From Producer to the World

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Alliance Grain Traders
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Financial Results Conference Call Transcript

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Speakers:

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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, Operator. Good morning and thank you for joining us on our second 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-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. The second quarter of 2012 provided the first positive signals that pulses and staple foods markets have seen in some time. Based on a number of factors and results in key production origins and consumption markets, the beginnings of normalized demand and normalized product flow appear to be returning.

This was, in part, illustrated by the first improvements in export data from Canada and other origins that have been seen in some time.

The impact of weather conditions on production is being felt elsewhere after hitting Canada and the United States hard in the past few growing seasons.

Reports from India are estimating an approximately 20% reduction in the key monsoon rains that provide approximately 55% of India's agricultural land with the moisture required for their spring and fall planting seasons. This is reported to have the potential to dramatically affect pulses production in the region.

Russia and Ukraine, which are also key agricultural production regions emerging in the pulse growing side, have reported dry conditions that have resulted in estimates of lowered agricultural outputs.

Production in Turkey has trended down, with extremely wet conditions lowering production overall.

And, of course, the drought conditions affecting the corn and soybean production regions in the U.S. Midwest have been widely reported in the media, with dramatic impact on production of these widely consumed crops ultimately affecting prices for protein worldwide.

However, through all of this, our North American pulse and special crops outlook is very positive as we look towards the fall harvest period, our busiest time during the marketing year. This follows a successful Australian harvest in late 2011 and early 2012, providing positive supply conditions for AGT's operations around the globe.

As a result of all of the weather effects, we expect an increase in the average cost of protein globally, as corn and soybean prices and pulses production in key consumption markets has decreased, requiring imports in non-traditional periods to fill shortfalls in domestic supply and estimated increased consumption demand, as markets require non-GMO, gluten-free, low-allergen vegetable protein in their diets.

While agricultural conditions are a key component to AGT's success in any given period, global economic conditions are also an important factor, as we have seen in the past few periods. We have been clear in our expectation that markets would normalize when importers felt that credit liquidity was easing and that currencies were indeed stabilizing.

Through the period, these global economic indicators appear to show that conditions may be improving. We view these improvements as necessary for more normalized business operations to be achieved, which in turn are forecast to have a positive effect on our earnings and our margins.

Pulses and staple foods markets appear to be signalling towards a gradual and steady recovery; however, a recovery will not come all at once. Overall, these are good signals to normalized business in the second half of 2012 and 2013.

Collectively, these conditions, including improved global credit, short production in key consumption markets, earlier buying activities to these markets, increases in protein prices globally and positive supply from new harvest provide some of the catalysts we feel that are needed to lead buyers back to the markets and give them confidence in large scale replenishment programs to bring normal trade flows back to the sector.

The Quarter 2 period reflected positive signals that we were optimistic we would see. In the 3 months ended June 2012, we reported EBITDA of $9.3 million and sales of $201.8 million.

Additionally, we reported positive progress on reduction of debt and dramatically increased our cash flow from operating activities as a result of some of the management initiatives we had discussed in the past periods. You can find our complete financial results and management MD&A on SEDAR and on our website at www.alliancegrain.com.

I am now going to turn things over to Lori Ireland to discuss some of the highlights from the quarter from the financial perspective and I will bring you a few closing comments before questions.

Lori?

LORI IRELAND:

Thanks Murad. During the last conference call we discussed that we were implementing cost cutting initiatives as well as various metrics for cash flow management.

I am pleased to see that our efforts are already making an impact and we expect to see continued improvements in these areas. We continue to assess synergies across our global platform and have streamlined many areas and processes as well, and we have also taken advantage of cost savings due to the global nature of our business.

For example, in Canada we have eliminated in excess of 30 positions, either through attrition or other means, with an estimated annual savings of $1.2 million.

We have also negotiated a discount on our Export Development accounts receivable insurance premiums in the range of 60%. We have arranged a property insurance reduction of premiums of approximately 15% and cargo insurance premium reductions of approximately 12%.

Our global facilities are also reporting various initiatives to save costs. We feel that the decrease in Marketing, Sales and Distribution costs of 10.4%, from $4.8 million for the three months ended March 31, 2012 to $4.3 million for the three months ended June 30, 2012, is a direct result of our cost savings initiatives.

