close the remaining gap within Poultry. In our Prepared Meats business, we did in fact get the pricing in place that we needed for Q4, but we know now that this will need more pricing in 2023 within Prepared Meats to address additional inflation that is in the horizon, and we have taken steps to price for that coming in May.

The second item is inefficiencies in our supply chain. While we did make great progress on the people and hiring front, we continued to face inefficiencies in labour, excess overtime, contractor costs, and service penalties. This had an impact of approximately $16 million or 140 basis points within the quarter. With the cyber incident now behind us and the labour situation materially improving, we are making good progress through Q1 and we do expect to have the supply chain fully stabilized by the end of the second quarter this year.

The third item is our Japanese pork business, which was a $17 million or a 150-basis-point headwind in the quarter relative to our five-year average. While it may take some time for margins to fully stabilize, we are confident that they will, and I would point to the fact that we are encouraged by the sequential improvement that we've seen from Q3 to Q4 as demonstrated in a 60-basis-point or $8 million pickup in improvement quarter-over-quarter.

The final item is pork market conditions, where the pork complex continued to be challenged in the fourth quarter relative to five-year average conditions as you heard from Michael, and overall, this was a $20 million or a 170-basis-point headwind for us in the quarter.

From a top-line perspective, it's important to note that in the face of all of this disruption around us, revenue results were once again very solid. Our Meat Protein segment grew revenue by 5.9%, driven by our consumer packaged goods portfolio in Prepared Meats and Poultry where our branded sales continue to grow. Our brands continued to perform extremely well in this inflationary environment and the volume response that we have experienced following price increases is in-line with or even in some cases ahead of our expectation as we continue to be satisfied with the relative stability of our market share performance.

We continue to make inroads into the U.S., growing our Prepared Meat sales for the year by over 10%, and we remain very excited about our Sustainable Meats business where we have grown sales each quarter for seven consecutive years, led by Prepared Meats, which continues to grow at double-digits. We now have a Sustainable Meats business that generates over $730 million annually, is margin accretive, and makes up approximately 17% of our Meat Protein business.

In terms of an outlook for Meat Protein for 2023, we firstly see several positive indicators that will allow for a recovery in our Adjusted EBITDA margin over time. As we continue to price for inflation in April and May, we improve our supply chain inefficiencies in the second quarter, we fully recover and put the cyber incident behind us, and we see some signs of market conditions stabilizing, including our shipments to China restarting.

Secondly, we expect that our first quarter margins will in fact remain challenged in the short term as we work through the transient factors we outlined in our comments and in our supporting materials. Finally, we remain confident that we will see margins improve throughout the balance of the year as we see the execution of the initiatives within our control taking hold, and obviously as pork market conditions normalize, we will continue to see further expansion within our margins.

Turning briefly to the Plant Protein business. The headline here is that we have made tremendous progress against our goal of achieving Adjusted EBITDA breakeven by the latter half of this year. Our focus remains squarely on pivoting our Plant Protein business to profitable growth, and we are well on our way. This is reflected in an improvement of Adjusted EBITDA by 57% in U.S. dollars within quarter four, a 57% improvement in quarter four. The decisive actions we have taken to date include a significant reduction in SG&A by reducing the size of our organization, and also in right-sizing our ad and promo investments.

The remaining gap will be closed throughout this year with improvements in gross margin and driven by five key initiatives. The first is right sizing our manufacturing footprint and optimizing our plant operating costs. The second is product cost savings and formula optimization. The third is a redesign of our outbound distribution model. The fourth is continued revenue management discipline and pricing as required, and finally through further reducing discretionary cost.

Lastly, before I turn it over to Geert, I'd like to offer a couple of very short comments with respect to the inciting inflection point we are at with our large-scale capital projects. We are right on-track at London Poultry and when fully ramped up by the end of 2023, the London Poultry project will add an incremental $100 million of Adjusted EBITDA on an annualized basis. The benefits will come from a more profitable product mix through improved bird utilization, increased operating efficiency from technology and scale that lower costs, and additional capacity to meet consumer demand for high margin, value-added poultry over the years ahead.

