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Alliance Grain Traders
Q4 & Year End 2010 Conference Call Transcript

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Speakers:

Murad Al-Katib
President and CEO

Gaetan Bourassa
Chief Operating Officer

Lori Ireland
Chief Financial Officer

Omer Al-Katib
Director Corporate Affairs and Investor Relations

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OPERATOR:
At this time, I would like to turn the conference over to Omer Al-Katib, Director Corporate Affairs and Investor Relations. Please go ahead, Mr. Al-Katib.

OMER AL-KATIB:
Thank you.

Good morning and thank you for joining us and welcome to our Fourth Quarter Conference Call.

On the line with us today, we have Murad Al-Katib, President and CEO of Alliance Grain Traders, Lori Ireland, our Chief Financial Officer and Gaetan Bourassa, our Chief Operating Officer.

Before we get started, I would like to remind everyone that today's call may include forward-looking statements. Such forward-looking statements are given as of the date of this call and involve certain risks and uncertainties. A number of factors and assumptions were applied in the formulation of such statements and actual results could differ materially.

This call may also include references to certain non-GAAP financial measures.

For additional information, with respect to forward-looking statements, factors and assumptions, as well as reconciliation to GAAP measures, we direct you to our news release and our recent filings on SEDAR.

I'll now turn things over to Murad for some comments and then we'll go to questions.

MURAD AL-KATIB:
Thank you, Omer, and good morning, everyone.

2010 was a difficult year in the global agribusiness sector, as sustained adverse weather events, spanning virtually every agricultural producing origin around the globe seemed to be affecting crops at every turn. Months of wet conditions from seeding straight through to harvest in Canada and the US, floods in Australia, drought conditions in Ukraine and Russia and an early 2011 unseasonably coldconditions in India.

While these types of issues are a normal part of the agribusiness sector, a back-to-back convergence of these issues can dramatically affect how the sector performs.

In the case of AGT, the sustained adverse global weather event affected us in every origin we operate in. it we compounded the timing issues we saw through the year that ultimately affected our ability to procure product and drive sales.

The wet conditions in North America, through the entire season, resulted in farmers being unable to deliver carry-over stocks to our facilities for processing and export.

The late, wet harvest in North America, completed about six weeks later than normal, resulted in limited quantities of product being delivered as farmers who were trying to complete harvest while the weather was cooperating and avoid the potential for all their crops being affected.

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The result was product delivered late, with a wide quality variance. We also saw similar results in all -- in other origins. A positive growing season in Australia was affected by wet conditions during harvest, resulting in quality downgrades in that market as well.

Ultimately, the conditions in 2010 could be described in many ways. But they were not close to normal.

As a result, in our fourth quarter and year-end results for 2010, we reported sales of $642.1 million compared to $388 million last year. Adjusted EBITDA was $37.2 million, down from $45.5 million in 2009.

Our year-end and fourth quarter 2010 results are available on SEDAR or from our website at www.alliancegrain.com.

Certainly we are disappointed with these results. We have prided ourselves as a growing company and we continue to view ourselves in that light. We believe that these issues are related to supply disruption caused by the adverse weather issues and not due to fundamental changes in demand.

We are not deterred from the developments in 2010. Ultimately, we have a solid business plan and we will stick to our strategy.

Current conditions in the market all reinforce our belief of stronger demand in 2011 for the pillar pulses and staple foods that AGT produces and offers. We expect these issues to resolve themselves going forward in fiscal 2011 by continuing to focus our efforts on staple food products and responding to strong market opportunities for the products we process.

We expect to continue to grow our core lines of business, utilize our assets in a manner that capitalizes on opportunities, while continuing to create value for our shareholders.

Our path forward is defined by our commitment to build a business around pulses, staple foods and branded products. That strategy is unparalleled in the market.

Globally, the drivers for our business are very simple; product mix, volumes and margins.

Volume is important because of the high fixed cost nature of our business. The more pulses and grains that are processed efficiently through our plants globally, the lower the cost of production per tonne and the more profitable finished products shipments can be.

We have demonstrated in our past the ability to deliver above average conversion efficiencies when we convert pulses into finished products, to gain efficiency through blending, color sorting and sizing the products that we offer to maximize the revenue per hour of processing.

Our efforts are always trying to improve on these marks of the past.

Certainly there are many factors that influence the timing and amount of shipments in a given year. Some of them include producers and buyer's expectation of commodity quality and prices, the timing and quality of crop harvest at all origins, export demand, foreign exchange rates, ocean container or rail car availability.

These are only some of the factors. It takes experience, expertise, to manage through difficult times in this sector. And I will say I feel that our executives and regional managers are the best in our industry.

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This strength, coupled with our extensive and geographically dispersed network of facilities positions our company to capture a significant share of the market for our core pulses and staple food products going forward.

The geographic diversity of our facilities also assists us in reducing our revenue risks from localized production variances. The ability to source pulses in most major origins of the world and our state-of-the-art value-added processing plant is a competitive advantage for AGT.

There is no doubt that this company continues to be Canada-concentrated. And with continued focus on investments in the United States, Australia, Turkey, India, China and other origins of production, we will reduce this reliance and realize the benefits of geographic diversity of our facilities.

In addition to the internal strengths, every day we are engaged in sales and promotion strategies spanning eighty countries around the globe with clients, agents, warehouses and distribution points in many pulse consuming regions of the world.

We are able to capitalize on pricing relationships that exist between commodities across different locations and times.

Through our multi-origin strategy, with multiple shipping points, common production qualities for product in different countries, and with a coordinated global sales strategy, with access to both supply and demand information, we expect to profit from the inconsistencies that arise in the pricing and cost margin relationships by arbitraging and building international sales strategies to capture margin from each of the origination regions, directly to consumption regions.

