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Alliance Grain Traders First Quarter 2012 Financial Results Conference Call Transcript

Date: Friday, May 11, 2012

Time: 10:30 AM EST

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





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 on our first 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 are applied in the formulation of such statements, and actual results could differ materially. This call may also include references to certain non-IFRS financial measures. For additional information with respect to forward-looking statements, factors and assumptions, as well as reconciliation to IFRS measures, we direct you to our news release, our website, as well as our recent filings on SEDAR.

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

MURAD AL-KATIB:

Thank you, Omer. As has been clear, global markets in many sectors have been volatile as of late, pulse markets are included. All of those participating in our industry, processors, importers, customers, and farmers alike are keeping a close eye on developments that may signal a corner turn and a return to more normal conditions.

Economic conditions affecting staple food markets have been ongoing through the early part of 2012 as they were in late 2011. The Eurozone economic crisis and political change in some of



the European countries have continued to lead to credit issues in Europe and have continued its effect on global markets, effecting liquidity and volatility of currencies in emerging market economies.

Together these factors have been affecting importers' ability to fill depleted local market stocks. This has affected our business and our ability to execute on our sales strategy. However, we feel based on the extensive communications we have with customers and industry sources every day, that markets are signaling a potential re-start of normalized demand.

In a period where major consumption markets like India and Turkey are traditionally out of the market due to the fact that they have or are soon to have their local production from upcoming harvests, we're seeing signs that they may in fact move into the market and begin purchasing earlier than normal. These are positive developments as they have the potential to act as demand catalysts, signaling that local harvest stock may be lower in these production regions, effectively kickstarting the flow of pulses and staple foods to key consumption markets.

There are also North American seeding intentions which have been a surprise for many in the industry. While we feel that these figures are overly optimistic, we nonetheless feel the estimates support our view that issues being experienced in the pulse markets around the world are not supply related, but rather appear to be a symptom of the issues of the global economy.

We have maintained for some time that people have to eat and consume non-GMO gluten-free vegetable protein from pulses, and it's an important source of nutrition for a large number of the world's population. Estimates surrounding consumption for pulses and staple foods has always remained strong. Now it is time for local stocks to catch up, and we feel this may begin in the coming quarters.

Regarding our business, this quarter has certainly been a disappointing one for our company. We collectively see the potential for recovery in the near term and we firmly believe it will come. We're confident in our strategy and ability to execute it, and we've remained steadfast about our



commitment to diversify our operations and ensuring our management strength is there to guide the company through what we feel is a difficult but short-term period in the market.

In this period we reported sales of \$197.4 million, EBITDA of \$6.1 million and net earnings of \$2.8 million. All of our financial results and notes as well as our management discussion and analysis are available on our website and also under our profile on SEDAR. I'm now going to turn it over to Lori Ireland for a quick review of our financial results and I'll come back with a few more comments. Lori?

LORI IRELAND:

Thanks Murad. I'll speak to a couple of significant items on the financial statements. Page 20 and 21 of the MD&A outline selected asset and liability information as well as a calculation of net debt. Inventory decreased from \$183.3 million at December to \$163 million at March. This is due primarily to inventory at distribution points in Turkey being sold during the quarter as well as decreased inventory levels in Canada and Australia.

AGT is continuing efforts to affect just in time inventory and monitor turns at all locations. We continue to closely monitor inventory to ensure that the financial statement values are representative as well. Accounts receivable is \$163.8 million at March 31 and decreased by \$7.7 million from December 2011. Accounts receivable collection is a focal point for AGT and all of its subsidiaries and is being closely monitored by management with the goal to continually reduce the length of time that receivables are outstanding.

Bank indebtedness and short term financing decreased from a combined \$240.2 million at December 31 2011 to \$226.2 million and long term debt decreased to \$77.5 million from \$80.8 million at December 31, bringing total interest bearing debt down by \$17.3 million. AGT continues to negotiate global lending facilities and management anticipates these facilities to result in favourable interest rates for AGT going forward.

Net debt has increased from \$264.8 million at December 2011 to \$268.1 million at March 2012. Although we did see a reduction in overall liabilities, including bank indebtedness and long term



debt, the cash position also decreased by \$20.6 million, resulting in an overall increase in net debt of \$3.3 million. The decrease in both accounts payable and cash is due largely to producer payments issued late in 2011 that were deferred until January 2012. Net debt will decrease as cash collection occurs.