We are also right on track at our Bacon Centre of Excellence, where the startup is now in commercial production and continues to ramp up in line with our business plan. The facility will deliver an incremental Adjusted EBITDA of $30 million annually, once it is fully ramped up, primarily from improved operating efficiency and incremental capacity to meet the high demand for pre-cooked bacon, which we expect will occur in the second half of 2023.

With that, I will now turn it over to Geert.

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

Thank you, Curtis. Good morning everyone.

I will begin by discussing the Company's consolidated performance for the fourth quarter. I will then turn to a more detailed look at both our Meat and Plant Protein groups. I will conclude by speaking to some key financial metrics, capital expenditures, and our outlook for 2023.

Sales in the fourth quarter were $1.2 billion, an increase of 5.8% from last year, as favourable pricing and mix in the Meat Protein business were partially offset by lower volumes and lower plant protein sales. Pricing actions implemented to mitigate inflation more than offset lower volumes.

Adjusted EBITDA was $55.3 million, a decrease of $21 million from last year. This decrease was driven by market headwinds in the pork complex and in Japan, supply chain inefficiencies predominantly due to people, and the cyber incident, partly offset by price increases. The Adjusted EBITDA margin was 4.7%, a decrease of 210 basis points from last year.

Net earnings in the quarter were a loss of $41.5 million or a loss of $0.34 per basic share, compared to earnings of $1.9 million or earnings of $0.02 per basic share last year. After removing the impact of the non-cash fair value changes in biological assets and derivative contracts as well as start-up expenses and restructuring costs from both periods, adjusted earnings were a loss of $0.28 per share for the quarter compared to earnings of $0.09 a share last year.

I will now turn to a discussion of Maple Leaf's two operating segments. Sales in the Meat Protein segment increased 5.9% to $1.1 billion in the quarter. The increase was driven by pricing action implemented in prior quarters to mitigate inflation, and structural cost increases, and a favorable mix shift toward growth in Sustainable Meats, partly offset by lower volumes, including the impact of the cyber incident. Meat Protein Adjusted EBITDA was $76.1 million, compared to $120.7 million in the prior year, or a decrease of about $45 million. This decrease was driven by market headwinds, labour inefficiency, materials inflation and availability, higher feed costs, and incremental costs related to the response to the cyber incident, partially offset by pricing action. Adjusted EBITDA margin in the meat segment was 6.6%, a 450-basis point decrease from last year.

Turning to Plant Protein, sales were $40 million, a decrease of 18.2% in constant currency compared to the same quarter a year ago. The decrease was driven by lower volumes as the entire category has contracted, partially offset by pricing actions to offset inflation. Plant Protein gross margin was a negative 25.8% in the quarter as a result of low sales volumes, low-capacity utilization, and raw material inflation that was only partially offset by pricing action taken midway through the quarter.

SG&A expenses in Plant Protein were $15.8 million, a decrease of approximately $24 million from a year ago, driven primarily by lower advertising and promotional expenses as well as by lower people cost. Sequentially, SG&A decreased approximately $4.1 million from last quarter, also primarily due to lower advertising and promotional spend. Plant Protein Adjusted EBITDA came in at a loss of about $20 million, a 54% improvement or 57% in US dollars from a year ago.

In total, during the quarter, we invested $57 million in capital expenditures, and this investment included about $11 million in construction capital, primarily related to London Poultry. For the full year, our capital expenditures were $312 million lower than the expected $375 million, primarily due to a shift in timing of the spend.

On the balance sheet, net debt increased to approximately $1.6 billion. This debt primarily relates to the over one billion in construction capital we have invested in the London Poultry facility, our Bacon

Centre of Excellence, and the new Tempe facility in Indianapolis. As we close the chapter on the construction of these large and lucrative long-term investments, we look forward to using the cash flow towards other capital allocation priorities, such as optimising our debt level, investing in other growth opportunities, continuing to grow our dividend, and returning capital to shareholders.

In the fourth quarter, we continued to repurchase shares under our NCIB program. We returned approximately $31 million to shareholders through the purchase of 1.3 million shares at an average price of $24 a share. We plan to continue purchase (audio interference) program as we believe current market valuations present a substantial return opportunity for shareholders. For the full year of 2022, we repurchased shares for a total amount of $59 million.