At the core of our entire program is a strict set of standardized risk controls to manage and monitor our exposure to various risks. These are monitored daily and appropriate actions are taken to mitigate or minimize some of the risks to which we are exposed.

When we talk about our business, we really distill things down to the following strategic points.

First is the depth of our distribution globally. The ability to move products in positive market conditions is not unique to us. We have the markets in our h ands, the market reach to move products of all grades in difficult conditions even the products with high-quality variances. And we saw this here in Canada and Australia that is our core strength. This is reflected in the geographic diversification of our assets as well.

Issues in one region can be substantially offset by conditions at another, having the effect of spreading our risks through multiple origins.

This certainty -- certainly has an impact on our efforts to smooth revenues and profitability in the future. This is a cornerstone of our strategy going forward.

I have spoken about the great strength of my management team. Successful agricultural processing companies have the expertise in technologies to deal with the challenges and opportunities presented by the weather and quality variations that happen year-to-year. We feel we have the country and regional management complementing our senior management team to handle growth and expansion, regardless of the crop quality and the market conditions.

An additional component of our management strength is the ability to identify how to solidify our destination markets through expansions and potential acquisitions. As well, increased risk management programs like prepositioning products into markets, we feel, will have steady, stable and liquid demand -

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- we will preposition products into markets that we feel have steady, stable and liquid demand, creating an opportunity for us.

We cannot depend on others in these markets to create the opportunities. We cannot rely on the liquidity importers and the economic conditions postponing consumption and import decisions.

In the future, we will continue down the path to do it ourselves to bring products into liquid consumption markets and to assist in distribution, creating margin and value for our shareholders.

With origination and processing capabilities that we have in place, incremental increases to our global processing capacity will assist us in smoothing supply and shifts new crop availability throughout the year.

This is a key component of our efforts to focus on products that have less seasonal consumption patterns, such as beans and chickpeas in the pulses platform, but also pasta, rice and niche products, such as our king red lentil, queen green lentil and the B-90 chickpea for the hummus markets.

If you look at our segmented reporting and our disclosures, you will see the reliance on our pulses platform has reduced from 93% in 2009 to 75% in 2010.

This is a positive move to diversify revenues and the profits of our company.

These efforts will also be very critical to drive the capacity utilization, opening new market opportunities for our company. Taken together, our focus is on markets, distribution and risk management and our strong management team is expected to allow us to continue our leadership position in the processing and supply of pulses and staple foods and end-use markets around the globe.

Our access to competitive financing for working capital and our long-term debt access for future acquisitions is a key competitive advantage for AGT.

As well, we continue to focus on our core strategy of building multi-origin origination, processing and distribution.

Make no mistake, our eye continues to be on expansion, acquisitions in the US, India, China, Australia and southern Africa. Ultimately, our company continues to believe in the strategy we have in place. We are undeterred.

The short-term supply issues are a reality in the agribusiness sector from time to time.

We feel our company has the key components to move past this difficult season. And we feel that our strength mitigated the effects of the year past.

Our facilities are well positioned. Our management team is experienced. And we are ready to attack the challenges going forward.

Global distribution is AGT's key strength. We are present in all corners of the globe that consume our products. This is a key to our ongoing and future growth. I want to thank everyone for joining us.

I'm going to call on Gaetan Bourassa, our COO, for those of you who are familiar, Gaetan runs our global marketing and trading and operations programs around the globe. I'm going to call on him for just a few comments on some of the markets.

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Gaetan?

GAETAN BOURASSA:
Thanks, Murad.

I'll start off with a quick summary of our origins and operations. In Canada, this season, heavier rains in the spring delayed seeding, which was followed by six weeks of intermittent rain over the normal pulse harvest period, which, for example, contributed to 35-plus percent less lentil exports than the 2009 harvest to December period.

With these conditions, quality was greatly affected across all commodities. For AGT, most notably, lentils and chickpeas had only 25% grading in the top two grades.

Selling of off-grade products provided -- proved difficult until all end-use markets had a good understanding of the overall quality available.

This greatly affected velocity at the factory level as well as the merchandising department. Capacity at the processing level, for example, is slowed by finding the proper grades to meet customer expectations, then later trying to educate the end-use markets on what was available and what they could expect for milling efficiencies, etcetera.

Until the new crop this fall, there are good stocks of product available on farm to process and upgrade.

In the US, the crop was harvested earlier and avoided most of the problems Canada encountered. Our US operations are running at near capacity and are poised for future growth in 2011 and '12. Looking forward, we are continuing to look further down the value chain at ingredient, market and distribution channels.

In Turkey, the lentil crop was of good size at 500,000 plus metric tons this past May, June. However, deliveries did not come as normally expected.

With this, our Turkish operations were under pressure to meet early shipment commitments. In the pasta segment, Arbella continues its diversification of its market strategy with growth targets set based on export market success.

Additional semolina and pasta processing capacity is set to come online in early 2011.

Rice milling activities are set to grow with the commissioning of AGT's new rice mill in northern Turkey, which will commence operations by June of this season.

Production levels are estimated to remain flat in 2010 -- or flat to 2010, rather.

In Australia, rain did affect harvest somewhat in Victoria in South Australia. However, not to the extent that Canada received.

Overall pulse quality is more marketable and our new operations are ramping up as expected in South Australia.

In Victoria, the milling operations are configured to deal with the offgrade product deliveries.

Poortmans, which is our UK, Dutch and Spanish merchandising and distribution offices are integrating as expected.

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Our entry into China is ongoing with a small pulse facility established and plans for growth and expansion.

Touching quickly on a few other market conditions. Media has reported continued political unrest and increasing food inflation in the Middle East and northern Africa, which are viewed as an opportunity to supply essential pulse crops to the region.