We saw our accumulated other comprehensive loss decrease from December 2011 to March 2012. This number is calculated by valuing AGT's net investments at year end and comparing at the year-end FX rate and comparing that to the net investment FX rate at the purchase date. This is largely due to the Turkish lira increasing in value by 3.6% from \$0.54 up to \$0.56 as compared to the Canadian dollar. I want to remind investors that investments in non-Canadian dollar denominated foreign subsidiaries are revalued each quarter and the respective gains or losses are booked at those periods.

The results for the quarter ended March 2012 show an unrealized foreign exchange gain. This amount is a non-cash item and relates again to the fluctuations of currencies and the effect of these fluctuations on foreign denominated financial instruments such as accounts receivable, accounts payable, loans and derivative contracts.

Since there was some strengthening of currencies during the quarter, the foreign exchange adjustment was positive. AGT believes that this is a non-cash snapshot entry, though, and whether it's a gain or loss it should be excluded from adjusted earnings and EBITDA calculations. We continue to enhance and improve our global information systems and as a result we are now able to segregate certain costs that could not be segregated in the past. This has resulted in \$4.1 million of cost being moved out of Marketing, Sales and Distribution and into Cost of Sales for the quarter ended March 31, 2012. As a result, the gross profit percentage for the quarter is 7.2%. Note that this percentage would have been 9.2% if it was presented on the same basis as in the prior quarter. The cost will continued to be classified in this new manner going forward.

General and Admin expenses remained relatively consistent. However AGT is striving to reduce these costs going forward. We also continue to look at ways to cut on costs and improve our



efficiencies. AGT's Export Development Canada accounts receivable policy has been implemented globally and we will recognize the premium savings beginning on June 1st.

We continue to work on enhancements to our global information technology platform and are involving all of the divisions in the sharing of information and the development of streamlined process. Thank you.

MURAD AL-KATIB:

Thanks, Lori. I want to now provide some colour on some of the initiatives that we've undertaken as management and as a company overall to assist in our goal of building long-term value and strength in our business. We are concentrating on a working capital management plan through a variety of mechanisms.

As Lori mentioned, inventory turns are being monitored, and a company wide effort is on to reduce our cash cycle. An extension of our risk management program to all origins including, our credit insurance through Export Development Canada, will minimize as much as possible credit risk exposure we may have due to customer liquidity. These are important improvements in our business in the coming periods.

We're quite confident that this will allow us to not be affected materially by defaults, repudiations and insolvencies. We view this insurance as we view any insurance. When you purchase fire insurance you do not do so expecting a fire. You do so to mitigate the risk of catastrophic loss. We are doing the same thing through our credit risk management program. We are insuring against credit and political risks of our global business.

This provides us the ability to replace global buyer risk with Government of Canada risk. This is good management practice. As a management team, we expect some of these initiatives aimed at improvements with regards to our working capital will continue through 2012 and provide results as market liquidity eases for AGT's clients, with inventory flows returning to more normalized conditions.



We're confident that our debt levels, made up largely of these insured receivables and inventory of many origins and types, will be reduced over the coming periods as our buyers in global business return to a predictable flow. Capacity utilization initiatives are also being undertaken. In the short term we have been focused on potentially lower margin products such as whole peas, flax and canary seeds which are aimed at maintaining utilization at our North American facilities to cover fixed cost components.

We forecast all assets will run cash-flow positive in 2012. We believe that the demand disruption globally is temporary and will be substantially resolved in the second half of 2012. You can see by the consistent tonnages shipped that our issues are margin compression-related. Product mixes have changed temporarily. We continue to be forced into the commodity segment of our business to keep our assets running. The day will come, in my opinion soon, where we will return to a mix of sales of high quality lentils both split and colour-sorted, chickpeas to all geographies, beans and high-quality value-added peas. Our available capacity can be turned towards these higher-margin and higher-value products rapidly should import demand from the Indian subcontinent markets and markets in Turkey, the Middle East and North Africa materialize sooner than we expect. You can be sure we're ready for this.