I will wrap up with an outlook for our business for 2023. In Meat Protein, we expect mid- to high single-digit sales growth in 2023, driven by continued momentum in Sustainable Meats, brand leadership and growth into the U.S. In normalised markets, we would expect to achieve Adjusted EBITDA margin expansion in a 14% to 16% range based on the building blocks Curtis outlined earlier. In Plant Protein, we expect to achieve Adjusted EBITDA neutral or better in the latter half of 2023. Furthermore, we expect at least 50% improvement in Adjusted EBITDA losses in the first quarter of 2023 versus the same period last year, representing a sequential improvement versus the fourth quarter of 2022.

For 2023, the Company expects total capital expenditures to be less than $250 million. Up to $120 million of this will be maintenance capital with the remainder of being growth capital. This growth capital includes, among others, an increase in processed poultry capacity at our Walker Drive Brampton plant to meet a pipeline of demand that has attractive growth and margin prospects, and capacity expansion in our high-margin snack kits business.

I will now turn the call back to Michael.

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

Thank you, Curtis and Geert.

The post-pandemic economy has been an unprecedented condition for Maple Leaf Foods and anybody in the food industry. It will pass, and I believe during this period of time, Maple Leaf continues to illustrate our resiliency as we operate within these unprecedented times.

I'm extremely proud of our people. They have managed through the operations and complexities of the past few years and indeed the last quarter, highlighted by the cyber incident. We will continue to be guided by our sustainability agenda, including continuing the build out of our Sustainable Meats business that grows year after year after year, and we remain proud and focused, investing in our portfolio of market leading brands. The post-pandemic economy will pass.

With that, I'd like to open it up for questions.

Q & A

Operator

Thank you, sir.

Ladies and gentlemen, we will now begin the question-and-answer session.

Your first question today will come from Irene Nattel. Please go ahead.

Irene Nattel — Analyst, RBC Capital Markets — Analyst, RBC Capital Markets

Thanks, and good morning everyone.

Listening to the commentary certainly it sounds like Q1 is going to be another challenged quarter. How should we be thinking about the cadence of improved margins, improved profitability as we move through Calendar 2023?

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

Good morning, Irene.

That is obviously the operative question and the question that we ask ourselves continuously. To address that question, I think I'm going to turn your attention to the single most important chart I think that illustrates the conditions we are in, that was distributed this morning in our deck, and I hope you have that in front of you.

Irene Nattel — Analyst, RBC Capital Markets — Analyst, RBC Capital Markets

Yes.

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

What you see from that is the magnitude, the sheer magnitude of the disconnect between the orange line and how that has risen so rapidly, and the blue line, which is the value of the meat. I cannot, nor can anyone else in our industry, predict exactly when that is going to change or what the cadence might be. All I can tell you is what I believe to be the green shoots that historically are the drivers of that change. Things like, for example, the fact that you can examine the results of any participant in the United States or Canada in this industry, and you will see extreme outcomes. That sounds like bad news, but it's actually good news. That's one of the key drivers, paradoxically, that changes these outcomes.

Number two is typically what changes these outcomes that you see here, is more often than not contraction in supply. You're seeing that in Europe, for example, today with Eurostats estimating the European supply will contract by 7%. That's not a small number, 7% in 2023. You juxtapose that fact with the observation that Europe has been for years the single largest supplier of imported meat to China at a time when China is going to need more meat.

You look at the data points around us here domestically, and you see many examples in the news of dramatic supply constrictions. Those are the green shoots that I can observe factually, but I cannot tell you when that exactly is going to translate into a change in condition. If history is any indicator, and the history is in here very clearly over the last 10 years, when it changes, if history is an indicator, it will likely occur at lightning speed. You can see that in the 10-year history.

I don’t know if that answers your question, Irene, or is helpful but that's how we look at it.

Irene Nattel — Analyst, RBC Capital Markets

Thank you. I think we would all love if we could have a clearer trajectory but understand that's not possible right now.