General and Administrative costs remained relatively consistent at $7.0 million for the three months ending June 30, 2012 compared to $6.7 million for the three months ending March 31, 2012. Severance pay and other costs of approximately $184,000 were included in the current quarter.

I just want to point out some information on the tax provision as well. During the quarter ending June 30, 2012, substantially all of our subsidiaries filed their 2011 final tax returns with the appropriate tax authorities. As a result of the filings, we adjusted the tax accruals to actual, resulting in an increase in the tax expense of approximately $800,000 seen in this quarter. Also, I want to point out that various jurisdictions have differing tax rates and tax rules. For example, the tax rate in Turkey is 20%, whereas the rate in the U.S. is at 39% and Australia is at 30%. Depending on where the earnings are, it could put a higher weighting on one tax rate over others, therefore increasing or decreasing total tax expense. We estimate that an appropriate average tax rate is in the range of 27.5%.

Overall, we see a margin improvement as gross margins per mt recovered from a compressed $51.36 per mt in Quarter 1 of 2012 to an improved $60.24. More importantly, the entire margin improvement flowed through to our EBITDA, as our EBITDA per mt improved to $33.57 for the quarter ended June 30, 2012 compared to $22.34 per mt for the quarter ended March 31, 2012. Margin gains and capacity utilization increases were observed in the latter parts of Quarter 2.

In addition, we discussed on the last call that we would be monitoring accounts receivable and inventory turns at the facility level and have now been preparing monthly metrics for review by management. We feel that this has assisted in the drop in accounts receivable of 8%, from $171.5 million at December 2011 to $157.8 million at June 2012. We also feel that this has assisted in the drop in inventory of 21.6% from $183.3 million at December 2011 to $143.7 million at June 2012.

As a result of tighter cash collection policies and quicker turnaround of inventory, we have seen an improvement in cash flows. We have seen a substantial decrease in net debt, from $268.1 million at March 31, 2012 down to $236.9 million at June 30, 2012. This is a reduction of 11.6%. Net debt is defined as bank indebtedness, short term financing and long term debt, less cash and cash equivalents.

This has resulted in a reduction of interest expense in excess of $600,000 when comparing the $4.4 million for the quarter ended March 31, 2012 to $3.8 million for the quarter ended June 30, 2012. Further initiatives aimed at reducing interest costs are underway as we bring the strength of AGT's consolidated balance sheet to lower our foreign operating subsidiaries, namely Turkey, Russia, South Africa and China, their cost of debt. This effort will be aimed at reducing real cash interest costs, boosting free cash flows and earnings per share. This focus will be largely on using AGT and its asset base to securitize our emerging markets credit facilities. In many cases, this is NOT new debt, but merely debt optimization.

For example, in late July 2012, AGT's operating subsidiary Advance Seed in South Africa signed a new credit facility with HSBC Bank South Africa, replacing its local credit facilities. This new facility, utilizing a security package and AGT's corporate guarantee, is estimated to save approximately $500,000 per annum in cash interest and fees, translating into a potential projected 2.5 cents per fully diluted share. Our Turkish business at Arbel will be the major target of this program later in 2012 and in 2013, where local costs of borrowing in Turkey have escalated and we see significant savings through consolidating the facilities and reducing debt utilization.

As our capacity utilization increases, we anticipate that net debt will increase; however, with our continued focus on cash flows, we expect that this number will remain at a manageable level. We want to ensure that debt levels rise slower than revenues and that effective cash management becomes engrained in our overall management system. This quarter shows the positive progress we achieved in a short period. We remain optimistic that as earnings improve and debt utilization remains on a downward trend as a percentage of sales and earnings, AGT shareholders will recognize the benefits of management's focus on debt.

I want to remind our investors and analysts that our short term financing is securitized by our current asset base. The Canadian bank financing is determined based on a borrowing base calculation and this financing is therefore backed by inventory and accounts receivable. AGT has current assets of $342.4 million as compared to total interest bearing debt of $269.4 million, and as a result AGT has liquid capital resources available to cover all debt obligations, including long term debt.