Where possible, facility staffing and overheads have been scaled down; however, key staff have all been retained. It's important to be fiscally prudent, but we must still be ready when the customer demand increases and normalized product flow begins. We'll manage our costs, we'll reduce discretionary expenditures, SG&A and fixed costs, but we will not do so at the sacrifice of our long-term strategy.

We operate in a very tight labour market, especially in western Canada and North Dakota. We cannot easily reduce our staff and rehire, especially with the specialized knowledge of the pulses and processing that many of our staff have gained over the past decade of AGT. As well as cost reduction measures, capital project restrictions have been implemented by management in order to further manage our financial position.



This includes the planned pasta facility for Regina which we have deferred to 2013. Planning and design will continue, so we'll be ready for implementation when we feel the time is right to do so. Overall we feel it's prudent to focus on our balance sheet and improve our business metrics.

There are many factors that are re-shaping the landscape of the agribusiness in the sector that we feel must be considered in our decisions for major expansions. Ending developments such as the de-monopolization of the Canadian Wheat Board and the proposed sale of Viterra to Glencore, as well as the impact of recent leadership changes in many European economies and the impact this may have on free trade negotiations between Canada and the European Union. These are all important developments that we may feel will have effects on our industry.

We will, however, continue to evaluation opportunities for expansion and acquisition in emerging production in markets and economies like India, Russia and South America. Entry into these markets will continue to be important long-term developments for our growth to strengthen our company. India and Russia are markets that we must grow into.

We will take managed and small steps, but we are confident these pursuits will create long-term value for our shareholder base. Before we go to questions, I want to reiterate, the long-term focus of the company and its management team, we say it all the time, we're significant shareholder's ourselves. As we have said in the past, we stand shoulder-to-shoulder with our shareholders, we're optimistic about the potential for correction in the market and a return to normalized business in the near term, which we feel will demonstrate our strategy is sound.

Our goal of building a strong global food company will become a reality. I thank you for your interest in Alliance Grain Traders. Omer I'll turn it over to you for question and answers.

OMER AL-KATIB:

Thanks Murad. Operator, I think we'll take the first question.



OPERATOR:

We will now begin the question-and-answer session. Anyone who wishes to ask a question may press * and 1 on their touchtone telephone. If you wish to remove yourself from the question queue you may press * and 2. If you are using a speaker phone please lift the handset before pressing any keys. In order to accommodate as many callers as possible one question from each person will be taken.

To ask a supplemental question please press * and 1 again to rejoin the question queue. If time does not allow for a response to all questions, the Alliance Grain Traders investor relations group will follow up after the call. Anyway who has a question may press * and 1 at this time.

The first question today comes from Jacob Bout of CIBC. Please go ahead.

JACOB BOUT:

Good morning. I just had a question on the margin side and looking for an apples-to-apples comparison. So there're some one-times in the quarter and you've also got the bolt-on at the training and distribution businesses, but on an apples-to-apples comparison, how is this quarter versus last quarter versus a year ago? And maybe talk a little bit about, you know, how much of this compression is just a function of asset utilization or product mix or how should we be looking at that? And where does this ultimately go in your mind over the next, say, couple of years?

MURAD AL-KATIB:

Well, that's a very comprehensive question, so let me see, Jacob, what we'll have you stay on in case I don't quite get it, but let me start with a couple of things. I mean, when we look at the comparison of this quarter over last quarter, if you look at it just on a gross margin basis, we were at 7.2 percent reported, but with the reclassification of the marketing sales and distribution expenses up to cost of sales, that lead us to this position where we don't have that apples to apples comparison.



So just to be clear on those \$4.1 million of cost, these are cost of sales, variable expenses related to the sales program, so if the sales program does not occur, those costs will not be incurred. Therefore, they did not belong to below the line but belonged in the cost of sales. So as we drill down and Lori and her team further refine the four operations subsidiary reporting, and we go more towards segments reporting and product line reporting and things like that, we get a better ability to take costs, to give you as an analyst a better picture of what is the fixed SG&A, what is the fixed marketing sales and distribution and allow you to model more effectively.