Follow-up question. We keep talking about the $130 million annual lift in EBITDA from the investments in the Bacon Centre of Excellence, and in Poultry. Are those dependent or independent of market conditions? In other words, if things don’t get any better, do we still get that $130 million?

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

One hundred percent, yes. They are completely disconnected. They're not connected to this at all. The London Poultry facility is rooted in, as you know—the key drivers are cost reduction and a change in the value-add mix, business mix, that exists inside the Poultry business, completely disconnected to market conditions, per se.

The same thing is true in our Bacon Centre of Excellence, which is just a—it's a repatriation of volume, and the addition of new volume of a very highly profitable SKU in our business mix, so they're completely disconnected. They're not connected to this dynamic at all.

Irene Nattel — Analyst, RBC Capital Markets

That’s great. Thank you. I will let someone else take over from here.

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

Thanks, Irene.

Operator

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

George Doumet — Analyst, Scotiabank

Yes, good morning.

Can you give us a little bit of a flavour on the mid- to high-single-digit revenue growth that you guys expect from Meat? How much of that is going to be pricing this year? Do you expect any material contraction to our hog volumes as a result of what’s going on?

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

Good morning, George, it’s Curtis. Thank you for your question.

I'll start with the mid- to high-single-digit growth in the year and then come back to the hog question that you had.

I'll maybe point you as a starting point to the fourth quarter as a bit of an indicator for next year. Overall, our sales grew in the fourth quarter, as you saw, at 5.9%, and that was predominantly driven by pricing. Our pricing was actually up 7% in the fourth quarter on a year-over-year basis. I think what an important point is, that I don’t want to get lost in this, is that our volumes were down at 2.7% in that environment. When you think about the strength of our brands and our product portfolio holding up to pricing, we have continued to comment that our branded and consumer packaged goods portfolio has been quite resilient and that's certainly been the case.

I do expect that pricing will lead our growth into next year as well, to answer your question. We've initiated as we said in our in our commentary here to start the morning price increases in both our Prepared Meats business and our Poultry business. Prepared Meats is effective in May and Poultry is effective in April. Those are in the 3.5% to 4% range for both Prepared Meats and Poultry. You can expect to see that materialize in pricing throughout the year, which will drive a portion of our meat sales increases.

Then of course, we do continue to see growth in the U.S. market as we've experienced over the last number of years, as well as in Sustainable Meats, which continues to be a key differentiator for us and is driving growth in our portfolio. Those would be the key areas.

On the production side, your question was around hog production quantities being reduced within our operations. At this stage, we don’t see that being any material impact or risk to our business at all in 2023.

George Doumet — Analyst, Scotiabank

Okay. Thanks.

Then just more generally, how is the ramp ongoing in London from a hiring perspective, and should we think of that as being the biggest variable that could impact the EBITDA margin ramp there or are there other factors to perhaps contemplate?

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

George, I didn’t understand your question. Please, could you repeat that?

George Doumet — Analyst, Scotiabank

Yes, sure.

I am just wondering how the ramp-up at London is going from a hiring perspective? Is that the thing we should be looking at the most in terms of getting that EBITDA margin ramped throughout the year?

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

The good news here, George, is that coming into Q1, as we speak, we would consider ourselves at normalized employment levels, hiring levels, which gives us some confidence that the improvements in the key drivers of our supply chain stability is currently and will continue to unfold over the course of the next few months. We're now at what I would say is pretty much normal hiring levels today.

Does that answer your question?

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

I’ll maybe add some colour, George—it's Curtis—if I may.

To add to your second component of your question around London, the people ramp-up in London is going extremely well. We had a discussion with our leadership team last night and we are now in a situation where salaried and hourly combined, we're somewhere around 1,000 people in that facility, and when you think about end state, it’s 1,600. This is a facility that started production on November 28, and we now have 1,000 people working inside of that building, which is a really remarkable feat. I won’t say it’s been easy, but we have been very successful in on-boarding the people that we need within the facility.