Governments of affected regions are working to calm unrest by increasing local supplies of staple foods.

We expect to see government tendering and UN programs to supply food to this region through 2011.

The reports of cooler weather and lower yield in India should translate into higher import levels of pulses to India. This should be clear by the end of April.

India is an important buyer of variable quality product, especially important for the Canadian lentil crop still sitting on farm. India's lentil harvest was later than usual. The first harvest is just taking place and earlier reports are that seed size could be slightly smaller than usual.

Delivery should start reaching the milling centers next week. We look forward to this news.

In closing, our view is that the 2011 outlook for AGT is only temporarily affected by the weather event and related timing issues, have subjected AGT to an inherent risk of the agricultural business. Volume risk.

We continue to believe that the key components to long-term value creation in our business are intact. We will continue down the path of building a truly global and profitable origination, focused on processing and distribution for staple foods, lentils, chickpeas, beans, faba beans, pasta, medium grain rice, bulgur and semolina.

Thank you.

MURAD AL-KATIB:
I think we'll pass it on to you, Omer?

OMER AL-KATIB:
Yes.

That -- we'll go to the Operator to start the Q&A session.

OPERATOR:
Thank you, sir.

We will now begin the question and answer session.
The first question is from Robert Winslow of Wellington West Capital Markets. Please go ahead, sir.

MURAD AL-KATIB:
Yes, Mr. Winslow. Go ahead, please.

ROBERT WINSLOW:
Yes.

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I'm just trying to reconcile the slightly better than expected top line, $165 million revenue, with the lower margin.

So it sounded like there was a volume issue, that was well telegraphed and you weren't able to get a lot of volume across the equipment because of late harvest, etcetera.

But -- and prices were down for the commodities, generally speaking. So I am trying to reconcile why the higher revenue and the lower margin?

MURAD AL-KATIB:
Robert, there's a couple of factors in there.

One is commodity prices in Turkey escalated dramatically. So when you look at the markets here, we had off-grade product, prices were coming down while prices in Turkey were actually going up dramatically.

And when you look at even the price of wheat and the price of our semolina and pasta, we had dramatic increases over -- quarter-over-quarter.

Wheat prices in Turkey were up over 50% in the past number of months. So you end up with a top line largely due to some price escalation, some of our core commodities.

ROBERT WINSLOW:
Okay.

MURAD AL-KATIB:
One of the reasons, obviously, that margins are -- were very strained in quarter four was as a result of the fact that as we have discussed before, we have new crop contracting programs. We contract about 10% of our annual requirements. And those contracts in the pulses sector are done largely with a -- what we call an Act of God clause.

And an Act of God clause is basically in the production contract with the farmer, it's a -- like a force majeure clause, whereby if there is a demonstrated act of God with the weather, so that would be excessive rains, drought, frost, floods, hail, those are the kind of natural disasters that would basically discharge the grower from their contractual responsibility.

And this is a standard clause in the production contracts of ourselves and other competitors.

We have sales commitments. As you know, Alliance has built a reputation as a reliable supplier. If the market is up $500 a tonne, we should shift. If the market is down $500 a tonne, we expect our buyers to perform and we hold them to a very high standard.

As a result, with an act of God that affected our results, we had to walk into the spot markets, we had to cover products, number one and number two grades. And we had to pay significantly higher prices than contracted prices to deliver our sales commitments.

Do I have any regret from that? Absolutely not, because we built an incredible amount of confidence in our distribution network around the world. Because we were one of the few companies in the sector that was able to deliver the quality contracted throughout that season.

So it has a temporary effect on earnings, but again, it's an inherent risk in this business. So that's -- I think that should answer your question, Robert.

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ROBERT WINSLOW:
Yes.

So the growers have the force majeure, but you don't, it sounds like. You don't have the ability to get out of those contracts.

MURAD AL-KATIB:
No, Robert. The way that we contract product is that we are -- we do a number of things to protect ourselves.

We contract, on average, no more than 33% of expected production. We bind the grower on the balance of their production to us, contractually, on an unfixed price basis. And for that binding of the balance of their production, unfixed on the price, we grant them an act of God.

ROBERT WINSLOW:
Yes.

MURAD AL-KATIB:
So there's a trade-off in the contracting program. They receive that. We receive a security of supply by buying the balance of their production.

If we look back at the last decade that I've been in this business, we have not had a year, except 2010, whereby the act of God clause left us in a position, exposed to that short supply.

So it's a very effective system and only disrupted when you have -- Robert, you've been an ag analyst for a number of years. People call this a weather event of the last five decades.

A weather event in agriculture usually has a defined start and stop. You have a hail event. You have a frost event. You assess the damage and you move on from that.

We had a five-month weather event that did not stop. So this is a very unprecedented type of condition.

ROBERT WINSLOW:
Yes.

MURAD AL-KATIB:
And as a result of that, one of the things that I think I really need to communicate is the strength of AGT allows us to deliver $7 million EBITDA in one of the most challenging conditions that we could expect in the business. It doesn't get a lot worse than this.

ROBERT WINSLOW:
Got you. Thank you very much.

OPERATOR:

The next question is from Christine Healy of Scotia Capital. Please go ahead.

CHRISTINE HEALY:
Hi guys.

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MURAD AL-KATIB:
Hi, Ms. Healy. Go ahead, please.

CHRISTINE HEALY:
I just wanted to start off with India. So I know you guys are recently there and it sounds like from Gaetan's commentary that you guys do believe that the frost and cold weather did damage the crops.

So I guess, first question is, what do you expect the crop size to be relative to the last year? Because I know last year's crop was short. Do you expect it to be larger or smaller than the last year?