So on an apples to apples comparison, gross margins were 9.2 percent roughly, versus last quarter at 8.2 percent, so a slight improvement, but as we mentioned this time, about 20 percent of the invoiced tons in our quarter were actually traded tons, meaning that we would originate them in Russia-Ukraine, they wouldn't touch an AGT facility, and they would go into our global distribution, so maybe a flax origination that goes to a North African importer, that doesn't touch an AGT facility. We do make margin off that, but the margin profile will be different than touching our particular facilities. So a year ago, I think we were running around 14 percent gross margin versus 9.2, so you can see a very significant compression of those particular margins. The one thing to consider is that we're not talking about gross margins of 13, 14 percent that we only did in one quarter. We delivered those consistently for nine or ten quarters.

We delivered them on a number of quarters in the spotting of the 2010/2011 crisis period, both on supply and economy, whereby we got back to those levels, and in many cases, Jacob, in an environment where commodity prices were declining, not increasing. So you can't look back at those margins and say it was as a result of only commodity appreciations so therefore they're not normalized margins. We know that we can get back to those margins over time, and that is going to be the goal to get back to higher-value tons and less traded tons.

On utilization side, if you look at the tonnage over the reported capacities, we're running at a capacity utilization that is very materially different than what we'd run in the past. I mean, we were running around two-thirds utilization in most of our asset bases around the world. If you subtract off the traded tons that don't touch our facilities, we were running around 50 percent



utilization and the product mix had changed from higher-value to lower-value commodity, almost like a grain handling type of business, and we think that's going to change over the coming periods. Does that answer, Jacob?

JACOB BOUT:

Yeah, it does. Just on the capacity to utilization, what's your expectation as you exit 2012?

GAETAN BOURASSA:

Gaetan here. Looking forward, we're hoping that we'll get back to two-thirds capacity utilization. Today we're running about 50 plus the traded tons Murad mentioned.

MURAD AL-KATIB:

We're expecting the demand is going to recover and ultimately, Jacob, we look at catalysts for that. Supply disruptions in other areas of the world, are being discussed by industry sources, so India and Turkey, and we think that'll be a significant factor, so we'll see how that all unfolds in the very near term.

JACOB BOUT:

Thank you, that was my one question.

MURAD AL-KATIB:

Thank you.

OPERATOR:

The next question comes from Marc Robinson of Cormark Securities. Please go ahead.

MARC ROBINSON:

Hey, good morning. I guess just further to what you were touching on the end of that last answer with respect to demands, so we're now well into Q2 and so really what I'm looking for is even just anecdotal evidence of any sort of demand recovery. What are you seeing now and if



you could maybe just try to put a little bit more meat on the bone in terms of your expectations for demand recovery?

GAETAN BOURASSA:

Gaetan here again. Listen, we're optimistic for the second half of this year. Currencies have become a lot more stable, liquidity in markets is slowly improving, we see some crop adversity in the Indian sub, including Bangladesh, Pakistan, Myanmar, which are some of our main markets--not Myanmar, but as a supplier. Most pulse crops are significantly short. Turkey, again, is looking a little bit short, less seeded acres, so overall we feel markets are stable and with the projected 30 to 40 percent decrease in pulse crops, it should be good for our main origins, Australia and Canada.

MURAD AI-KATIB:

I think Marc, one of the key things that we need here is—volatility in the market created by this currency devaluation situation and credit liquidity, leaves the importers in a position where they're constantly under uncertainty in terms of their ability to import, convert product into cash, and continue to turn their money, because—well, let's recognize one thing. Importers' impulses, part of the reason why the trade is containerized trade and not bulk vessel trade and will never be bulk vessel trade dominantly, is because you're dealing with thousands of small importers in a hundred countries around the world.

So their ability to convert to cash is an important aspect of quote, "normalized turn and flow our industry." So what I think, from my perspective, one of the most positive signs anecdotally is that we see our buyers starting to be in a position to open their LCs on time. Their letters to creditors are getting opened. The thesis of our business is "capital will flow to staple foods." The duration and magnitude of the effect of a global economic crisis on our sector will be shorter and less severe than discretionary goods.

So again, not a rocket science equation to solve; it's basic staple food, protein and basic nutrition. So capital will flow there because it's a need-to-have. We're seeing that start to



happen and, I mentioned in my comments, India and Turkey are harvesting, are going to harvest. To have any demand from that region today is a positive anecdotal sign.

MARC ROBINSON:

Okay. If I could just ask a very short housekeeping question. With the delay of the Canadian Pasta Project, what is the new CAPEX expectations for 2012?