At this stage, we don’t expect any material issues, but of course, that can change over time. The headline is the early view on ramping-up people in London has been incredibly successful and things are going really, really well within the plant to start. I think you asked is that the only thing that can go wrong. Of course, there are other startup barriers that we might face over the coming months, which is why we’ve continuously been consistent in our communication that you should expect us to be on a run rate by the end of the year to deliver our $100 million in annualized benefits.

Those can come in how the equipment operates and in transitioning from other facilities and all that good stuff, but at this stage, everything is right on-track and we're really, really pleased with the early news at London.

George Doumet — Analyst, Scotiabank

Okay. Thanks. I’ll get back in the queue.

Operator

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

Peter Sklar — Analyst, BMO Capital Markets

Good morning.

First on the $23 million of cyber costs that you estimate that you incurred in Q4, is there any leakage in Q1, or should we think of all those costs going away?

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

Good morning, Peter. This is Geert.

The $23 million is really a combination of incremental costs that we incurred in the quarter, and those would go away. The second part is what I would call more the knock-on effects of lost sales volumes, lost margin, etc. Obviously, that was highly concentrated in Q4, so I do not expect any of those direct costs in that magnitude to continue in Q1.

What you have, Michael, and Curtis referred to, is the knock-on effect that we incurred in Q4, which was the I would say pushing out the momentum that we had in resolving some of the supply chain inefficiencies of 2023 as a result of the entire team shifting focus to fixing the cyber security event. We will see that normalize by the end of the second quarter this year.

I would say direct costs, no. The knock-on effect of a delay in recovering those supply chain inefficiencies that we had in 2023, yes, that will linger on a little bit, but you will see that abate as we continue this year.

Peter Sklar — Analyst, BMO Capital Markets

Okay. Got it.

The other question I had is, you’re adjusting for the start-up costs I guess related to London. That amount was, I believe, $26 million in the quarter. From an accounting perspective in your presentation, when are you going to stop adjusting?

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

We will stop adjusting for the start-up expenses when the start-up is declared done, and that means at the end of the ramp-up period, Peter. We expect that to be by the end of this year, early next year, but everything is going according to plan so I would expect that we would not be talking about that anymore come 2024.

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

Peter, it's Michael.

The key drivers, to just add a little colour there, that are really important to have insight to are—the four big buckets would be duplicate of overheads because we're now running overheads in a duplicate supply chain.

Number two is, Curtis referred to a thousand people in on site. That's good news. We actually, for the amount of production in that facility, don’t need a thousand people today because we're not operating it fully, but there's a training period that goes with them, and we over hire as part of the start-up.

Number three is in manufacturing terms the OEE (phon) or the efficiencies of the lines clearly are not at design level, and they never are in the early stages as you debug equipment, and there are variances is attached to that.

Finally, the yields obviously in the early stages while people are in training mode, etc., are not at the designed levels. All of those things go into that bucket, and as Geert it says, by the time the last facility's closed and the start-up’s declared done, we would expect those to be on or above our business case.

Peter Sklar — Analyst, BMO Capital Markets

Okay.

Then my last question, Michael, is the chart you keep referring to in the slide deck on Page 11 where you're showing the negative spread between the cost of the hog and the cut-out. It's really hard to see on the chart, but based on what you’re seeing in Q1, because you’ve experienced two thirds of the quarter at this point, is that spread going to be worse in Q1 than it was in Q4? It’s hard to see from the chart.

Michael McCain—Chief Executive Officer, Maple Leaf Food Inc.

We're partially through the quarter, but it's continuing into the first quarter.

Peter Sklar — Analyst, BMO Capital Markets

Okay, but at a worse level or improving or what's—how is—overall?

Michael McCain— Chief Executive Officer, Maple Leaf Food Inc.

I don't want to make a prediction on that, Peter, because the quarter's not done. I just don't want to make a prediction in that regard.

Peter Sklar — Analyst, BMO Capital Markets

Okay. Got it. Thank you.

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

Clearly, it's continuing.

Peter Sklar — Analyst, BMO Capital Markets

Okay. Thanks for all your comments.

Operator

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

Derek Dley — Analyst, Canaccord Genuity

Yes, thanks.

Geert, maybe one for you, just on the cyber security impact, the $23 million you guys called out. In the presentation, I believe it says you're considering, you expect to get a reversal on that later in 2023.