And the second point is has India stepped in as a lentil buyer already in 2011? And if so, what month were they buying? And was it meaningful quantities?

MURAD AL-KATIB:
Well, actually, there's a couple of things I guess I wanted to say.

One thing is, let's be careful on one thing. Damage, we don't know. Yield, we certainly think there's an effect. Okay?

So I guess if you're using damage, Christine, to be synonymous with yield loss, we would agree. We think that -- I mean, the weather in January in regions of India reached minus six degrees Celsius, in areas where they have not seen a minus temperature in the last five decades. And so from that perspective, when you're looking at a critical stage of flowering to podding, you will certainly have a yield effect when it comes down to finishing the crop.

Has India been buying? Yes.

Has India been buying meaningful quantities? For the period of the year, yes. Because they don't buy in January, February, March. They weren't buying.

CHRISTINE HEALY:
When were they buying a lot?

MURAD AL-KATIB:
A lot. That's a signal that there is certainly -- there is a very -- there is certainly potential for strife in their supply and if you look at the import statistics, India was unusually absent in the fall shipping period this year.

So unusually absent in their traditional period, buying in the non-traditional period, signals to us opportunity.

CHRISTINE HEALY:
So are they buying in March and April? Are those the months that they're buying in?

MURAD AL-KATIB:
They're buying in Jan, February, March and there's shipments going for April, May as well.

CHRISTINE HEALY:
So right in the middle of their harvest, they're actually buying? Okay.

That's interesting.

MURAD AL-KATIB:
I mean, you know, Christine, like I said, when you talk about meaningful quantities, to me any buying in this period is a meaningful quantity because it's a market signal that we're taking.

CHRISTINE HEALY:
Oh, I know. They never buy in April.

Are they buying from Canada or Australia?

Why country are they buying from?

MURAD AL-KATIB:
Both.

CHRISTINE HEALY:
Both. Okay.

MURAD AL-KATIB:
Both.

CHRISTINE HEALY:
Okay. That's good news.

Okay.

Now moving to Turkey, I know the way most of us think is that large crops in all of your regions are good for you. But when I look at your strong quarters, you had about a year ago, you were shipping a lot of lentils to Turkey from your Canadian plants.

And because there was tight supply in Turkey, your margins got a big boost.

So first of all, I just wanted to -- is that an accurate way of looking at it? That you actually benefit from having lower crops in Turkey?

And the second point is, I noticed that probably a lot of people read that and it's saying that the Turkish crop is big, but when I see the local reports in Turkey, they're saying that extreme dry weather is going to result in a smaller crop there.

So can you talk about that?

MURAD AL-KATIB:
Yes, I would -- okay. Let's split into two parts the question.

Part one, the strategy in Turkey simply defined is to utilize a large asset base directly at the port location for import, storage, processing and distribution, to balance the local production buying that we do.

If a company like Arbel, with our capacity and size, is wholly reliant on the deliveries from the local market, we will have margin pressure.

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Because one thing to understand about the Turkish market that's different than Canada, US or Australia is it is a physical goods market. Goods physically arrive into the port city of Mersin on a daily basis and from that perspective, buyers buy products and if buyers don't buy it, the trucks go back out to the villages and they come back the next day.

We like to have Canadian and Australian product in our warehouses and silos on every given day, 365 days a year to act as a pressure release valve.

The pressure release valve is if we have sales commitments and product is not coming to the market, we don't have to worry because we have adequate stocks in our warehouses.

Remember, we are physical goods, handlers, processors and sellers. So we're not paper speculators.

You are correct that when products are tighter in Turkey, it's not necessarily a bad thing for us because we have origination and access from all of our origins, from our own facilities.

So we prefer to have a balance of local production and also imported product.

The same strategy is going to be employed in our entry into the Indian market. All of these large, liquid consumption markets that have local production, so Turkey and India are the two biggest ones, it's all about a balance of local and import.

Now, on your next question, Christine, you're going to have to remind me what your next question was. It was weather?

CHRISTINE HEALY:
Well, I've seen just local reports in Turkey saying extremely dry during season?

MURAD AL-KATIB:
Oh, yes. Sorry. You just reminded me.

CHRISTINE HEALY:
Yes, and just wanted to know if that could benefit your earnings?

MURAD AL-KATIB:
No, when we look at local reports, I mean, the bottom line is statistics aren't so reliable. In every -- we Canadians are the only ones that like to give reliable statistics, so we can thank our government for very accurate statistical reporting.

Because the Australians, the Turks, the Indians, you can never rely on anything from their statistics.

But certainly I would agree that the season in Turkey started out dry. Again, in the crop development cycle, any time you have a weather event throughout, dryness, cold in India in January in the crop cycle, you will have some effect on yield.

And so if you look at, I think I'm looking at stat publishing data from the Turkish Grain Board, USDA and things and our MD&A disclosure in our AIF, I think.

Production and 2011 estimate was pegged at 388,000. So when we look at that particular thing, this is largely from the US Ag Attaché in Turkey. There's conflicting reports.

I mean, Turkish Grain Board and USDA say 388,000 tonnes.

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The USA Ag Attaché says 550,000. I think it will be somewhere in between.

CHRISTINE HEALY:
Okay and then last question just on the competition and the key to industry. I've heard from some people at a conference a couple of weeks ago that some of your competitors are having really tough times in Canada -- they don't have the color sorters or the lentil splitting machines that you do. They don't have the capacity you do. So, I've actually heard that someone's gone under or a couple of players have gone under. Maybe they're laying off.

They're not doing very well at all. So can you talk about your market share in Canada in 2011? Maybe give us a sense of how busy you have been versus some of your competitors? Any insight on that would be helpful. Thanks.