MURAD AL-KATIB:

We're preparing a CAPEX budget which we'll submit into our board in August, but I can tell you that we mentioned our continued pursuit of some very small step, tuck-in or entry points into places like Russia and India, but outside of that our CAPEX budget, which is largely allocated and even largely spent or funded related to the Minot North Dakota Project, so that project is ongoing. It'll be completed late this year, and outside of that it's really just maintenance CAPEX and that's going to be a very—we're going to focus on our assets. We like our global footprint, we like our current assets footprint. We think it's one that no one else in the world in our business has, so we're going to focus there so you're going to see a real... we're going to manage our balances, Marc.

MARC ROBINSON

Okay.

OPERATOR

The next question comes from Rod Nickel of Thompson Reuters. Please go ahead.

ROD NICKEL:

Hi Murad. Wondering if you can elaborate on your comment that delaying the pasta plant allows you to monitor some of the changes in the North American grain market. Wondering how you view Glencore's takeover of Viterro in particular and how it affects Alliance prospects and your plans to move into grains?

**MURAD AL-KATIB:**

Yeah, I think the first thing I'll say, Rod, is the perception of that acquisition is really a matter for the shareholders of Viterra to decide and they'll do so, I think, at the end of this month. So when I look at just a comment on Glencore overall, we have a very close working relationship with Glencore around the world. In fact, I would characterize it as a very close working relationship with a number of their important international subsidiaries related to the pulse sector.

So we are a supplier of theirs, we've done business together in the past and have known some of their key people for many, many years. When I look at the comment about the changing landscape, there are a number of things that will get settled over the next six to nine months. We have a repositioning of the cereal grain marketing system, in addition to the Wheat Board de-monopolization, you throw in this Glencore-Viterra takeover and it adds an element of uncertainty to the whole transportation flow side.

We want to see it. Is it going to be a north-south flow; is it going to be a port flow east-west? We want to see how those things play out. The other side is it is no secret to the public equity markets that Viterra was a major player in the North American pasta industry, so we want to see how that all plays out with the acquisition of Viterra by Glencore, we'll be monitoring that.

I think, Rod, one of the key things that has left us in a position to weigh—well, there's really two things. The complexity of the design and implementation of this project on a very short timeline in a red-hot Saskatchewan economy has left us in a position where we want to take our time, we want to select our contractors, we want to make sure that the cost is certain of the project, and we want to see how Europe plays out, because I think the figure is nine consecutive leaders in Europe have been defeated in their elections.

We have a political landscape change, and the free trade agreement with Europe is a very key component of our desire to invest further in value-added processing in Western Canada, to access the 450 million consumers in Europe, so we're going to hold tight. But again, we're designing, we're working and we'll be ready to move when the time is right.



OPERATOR:

The next question comes from Christine Healy of Scotiabank. Please go ahead.

CHRISTINE HEALY:

Thanks, hi guys. Murad, last quarter you talked about grain shipment defaults and quantified the EBITDA impact to be about \$3 million to \$5 million. Can you give us an update for this quarter? How big was the issue; did you recover some of the losses from Q4 either through selling the product or through insurance claims?

MURAD AL-KATIB:

Yes, we did. The products that were in a default position, Christine, are largely liquidated and sold into the market now, so I think that the impact of those... we did see some impact in Quarter 1 related to settling up demerge, detention bills, liquidation costs, warehousing and storage cost related to that crisis. So those particular costs would have flowed through and been one of the contributors to margin compression.

And so when you look at our margin, you have to recognize it's not just margin per ton. It may be that we actually had costs that were not anticipated that lead to an overall reduction in our margins overall. So we think that a lot of those one-time costs are gone. We're not seeing that type of concern and that's kind of that anecdotal evidence that we mentioned to Marc Robinson earlier, that importers are actually able to access capital to clear their cargo. We're not seeing that type of disruption that we were seeing over the last, say November, December, January, into February, were really intense periods. By end of February, early March, we started to see the improvements and, you know, Christine, it's as we said. We said a couple of quarters we're going to be rough, and by second half, 2012, we'd see a recovery, which would imply that Quarter 2 is a transition quarter back to, quote, "normal."