Why isn’t that adjusted out of the EBITDA numbers if you're expecting to get it back? Are you expecting to get all of it back at some quarter in 2023? Will you disclose that when you get it back?

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

Thank you for that question, Derek.

It is true that we have cyber security or cyber insurance in place. We are working through that file now. We expect to get some recovery, not all, some recovery somewhere in 2023 as we work our way through the discussions with the insurance company.

We could not recognize that yet because that is not what we’re supposed to do. You saw all the players in the market having gone through a similar incident make that same comment. We will recognize that when everything is signed, sealed, and delivered with the insurance company, but we're very confident that we will get some of that back.

Derek Dley — Analyst, Canaccord Genuity

Okay. Again, will you disclose when you do, because it's obviously going to add to the EBITDA in that quarter?

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

Yes, we will. We will.

Derek Dley — Analyst, Canaccord Genuity

Okay. Good.

Just as it relates to the pricing commentary, last call, you guys sounded very confident that you had pricing in place to offset what at that point was I believe a 90-basis point impact on the margins in Q3. I’m just curious, what happened within—it sounds like namely within the Poultry business that led to you not being able to implement those price increases or implement enough of a price increase to offset the incremental cost?

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

Yes, that's a great question, Derek and a good one, and a very appropriate one.

In the fourth quarter we had all of our Prepared Meats pricing in place and we fully expected our Poultry pricing was in-line as well, but it was grounded on assumptions of live poultry pricing, and the assumptions were wrong. The market went in the opposite direction. It went up when we expected it to seasonally and from a futures market perspective go down, and it didn’t, it went up. We experienced that in the latter of half of the quarter, and it wasn’t what we expected. It was not mainly Poultry, it was all Poultry. Obviously was the genesis of taking pricing action to offset that, as Curtis alluded to for April.

Curtis, is there any additional colour on that?

Curtis Frank — President and Chief Operating Officer, Maple Leaf Foods Inc

Yes, maybe just a little bit more colour, Derek.

We last took pricing in August and September last year. In Prepared Meats, it was in and around 4.5%, and in Poultry was in and around 2%. That gives you some grounding for what Michael’s talking about. We thought that that 2% in poultry was adequate because we expected some of our costs to come off, and obviously, we got that wrong, bluntly. We've taken the appropriate steps to adjust that and reflect it coming up here in the spring.

Prepared Meats for the fourth quarter, it turned out that we got it right, and we know we're going to need a little bit more in 2023 to cover for the 2023 inflation that's coming. Again, we feel like we're in the right place, but we'll see how things play out in the spring.

At this point, from my point of view, there's no reason to believe that we won’t be caught up to inflation in the second quarter, based on what we know today.

Derek Dley — Analyst, Canaccord Genuity

Is there a structural reason? Is it annual pricing typically why you can’t increase the pricing in Poultry until April?

Curtis Frank — President and Chief Operating Officer, Maple Leaf Foods Inc

No, it's just mostly timed with the cost of live, regulated price changes in poultry. We try to time that to grower period, number one. Number two, as we talked about before, the retail environment is such that we can’t take pricing until we feel inflation.

There's typically, depending on the type of pricing action that is taken a 6- to 12-week lag in the time we feel the inflation between the time we can pass on the inflation in the retail environment. It’s just simply that lag time, Derek, in feeling the inflation to passing it on. We moved it as quickly as we possibly could including through a seasonal timeframe at the holiday season.

Derek Dley — Analyst, Canaccord Genuity

Okay. Got it. Thank you very much.

Operator

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

Mark Petrie — Analyst, CIBC

Yes, good morning.

I wanted to ask about the brand performance, particularly in this environment where trade down is so prevalent. Obviously, the brands are performing well but you did change your language a little bit in terms of what you're seeing with regard to trade down. Just hoping you can expand on that. Is that broad-based across brands and categories? Or anything specific you can call out?

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

Good morning.