MURAD AL-KATIB:
Listen, when you look at total volume shipped, we're tracking where we always do. I mean we're a very dominant player in the overall lentil industry, chickpeas, of course, in Canada, we're a dominant player. In the split pea value-added side in Canada and US, we're a dominant player. So in those areas, our market shares are stable to up.

If we look at the overall quantity shipped, in the fall season, there was a significant quantity of very poor quality, bulk vessel shipments of grains to various -- well, basically, to India and to Turkey, not to us. When we look at excluding the very poor quality, bulk shipments, I would say our market share is up. We have a tremendous capacity in terms of our capacity of our factories. We took an approach to the poor quality Christine, that would allow us to really try and de-risk the final product to our end-use buyers.

So poor quality lentils were cleaned, they were sized and they were sent into market. So we took out as much of the garbage -- the shriveled lentils, the thin kernels, the really burnt kernels. The ones that would never be milled or dealt with in another market, we took them out and left them in the feed industry here and we shipped color sorters, splitters. Our splitting is certainly booked up and running well.

This is the year we wish we had five times the splitting capacity. As you know, splitting is only a small part of what we do in Canada now, but it's certainly been a good advantage to have this year.

CHRISTINE HEALY:
So, are those reports true then, that some of your competitors are struggling with this quality and that you are capturing -- it's not a little bit of the market share here. What I've heard from people is that it's pretty meaningful because you have more capacity and have those color sorters and the -- that's just what I want to get answered.

MURAD AL-KATIB:
Christine, you know what, I can't really comment on what our -- most of our competitors, as you know, are very small private companies so I couldn't give you anything but anecdotal. So I think I could just comment on the fact that on the business segments that we're concentrating on, the higher quality is, the value-added side, we're certainly doing well in terms of our market share.

CHRISTINE HEALY:
Okay, all right. That's it for me. Thanks.

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OPERATOR:
The next question is from Anoop Prihar of GMP Securities. Please go ahead.

MURAD AL-KATIB:
Mr. Prihar how are you?

ANOOP PRIHAR:
I'm fine, thanks. A couple of questions please. First of all, can you give us a bit more color on to -- of the quality of the current Australian crop. I know in your MD&A you made reference to the fact, as well as in your commentaries earlier, that there had been some rain late in the harvest, but can you give us a bit more color on the quality and more explicitly, how would it compare to Canada?

GAETAN BOURASSA:
Gaetan here, yes, the quality in Australia is very comparable, overall, to the Canadian Number, 2. So there was some weather damage, but overall, it's not significant.

MURAD AL-KATIB:
I would certainly say that according to regular Australian, their crop is affected. Because of the -- one thing to realize Anoop is, during the harvest season, Canada is the only origin in the world where the weather is getting colder as you're getting into harvest. That's our frost risk and it does give us a quality risk.

Australia is usually getting hotter, which gives them a drought risk, but usually the hotter weather at harvest leads to very good quality kernels. So this year with the rain has basically knocked them down to about equivalent to a Number 2 Canada. So we're in a position where I can tell you that our recent significant expansion of our storage and handling and processing capacities that we're building out in Australia will certainly benefit from the fact that the crop quality is affected, which is a factor for the growers there. The volume was there though and again, we have the splitting mills, the color sorters and we have very large segregation storage opportunities.

If you're a farmer in Australia and you have 10% weather damaged lentils and the public warehouse system doesn't have a segregation available for that, you cannot deliver.

This year, we have significant amounts of segregations available just for lentils and our segregations are maximum size. We're 1,500 tonnes on the silo side and 7,000 tonnes on the warehouse sides.

So we provided a lot of segregation options because our business, as you know Anoop, is all about quality differentiation. We don't want 20% weather damage and 10% weather damage to be mixed. We want 5%, 10%, 15% and 20% all to be separate because every one of those has a different market in the world. Every one of those has different margin profile and every one of them, like AGT, has reached a seller to make its money.

ANOOP PRIHAR:
Okay, so it's fair to say that at a Number 2 Canada equivalent, you're not going to face any sort of blending issues or more importantly, you're not going to have to do and educate the customers as to exactly what's available there. Is that a fair statement?

GAETAN BOURASSA:
In Australia, not so much. In Victoria, there is say, a third of the crop that was lower -- higher damage that we're dealing with on the milling side, but outside that, no, I don't think so. When people see the sample of the milling side, they know what they can split and what they can't.

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In Victoria can take the poor stuff and we can throw it through the largest splitting mill in Australia. So that's a great advantage.

ANOOP PRIHAR:
Can you just remind us how of your product comes out of Victoria and Australia on a percentage basis?

MURAD AL-KATIB:
Well, I guess you'd have to look at historicals. We just put the Balco and the Northern Yorke site into storage production in December, but our estimate would be -- it would be about -- would you say 50/50 now Gaetan?

GAETAN BOURASSA:
Well, you have to be very -- the crop size are 50-50 --

MURAD AL-KATIB:
But what I'm saying our production would be...

GAETAN BOURASSA:
Well, I'd say moving forward it would be two-thirds in the south and 50% --

MURAD AL-KATIB:
Exactly, so this year I think we take 50/50 Victoria, South Australia. Moving forward Anoop, you're probably about a third Victoria, two-thirds South Australia.

ANOOP PRIHAR:
Okay and the second question I have is with respect to the crop in Canada that's currently in storage right now, if -- for portions of that crop that are deemed to be of feed grade, what level of processing, if any, is required for that?

MURAD AL-KATIB:
Depends what we're going to do with it. If we're milling it, we're buying feed-grade lentils every day. One thing they could really, strongly, define is feed does not mean fed to animals. Feed is a grade. We call it sample grade actually. There is no feed grade in lentils. So we have what we call Number 1, Number 2, Extra 3, Number 3 and Sample.