So that's where we're at. In terms of the overall EBITDA impact, there's the cost side, the demerge, the detention, the storage, liquidation, and there's also another side that we all have to recognize. We are not a commodity speculator. We are an asset runner, so we run our own



assets, 29 of them, as you know, in five continents around the world, so we always have to have a level of stock in our factories, ready for processing, to meet our customer demand.

When you come into a crisis period, you have commodity price volatility, and in this case, late Quarter Four, early Quarter One. The lentil markets corrected downwards fairly dramatically, and so we would have ended up in a position where we had part of our margin compression coming from the liquidation of our own internal stocks, through our factories, to clean up the inventory that was in a shipment position that was unsold. Those have worked their way through and I think we're back to the normalized conditions for Quarter Two. Anything to add at all?

GAETAN BOURASSA:

Yeah, I guess I would say, if 50 percent was contracted our inventory, the other 50 percent that would be unsold could also be spread across approximately 50 different commodities in five different countries.

MURAD AL-KATIB:

So very diversified.

CHRISTINE HEALY:

Thank you.

OPERATOR:

The next question comes from Robert Winslow of National Bank Financial. Please go ahead.

ROBERT WINSLOW:

Good morning.

MURAD AL-KATIB:

Good morning, Robert.



ROBERT WINSLOW:

What can you tell us about, I think we talked about last quarter, debt covenants? Some of your debt covenants was tied to EBITDA, but only a few of them, or a modest amount, and the rest are tied to the balance sheet. Could you just remind us what all those various—or what the key covenants were please?

MURAD AL-KATIB:

Well, we confirmed, Robert, in our disclosures that we're in compliance with all our covenants, and our covenants are at the subsidiary level, not at the AGT level. And so when we look at EBITDA related covenants, we only have one covenant that's only tested annually, and so it's not tested on a quarterly basis, and that's a debt service coverage ratio, which I think we disclosed last quarter. The test is one and a quarter and last year at year-end we tested at 5.52, so we are in compliance with covenants, we have very committed and cooperative lenders. Scotiabank is our lead. HSBC and Rabobank confirmed their commitment to this company by extending the existing credit facility back in March in the middle of a storm that we were going through by extending it for one year with a one year term-out.

So with Farm Credit Canada and Scotia, HSBC and Rabp, we have a very strong group of lenders for our Canada, U.S., Australian business. On the Turkish side we have a number of lenders, and we're in compliance there. Of course, in Turkey the facilities are all short term credit facilities. So as unsecured short term credit facilities, they don't have covenant requirements like our facilities in North America and in Europe.

So we don't have any material issues to report, Robert, on that particular side.

ROBERT WINSLOW:

The Scotia facility, was there a tangible equity covenant on that one?

MURAD AL-KATIB:

There's a tangible network covenant at the subsidiary level and there's not any issue of that particular covenant today.



ROBERT WINSLOW:

Thank you.

OPERATOR:

The next question comes from Vitali Savisky of Canaccord. Please go ahead.

VITALI SAVISKY:

Hi there. I'm just here for Keith Carpenter. A quick question, your interest expense then, SG&A going forward, what do you think—what kind of clarity can you give us here?

LORI IRELAND:

Well, I guess as I mentioned in terms of interest expense, we are looking at negotiating global credit facilities right now, and we anticipate that we will see a positive movement in interest expense going forward.

In terms of G&A, right now, as Murad said, we're focused on running our assets. We're not doing a lot of big acquisitions right now. So I think that we'll see a fairly stable level of G&A expenses and we continue to look at ways to improve our costs and streamline our processes. So we're expecting to see that those numbers remain fairly stable or slightly lower going forward.

MURAD AL-KATIB:

I think that one thing to mention, just a bit of clarity from a couple of questions that came to me over the last 12 or 18 hours since we released. The \$4.1 million of reclassified costs, I did mention earlier, but just to reiterate, those are variable cost of sales. And so, to think that we just re-classed them up to cost of sales and their reoccurring fixed cost is not the intention. They were segmented and reallocated because they were a variable cost of sales and belonged in the cost of sales category.



So when you look at the reduction of our SG&A and marketing sales and distribution from around over \$15 million last quarter down to \$11.5 million this quarter, that's a significant reduction, but we don't believe it to be a one-time reduction.

Now on the interest side, emerging markets interest, meaning our Turkish facilities, our South African facilities and our Chinese credit facilities, the pricing has increased. And so the movement to AGT consolidated global facilities with AGT parental guarantees, this won't be necessarily additional debt. It will be replacing existing debt on much more favorable terms.