I don’t think we changed our language with respect to performance. If we did, it wasn’t entirely intentional, so I'll maybe just start with that. What we are seeing on the brand side, or particularly within our Prepared Meats business, is strong sales growth, mixed favourability, we’re seeing U.S. growth, we’re growing Sustainable Meats and Prepared Meats double-digit, and the brands are healthy. The way I describe health is our volumetric performance relative to what we expect, following price increases.

I said earlier in our total portfolio, our sales were up 7%, our volume was down 2.7% overall. We don’t carve out the Prepared Meats numbers specifically, but they're relatively close to in-line with that same type of performance, so we’ve been pleased.

The other thing I would point to from a brand health point of view is what you see in the market share performance data. There has been some trade down in our categories, to be blunt, but it's mostly come from competitive brands to private label, not from our brands to private label. That's something we’ve been—I think that speaks to the health of our brands overall.

Our share performance has been mixed and that's not uncommon following price increases. We have got categories where our market share has increased, places like wieners and ham and lunch kits, and our Poultry business has gained more than 0.5 of a share point in the fourth quarter. Then we have some more price sensitive categories, like say canned meats would be an example maybe, where we've given up a little bit of market share in the short-term just given the price sensitivity in the quarter.

Overall, we continue to be pleased with our share performance. The volume declines are in-line with our expectations, given the inflationary environment we’re in, and any trade down we’re seeing to this point has predominantly come from our competitors in brands, not so much our brands.

The last thing I would say maybe is, teasing apart that data particularly in the fourth quarter is really difficult because you're dealing with the cyber impact, you're dealing with service level implications that ultimately affect the volume and market share, and then of course, there's price inflation in the marketplace.

There's a number of factors, but overall, we feel really comfortable. I don’t think we've materially changed our position, from my perspective.

Michael McCain — Chief Executive Officer, Maple Leaf Food Inc.

The other colour to that, Mark, that I would add—it’s Michael—when you, and the qualification here is that these comparisons can be challenging, but it is something to take a look at. For the most part, we're dramatically outperforming what the leading brands in the United States are accomplishing in terms of year-over-year volume impacts, as a result of the pricing that they’re taking. I think again that speaks to the resilience of our brands and our brand effort.

Mark Petrie — Analyst, CIBC

Yes. Thanks. Those are helpful comments. Thank you, guys.

Two more. One, just on Sustainable Meats, the growth continues. How much of the growth today, or I guess maybe in 2022, was your capacity and the number of doors that you're selling your core portfolio into versus the consumer accepting a broader range of products in the sustainable sort of subcategory?

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

Yes. There's a number of contributing factors to the growth that we are seeing in Sustainable Meats. Pricing obviously plays a role. We are gaining distribution, particularly in the United States, and we're also adding new items that are being well accepted by the consumer. We have now, I think last quarter, we claimed within the Sustainable Meat segment in the United States, we had the number one selling SKU, which was antibiotic-free bacon in our Greenfield brand.

We now have three number one selling items maybe as a point to support our perspective on growth, which includes our lunch kits portfolio and smoked ham as well. Between smoked ham, lunch kits, and bacon, we have three of the number one selling SKUs in the Sustainable Meats or Raised Without Antibiotics segment in the United States.

It's a combination of all of those things: our price-led growth, volumetric growth tied mostly to distribution and new retailer acceptance in terms of distribution, adding new products, and the velocity expansion that comes with that.

Mark Petrie — Analyst, CIBC

Okay. Thanks.

Last one, just any comment you can share with regards to the expectations for the impact of the China reopening? It was a material revenue business and attractive margins at one point, but how has the dynamics changed? How should we be thinking about that? Thanks.

Michael McCain — Chief Executive Officer, Maple Leaf Food Inc.

I would draw two conclusions, Mark. Number one, obviously, being back in China is accretive to our earnings. I know you would like to know how much it's accretive, but we resist itemizing individual country or segment or customer profitability, so we'll avoid that, but it is decently accretive.

I think the overarching observation is that Maple Leaf and other Canadian processors expanding their listings into China I think is indicative of the macro situation that is going on in the pork global markets where their demand is increasing at a time when European supply is declining.

Mark Petrie — Analyst, CIBC

Yes. Understood. Okay. I appreciate all the comments, guys. All the best.