Now, Sample and Feed are synonymous terms in the trade. But feed just means more than 10% damage. So, yes, we're selling regularly Anoop, 15% damaged product with only just cleaning and sizing. Or if we see the opportunity -- let's say in chickpeas, we'll take 15% damage chickpeas and we'll color sort them to be able to sell them into the hummus trade.

We look at the product, the ability to take out the deficiencies and upgrade and then we play the grade spreads, right. If we're buying it at one grade and we're able to value-add it and bring it up to the next grade or two grades even, we can capture the spread in the margins. It's all a calculation on revenue-per-hour. If you lose 50% capacity and don't have a big enough grade spread, you won't process it to that level. If the grade spreads are wide, you'll spend extra effort because it makes money doing it.

ANOOP PRIHAR:
Okay and just the last question. I haven't had a chance to go through the full detailed financials yet. Can you just confirm that you're onside with all your debt covenants?

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MURAD AL-KATIB:
We're onsite with all our debt covenants. What about the subsidiary one Lori, the...

LORI IRELAND:
Are you talking about the Arbel one?
MURAD AL-KATIB:
Yes, that's the only one, right?

LORI IRELAND:
Yes.

MURAD AL-KATIB:
Go ahead, Lori.

LORI IRELAND:
We have one financing agreement in Arbel and I guess there was just -- we're not clear on whether we're offside or not on that covenant. So to be conservative, what we did was, we re-classified that debt to short-term for the financial statements and we put a small note in our financial statements on that just to be on the conservative side. And even with that as AGTI as a whole, we're still within all of our covenants.

MURAD AL-KATIB:
Anoop, let me just clarify that. This is a debt agreement that was signed in 2008 during the financial crisis when Arbel was still a private company. It's the only long-term facility that Arbel had when we bought them. It's a $10 million facility which used to be ABN AMRO, but now the Royal Bank of Scotland. And there's a covenant in that agreement that was crafted in 2008 where the covenants were, of course, very tight because of the financial crisis.

As a result, we classed the two to current because we have in Turkey about $125 million of unutilized credits and this debt covenant is $10 million.

So today, I can take $10 million from another bank and pay it off, but I have to pay an interest penalty. So as a result of that, there is one small covenant issue. It's just a calculation of total debt to EBITDA or something. So, we'll get a waiver and move on. Nothing -- no material issue.

ANOOP PRIHAR:
Thank you.

OPERATOR:
The next question is from Marc Robinson from Cormark Securities. Please go ahead.

MURAD AL-KATIB:
Yes, Mr. Robinson, go ahead please.

MARC ROBINSON:
Okay, thanks. So Alliance has had sort of a long strategy of matching, buying and selling and not having a substantial amount of inventory risk and as I read through the MD&A, there's commentary on being short, quality product and having to cover that at a loss. I'm wondering if there's been any shift in strategy with respect to taking on inventory risk and how you manage that.

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MURAD AL-KATIB:
Okay, component one is, we were not short that product, that product was contracted from farmers. It was sold and as a result of an act of God, we had to walk into the market to cover that position.

So I think that what you need to recognize is, it is a unique circumstance caused by a significant weather event. It is not a recurring theme that we're walking into the market on large volumes of product and covering it off.

You have to recognize that our capacity is large, our sales program is large. When there is a weather event of this magnitude, there's going to be an effect on a short-term basis to cover off those commitments. Because we will not ship -- we will not knowingly ship sub-quality product and damage the Company's reputation and its quality standards in the world.

I will tell you as long-term investors look at this strategy they should applaud management for not sacrificing long-term margin and long-term earnings for short-term results. And I can tell you that there are companies in our industry, in the world, that look at short-term results. If they were faced with the quality issues that we're faced with, they would have shipped substandard quality to make sure they didn't lose money.

So that's issue one on the shorts that you mentioned.

On the other side, I wouldn't say it's a fundamental shift in our strategy, but as the scale of our business gets bigger -- Marc, we need a certain amount of what I would call frictional inventory that's in our system to drive 26 processing plants around the world.

So as merchandisers, meaning we buy from the farmer, we process in our own factories and we ship to a global distribution network, we have a certain amount of commodity in our system that is un-priced, destined for processing. Okay, that's issue one.

Issue two, we are going to go down the path in a managed basis by setting product limits, country limits to pre-position inventory into various distribution points around the world. We need to take the transit time discounts or the transit time decision-making out of the hands of every one of our customers in the world.

Many of them are able to deal with that because they have good liquidity, they have good storage of their own, but there are a number of our key distribution partners -- some of them are smaller distribution partners that need us to have ready product in our warehouses to be able to facilitate their distribution at the store, retail and regional market levels.

So I would say that in the future, we will certainly go down the strategy of strengthening our global distribution which will add to our mix and ability to drive that capacity utilization in non-peak demand periods.

We're in a business wherein the, peak, demand periods, we couldn't potentially process one more kernel of lentils, but there's other periods of the year where our utilization can go as low as 20%. With this type of program, we'll be able to boost utilization and let's say at quarter two, a quarter three, let's say leading up to a harvest of carrying stocks and we'll be able to feed it with all our origination points around the world.

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MARC ROBINSON:
Okay, so everything else being equal though, there's the potential under that strategy to have increased volatility in earnings just because you're more likely to exposed to the commodity price?

MURAD AL-KATIB:
You know what Marc, I wouldn't say -- I'll tell you right now, we always say now production contracts or inventory positions would be 4% to 5% of our worldwide handle. So you might increase that by 1% or 2%. We're still not talking, what I would consider to be, any material change in the risk profile of this business.