So from that perspective, we expect the interest expenses as debt utilization will reduce this and, as we replace current unsecured credit facilities with a more organized global credit, we expect the interest to come down, which will, of course, have a positive effect on earnings per share and free cash flow.

OPERATOR:

The next question comes from Steve Hansen of Raymond James. Please go ahead.

STEVE HANSEN:

Good morning everyone. Murad, could you just maybe elaborate a little bit more on the specifics of this EDC global policy for AR and just maybe some precise detail on exactly what products of origin is covered under the policy or maybe, and perhaps more importantly, what percentage is not covered or what product is not covered under the policy and what degree of confidence do you have in your ability to bring in reign in some of the working capital.

MURAD AL-KATIB:

Let's start with the EDC. Export Development Canada is, as you know, the Canadian government's export-import bank. It provides credit insurance services to Canadian exporters. And under the Advantage Canada initiative of the Conservative government, a number of years ago, Minister Flaherty had clarified a strategy of the Canadian government to support what they called CDIA, Canadian Direct Investment Abroad.



And there was a recognition from our government, which I can tell you as a business person is a very welcome and forward-looking type strategy, that Canadian exporters that wanted to be competitive in a global environment must look beyond the borders of Canada to achieve their competitiveness. And so, with only 34 million people here, it was inevitable that Canadian companies would do exactly what Alliance is doing, which is locate production facilities abroad, originate product abroad, set up global distributions and locate head office jobs in Canada to run a global company.

So under that particular program, Export Development Canada was in a position to start extending cover under their global credit insurance programs to Canadian head office companies that were active internationally.

So as a result of our 2012 policy renewal, we will be insuring Canada, U.S., Australia, Turkey, Chinese origin sales, South African origin sales, all of our European business with Poortmans, everybody is in. And so we will have a dramatically larger insurance policy, which has allowed us to, of course, benefit from a significantly higher volume of insurance in 108 countries around the world with over 800 or so clients. So a very diversified book has altered our premium structure to provide us with more insurance coverage globally at a lower premium than we were paying just for the Canada, U.S., Australia business.

So that gives us the 90% cover on repudiation and non-payment related to insolvency, political risk, so if there's a major change like we saw in the fall of Mubarak and you can't clear cargo as a result of government change, regulatory change. All of these eventualities provide AGT with a catastrophic loss policy which covers 90% of our loss on the default insolvency repudiation of cargo.

So we take a 10% exposure and what we're doing in effect is trading buyer risk in all of these countries around the world for Government of Canada risk. And as I said in my comments, I think that's prudent management, and I think that it lends significant credence to our position that when you look at our debt levels, we are talking about a large receivable base that is insured.



So when we look at the quality of the securitization of our current debt position, with inventory in five continents, 50 different products that's turning and it's non-perishable and then you have the insured receivables, our net debt position is actually pretty low as a company. So I think it's very important to recognize that the securitization of our debt position is there. And it's a non-negotiable part of our risk management program.

That's kind of how we built—you know, when I built this company, it wasn't to trade lentils. It was to manage the risks of the emerging markets, and this trading part or the handling of lentils could have been another commodity, but we happened to choose this one because we thought it was one that we could achieve an influence position in the world.

STEVE HANSEN:

Okay, that's helpful, thank you. And just a follow up, if I may. If the demand for some of the higher-value products or high-margin products returns over time through the course of the year, do you think you just drop the more commodity-based products all together or do you keep those as part of the portfolio to try and bolster utilization where possible?

MURAD AL-KATIB:

Definitely. As capital is available and as facility utilization is available or facility capacity is available in windows in the market then we'll be in a position to continue. But you know, Steve, the one advantage with the commodity segment is you can enter and exit as you like because it's a commodity. It's a price-driven handle over commodity.

And with our global origination and our global processing and our global distribution, we can turn around and turn on flax in China, turn on peas in China, Indian subcontinent. Gaetan can turn it on with two days of effort. So it will definitely help us to boost the utilization over time.

OPERATOR:

The next question comes from John Priesing of Mahler & Emerson, Inc. Please go ahead.



JOHN PRIESING:

Gentlemen, what's your current dividend philosophy?