Operator

Your next question will come from Michael Van Aelst. Please go ahead.

Michael Van Aelst — Analyst, TD Securities

Thank you.

Just following on that commentary around China demand increasing as supply is decreasing in Europe, is that also starting to show some benefits in Japan?

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

I think it's too early to connect those dots, but inevitably, the macro environment would suggest, not predict, but it would suggest that would be true. I would say our situation in Japan is showing signs of improvement. Whether you can connect those dots or not, Michael, it's hard to make a direct causal relationship, but the situation in Japan is improving and this is occurring, so I would say that's true.

Michael Van Aelst — Analyst, TD Securities

Okay.

On the Poultry margins or part Poultry pricing, I guess, you said that the hit to margins came later in the latter part of Q4. Are we to assume that the Poultry margin hit is going to be greater in Q1 than it was in Q4?

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

No. I would not arrive at that conclusion. The impact didn't come so much later in Q4. I would more describe it as the percentage increase that we took that we expected to cover the inflation we would experience in the fourth quarter didn't materialize the way we expected. You saw the impact of that. We won't get it again in the first quarter, but we will in the second quarter. I would not expect it to get worse. I don't think that would be an appropriate (inaudible).

Michael Van Aelst — Analyst, TD Securities

Okay. Historically, when you've taken a bigger price increase, like 7%, what kind of volume reaction is there usually initially, bar all other things holding constant, let's call it?

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

Historically, Michael, there are so many influences. Historically, in the initial response to a price increase, if we see trade downs in the small single-digits on a temporary basis, that would be probably indicative of the norm. A good outcome would be no impact, a normal outcome would be small volumetric declines immediately after a price increase while the competitive set catches up, assuming they do.

Michael Van Aelst — Analyst, TD Securities

Okay.

On the plant-based side, I'm not sure if you said this earlier, I missed the start of the call, but are there any signs that the volume erosion is nearing an end? Are there any pockets of strength, and are you seeing the weaknesses stabilize?

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

The way I would characterize this growth situation in Plant Protein is maybe from a couple of dimensions. Number one, the category to your point does continue to decline. It's most certainly facing headwinds. Much of the demand in the burger game has moved from refrigerated to frozen. That would be a burger comment, has moved from refrigerated to frozen.

In the refrigerated category, which is predominantly where we participate, if you remember, we have a broad range of assortment in the refrigerated category, we're actually gaining share in that part of the category. If you looked at our POS sales, you would see we're down somewhere in and around like 9%, the category is down about 18%. So we're basically picking up almost 2 share points in refrigerated Plant Protein.

That doesn’t mean—in a category that is declining, which is cold comfort, I understand. I think what's important is at this stage, we've right sized our organizational design and added promo investments to reflect the current size of the business. If we continue to see declines, we will have to take further steps to ensure that we're on-track, and we’re prepared to do that.

I, for one, just given the consumer sentiment here, I feel, and we've continued, given the research we've done, feel confident that the category will at some stage return to moderating growth. We've said over a long-term horizon, that would be likely in the 10% to 12% range, which is what the category was growing at well before the COVID situation. At this stage, we continue to see declines, we've right sized the business to reflect that. If we need to make further moves, we will. At the same time, we do expect that there'll be some growth return to the category in the future.

Answering the when question is a bit elusive at this stage, but the sentiment from the consumer continues to be that there's interest in this category should their needs to be met.

Michael Van Aelst — Analyst, TD Securities

Okay. Your OpEx or SG&A for Plant Based was actually a bit better than what I expected, so I was just wondering if you had cut it more than you had originally planned because you were originally planning to right-size it to a revenue base of I think US$150 million, if I remember correctly, and it doesn’t seem like you're going to be at that level this year. Are you cutting SG&A more than originally expected at this point?

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

No, not materially. We're right around where we expect it to be.

Michael Van Aelst — Analyst, TD Securities

All right. Thank you.

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

Thank you. I think that concludes our call.

With that, we will look forward to updating you as the progress that we make unfolds into the next quarter. We'll look forward to speaking with you after our AGM in May.

Thank you and have a wonderful, wonderful week.

Operator

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