MARC ROBINSON:
Okay and I guess B part to the question, with respect to Arbel, is there any -- when you took over Arbel was there any fundamental change in the strategy of managing that company vis-a-vis the inventory risk that -- the pre-positioning that they were taking prior to be under the Alliance umbrella, post-being under the Alliance umbrella?

MURAD AL-KATIB:
Yes, there's a couple of things I would point out. One is it's not a change, but we were able to capitalize their strategy to dramatically alter their product mix. Okay, we were able to capitalize past the line number five, which was put in, in 2009. Past the line number six, which I saw the first production tests coming off the line two weeks when I was in Mersin and rights Mill number one is one of the largest state-of-the-art mills in the country, which will come online end of April, beginning of May.

So, from that perspective, we're able to capitalize asset bases to take the Company out of the reliance that it had on the pulses sector.

Number two, we are able to feed Arbel, 365 days a year from our origins around the world to make sure they are positioned as the most competitive supplier in the regional markets of Turkey, Iran, Iraq, Syria, Central Asian Republics and Sudan, Eritrea, North African countries.

Every day in our store, we have Canadian and Australian products, we have Turkish origin products and we have a multitude of things that we're selling into the cash-and-carry transit business that happens in that region. Turkey's geopolitical and economic importance in the region is being magnified in the political unrest and by the democratic developments that are going on in the Middle East and North Africa.

And I can tell you that as an owner of a business, I've never been happier to have assets in that region of the world in the position that they are than I am today, for tomorrow and the day after. Because we really see Turkey as being the feeder of the region and it's a great place to be today.

MARC ROBINSON:
Okay, but just more direct at what I'm looking for is more around that strategy on pre-positioning and inventory risk. Whether Arbel was taking more risk on before it came under the Alliance umbrella and whether there was just any change in strategy on pre-positioning or inventory risk; pre and post that deal.

MURAD AL-KATIB:
Alliance was -- sorry, Arbel was buying from Alliance before the deal. Arbel is receiving the inventory transfers after the deal. So that's not what I would consider to be a fundamental shift of anything. There was already that commodity risk being taken by one of the players. When you're transferring product from regions to regions, intercompany, you are transferring inventory.

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So I'm not going to avoid that view. Do I think it's a fundamental change? Actually, I think it de-risks the business. I don't think it increases the risk to the business. So having product there allows Arbel not to be a hostage of the physical goods arrival into the Mersin market on a daily basis.

MARC ROBINSON:
Okay.

MURAD AL-KATIB:
We can be the market maker. We don't have to be the price taker. That is the strategy.

MARC ROBINSON:
Okay. We'll leave it at that for that. I just want to ask one final question. There's some language in the disclosure for the outlook on North America that's talking about flat -- expectation for flat volumes in 2011 in year-over-year. Did I read that properly and if it's -- any commentary on that?

MURAD AL-KATIB:
I don't know where you're looking and if we're looking at that, you should point that out to me because I certainly don't believe that volume in 2011 will be flat year-over-year. We had -- in Canada we had seven months of the year where we didn't have any substantial product to process. We had utilization running at levels that we've never seen in our business in terms of low levels.

Our specific plants have never been painted and they've never been cleaner than they are Marc, so I can tell you that. But I think that one thing, that I'm not sure if you reference is related to, production year-over-year and available supplies in 2011 are forecast to be flat.

Okay, so if you look at -- our forecast is that acreage will be down and carryover stocks are up dramatically, which leads to a static availability of product volume year-over-year. Do I think our utilization will be up? Absolutely.

MARC ROBINSON:
Okay, it says higher carryover stocks are expected to result in similar to slightly increased product volumes to the 2011 crop or when compared to 2010 production levels.

MURAD AL-KATIB: Yes, I think that we're talking about the general market, not our facility utilization there Marc.

MARC ROBINSON:
Okay. All right, we'll leave it at that.

MURAD AL-KATIB: Good question, very good to clarify that. We're trying to say that we certainly think with the large carry in that we're not going to be affected in terms of having a shortage of available product to process.

MARC ROBINSON:
Okay. We'll leave it at that. Thanks.

OPERATOR:
The next question is from Michael Goldberg of Stonecap Securities. Please go ahead.

MICHAEL GOLDBERG:
Hey, good morning guys.

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MURAD AL-KATIB:
Mr. Goldberg, go ahead please.

MICHAEL GOLDBERG:
You mentioned that the velocity at your facilities would be negatively affected by the crop quality going forward, but potentially offset by some margin gains. Can you give an idea of the magnitude of that velocity reduction and whether you've seen any substantial margin increases so far in Q1?

MURAD AL-KATIB:
Yes, we don't give earnings guidance. You know, Michael, I can tell anecdotally that it's all about what I explained to, I think it was Anoop Prihar's question from GMP. When you are utilizing value-added technologies like color sorting, sizing, splitting, all of those things, part of your calculation is conversion ratio. Conversion ratio defined is, put in 100 tonnes of product, how many tonnes of finished product do you get out? So if you get out 85 tonnes, you have an 85% conversion rate.

The more -- the higher we can take our conversion rate, the more profitable we are. The lower the quality of the product that you put in the front end, the lower your conversion rate is, but when you have substantial discounts between the grades of commodities, then you are doing a revenue-per-hour calculation.

So, if you can take an Extra 3 quality green lentil and Gaetan can have his boys color sort it to a Number 2 quality, today, the grade spread between an Extra 3 and a Number 2 would be about $110 a tonne. So if you lose 20% capacity, but you gain $110 a ton on your grade spread, potentially it's very economically viable to utilize your technologies to boost your margin.

So that is the question. If I gave you that answer, I would be giving you earnings guidance.

Am I telling you that we're optimistic about our ability to deliver an offset on the velocity? Yes, we are. That's the business we're in. That's all about processing expertise.