MURAD AL-KATIB:

John, the dividend philosophy is going to be return to profitability, continue to maintain a yield for our shareholders and start to, again in a cautious manner, deploy our capital back to continue to grow. As free cash flow gets back to normalize, we have a high free cash flow business.

High fixed cost component, John, gives us what I see to be the advantage and the disadvantage all at once. The advantage is we have a high fixed cost component. So when we have free cash flow and more earnings, a significant part of our increase in utilization and earnings goes to that free cash flow.

But when earnings are under compression like today, we have a high fixed cost component. We are, as a board, and on a quarter-by-quarter basis, we improve our dividend. I can tell you that the board is committed to continuing with the yield.

OPERATOR:

Next we have a follow up question from Anoop Prihar of GMP Securities. Please go ahead.

ANOOP PRIHAR:

Good morning. Now earlier on and in the MD&A, you talk about your initiatives to reduce working capital as well as costs. Are there any targets that you can share with us in terms of what kind of improvement on those metrics you're actually tangibly looking for?

MURAD AL-KATIB:

You know, Anoop, I mean it would come down to me being in a position to say I want to increase inventory returns by this much and I want to reduce my cash cycle by this many days. I can tell you that, at this point, this is a company-wide initiative that everyone is directed. We've



put in place regional responsibilities for management and this will become one of their performance metrics is working capital management.

Inventory management has always been a performance metric on reconciliation of book to physical inventory because we practice a very vigilant—you know, lower our cost in market, monthly strategy because we need to know where we're at on efficiencies of processing, which affects our margins and all those things.

So the inventory management is already there in terms of when it gets in the facility. Now what we add onto that is we don't bring it in until we need it and we're trying to move more and more towards just in time processing to reduce inventory levels.

And I think right now, Anoop, it's too early for me to give you the quantitative target, but I can tell you that we want to return back to working capital levels that would be between our position a year ago and where we are today. Because, if there's one aspect, Anoop, that's changed here, we do have an active distribution marketing platform.

We do believe that our inventory should not be located in Canada and Australia between 45 to 65 days away from consumption. We should have a portion of that inventory direct in the consumption regions, ready for our distribution to monetize it and ready for us to be in a position to monetize the earnings. But that will require some additional working capital to run that, but we think that prompt delivery premiums are real when demand gets back to normal and we'll be there to capture those.

ANOOP PRIHAR:

I understand what you're saying, I'm just a little confused as to how you go about rewarding your managers for these initiatives if there's no targets out there for them to achieve.



MURAD AL-KATIB:

No, Anoop, I'm telling you the targets are under development. I mean we've got initiatives to reduce inventory levels by 20%. We have to see whether we can achieve those. If we want to reduce our cash cycle by 10 days, we have to see whether we can achieve that.

There are many factors that will play into what the right target is. So what I'm telling you is we have targets. We'll provide a bit more clarity as we continue to go along and, frankly, you're going to see the results. So the targets are going to generate results even in the next quarter and the quarters beyond, we expect, because if you look at the quarter one position, Anoop, the payables were reduced dramatically as a result of our utilization of our cash to settle deferred settlements to producers. That's a normal cash cycle, that in the first quarter we use our cash to pay our producers.

Now, for the definition for everyone listening today, when we talk about a deferred settlement, to provide clarity, a farmer who is in a position to deliver grain in 2011 may, for his own tax planning purposes, request only to be paid after January 1st. So under Revenue Canada Guidelines, this is allowed and with that particular thing, in the first quarter of the next year, you have tens of millions of dollars that clear your account in the first few days of January.

Now why that's significant is when we reduce inventory and we reduce receivables, payables are at a level, I think, where they'll stay. Then the collected cash will go to the application to short term debt and you'll see a debt reduction coming and you'll see the working capital improvement. That has been our normal cash cycle over the years.

OPERATOR:

There are no more questions at this time. I will now turn the call back over to Omer Al-Katib for concluding comments.

OMER AL-KATIB:

Thank you. And that brings us to the end of our questions in this session. I'd like to thank you all for joining us. I'd also like to remind everyone that's still on the call that if you have any follow



up questions, you can feel free to contact us at our Regina head office and we'd be more than happy to follow up with you.

Again, thank you for attending our conference call and I wish you all a good day.

OPERATOR:

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