MICHAEL GOLDBERG:
Okay, thank you.

OPERATOR:
The next question comes from Keith Carpenter of Canaccord. Please go ahead.

KEITH CARPENTER:
Hi good morning, Murad. A couple of questions. We don't want to -- I just had one follow-up question on Robert's original question about the contracts. Are they fully covered off in Q4? And is there any item -- I'm assuming I know the answer to this, but can you give us any color on what dollar impact that may have had during the quarter?

MURAD AL-KATIB:
They are fully executed and gone. These were September, October, November, December contracts. The sales that were back-to-back on those production contracts would have had to have been executed mostly October, November. If you look at that timing Keith, I'm telling you what the problem was. In October, any product that was available, which of course, is normal -- normally harvest is fully complete by then.

So any product that we had to buy in October was harvested before the rains and as a result of that we paid a significantly higher price. Any product that was harvested after October 1st was affected by the rains, so we again, in our November commitments, had to go back and buy pre-rain product.

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I don't have an exact number of the affect, but I can tell you that it was multiple millions of dollars that would have been affected in quarter four. Is it a recurring loss? No.

Do I expect it to happen again next year? No.

The production contracting program had so many aspects of risk management built into it. As I mentioned, I want to reiterate, we only contract a third of expected production. So in the case of a drought, we'll still get a third, so we're covered. In the case of a frost, we're usually still get our products. Okay.

When you look at the mix -- the product mix over the last five seasons, the average I think, is 75% of our product fell at a Number 1 and a Number 2 category. 25% fell in the off-grade categories. This year was the absolute inverse. 25% in Number 1 and Number 2, 75% off-grade. So, you can see by that statistical view of the crop quality, this was an act of God.

KEITH CARPENTER:
Okay. Can we just switch to India again, here. There's some purchases through the first part of this year, possibly those -- is it possible that some of those were to make up for lackluster sales in Q4? But then the second part of that question, I know you were recently in India, would you comment that the buyers there, over and above your views and concerns with that crop, that the buyers there themselves have this concern and that's why they're hedging themselves for March and April deliveries?

MURAD AL-KATIB:
Listen, you can never read the psyche of an Indian importer. That will be one of the most difficult psyches in the world to read. I judge them by their actions. When we have large importer millers in India, importing for March, April, it's a signal that I love to take, put in my back pocket and tell the public about on my conference call.

KEITH CARPENTER:
Okay.

MURAD AL-KATIB: That was a joke, Keith. I don't think you laughed, but I thought it was funny.

KEITH CARPENTER: I'm smiling. Can you just on the financial statements, we had amortization of $1.6 million during the quarter and I was looking at the detail to that. Can we just get an idea of what the go forward number, Lori, we can expect on that would be? Because there was something in there and I just don't -- it's not clear what the go forward number would be.

MURAD AL-KATIB:
You're talking about amortization?

KEITH CARPENTER:
Yes, there's $1.6 million during the quarter.

LORI IRELAND:
That should be very consistent with what was posted in Q4.

KEITH CARPENTER:
Okay, perfect. And then just on the G&A, it was 6.2 -- it was explained during -- explained in the notes that we should look at the previous quarter, so we should -- previously we had...

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MURAD AL-KATIB:
Did you say that's G&A?

KEITH CARPENTER:
No, originally, I said amortization for the first question.

MURAD AL-KATIB:
Okay, but now, what are you asking? Sorry, I couldn't hear you.

KEITH CARPENTER: Now, I'm asking about G&A. It was 6.2, it said --

MURAD AL-KATIB:
Remember, all of you analysts were making a really big issue about the fact that last quarter G&A were $10.3 million, this quarter its $6.1 million. Okay, I said very clearly that G&A expenses should track around that $7.5 million to $8 million. If you look at the average of the year, I think we're running around $7.8 million or something, average, for the year. This is now a fully integrated number, so in our minds we've shown you exactly what I said. The G&A aberration in Q3 is not expected to be a recurring item.

KEITH CARPENTER:
No, but we asked that on the call and we said shall we assume $10 million going forward and the answer was yes, because that has a significant impact toward EBITDA. So we're assuming now that it should be around $7.5 million?

MURAD AL-KATIB:
You have to re-listen to my call, Keith, because I don't think I've ever said it was $10 million. I can tell you that -- today I'm telling you that our expected G&A is running in that $7.5 million to $7.8 million range, which is validated by the average of 2010. When we had basically all of our operations at Arbel were integrated in the four quarters so I think that we've got a very consistent number there and yes, you were correct. Significant earnings impact if you consider ten versus $7.5 million to $7.8 million.

KEITH CARPENTER:
Okay, so $7.5 million to $7.8 million, then, going forward.

MURAD AL-KATIB:
Yes, but that's a good number.

KEITH CARPENTER:
Perfect.
MURAD AL-KATIB: And we're going to work to bring that down. Remember, the whole concept of global origin diversification and scale is synergies that are going to reduce our costs. And I can tell you I have a Sheriff in town name Gaetan Bourassa who's on the cost -- the cost side looking at cost reductions among all our operations, because as you integrate, you reduce duplication.

KEITH CARPENTER:
Thanks Murad. That's all I have.

MURAD AL-KATIB:
I think we're -- that's probably all the time we have, right?

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OMER AL-KATIB:
That brings us to the end of our questions for our conference call. I'd like to thank you all for joining us and I'd like to also remind you that if you have any follow-up questions, you can feel free to contact us at our Regina head office. We'd be more than happy to follow-up with you. I'd like to thank you all for attending our conference call.

OPERATOR:
Ladies and gentlemen, this concludes today's conference. You may disconnect your lines. Thank you for participating and have a pleasant day.