AGT's inventory is managed closely, with monthly reviews of values and tonnages and adjustments of physical tonnages and values to reflect the lower of cost or market if applicable. Also, AGT's receivables are insured globally through our Export Development Canada policy to mitigate payment risk. This ensures the quality of the current assets on our statement of financial position.

In July, we paid a dividend of $0.15 per share for the quarter, or 60% annually. The dividend amount was increased in 2011 from $0.54 annually. A quarterly dividend or distribution has been declared and paid by AGT and its predecessor Fund (Alliance Grain Traders Income Fund and Agtech Income Fund) ever since inception in 2005. We have never missed a dividend, and management and the board remain committed to delivering a balanced approach of growth and yield.

Overall, we are very pleased with the positive progress we see in our financial results. Thank you.

MURAD AL-KATIB:

Thank you, Lori. We are optimistic in the continuation of these positive results and trends in our traditionally busy periods in the next quarters, with a gradual and steady recovery in our business as markets normalize in advance of the traditional shipping periods in the second half of the year.

We also remain focused on the development of sales opportunities in our core platforms for growth, those being our pulses and special crops processing and export business, our packaged food and ingredients business and our trading and distribution business through the balance of 2012 and 2013.

We are particularly excited about our new initiatives like the marketing of pulses ingredients as well as our new protein, fibre and starch business that is developing through our investments in Minot in the United States and Tianjin in China. We remain committed in our efforts to diversify our business based on the strategy of origins, products and markets to ensure that our shareholders are better protected against the earnings variability that we observed in AGT in the past quarters.

We have held the opinion that capital will flow to staple foods in times of macroeconomic crisis, as was demonstrated in the 2008 global economic and banking crisis.

The short-term macroeconomic events that affected other sectors typically affect agricultural supply and demand fundamentals but much less severely. This really is what provides the basis for our optimism on the expected recovery in the second half of the year and into 2013.

As the global economy has improved, so has our customers' ability to open letters of credit and clear documentary collections on time for shipments. Banks, which have been experiencing their own liquidity issues, have re-opened credit facilities for many of AGT's strong importers, allowing for more reliable flows of orders to be shipped from AGT's plants around the globe. We expect these conditions to continue.

And as global markets continue their recovery; we forecast improvements in our capacity utilization that would see our facilities move away from potentially lower-margin products we have been working to our more higher-margin, value-added products that are a core part of our business and strategy. We expect this return to our preferred business segments to have a positive impact on our margins and earnings.

The management initiatives we previously announced surrounding debt reduction, capital project restrictions and scaling back of operational expenses appear to be providing more efficient operations and some of the cost savings that we expected.

These initiatives are forecast to continue in the near term, as we view them as providing significant opportunity to continue streamlining our operations as markets and earnings improve.

Our continuing efforts to strategically diversify our business through origination and investments are aimed at reducing our reliance on our traditional origins and operations in Canada, as well as realizing new opportunities from other regions and new product offerings, will continue over time.

In the long term, we feel that these strategies will assist us in growing and transforming our business from where we are today to our next stages of growth.

We will continue our efforts to reduce costs, optimize working capital by managing our cash cycle, reduce our debt utilization and boost margins and earnings.

Our management team and our board remain committed to growth and yield. We will continue our efforts to improve free cash-flows; we'll provide capital for debt reduction, growth and acquisitions and improvements to our dividend yield. That's what returning to normal operations will do for this company.

The demand for protein and pulses and staple foods is growing both in traditional consumption markets and new ingredient markets. Consumers around the globe are demanding non-GMO, gluten-free, low allergen, healthy, nutritious and tasty foods.

The indicators for a restart to import demand to fill pent-up consumption demand are now appearing, and more predictable export flows and supply replenishments in most core consumption markets are expected.

The agricultural and food sector has been affected, as have all sectors of the global economy. However, we remain committed to our strategy and optimistic in our opinion that we will be able to demonstrate the earnings power and compelling global footprint of our asset base, our markets and our products as we continue on the path to becoming a global leader in the origination, processing and distribution of pulses, staple foods and ingredients.

I thank you for your interest in Alliance Grain Traders. We're going to open it up for some questions. Omer, go ahead.

OMER AL-KATIB:
Operator, we will take the first question.

OPERATOR:
Certainly, sir. The first question is from Jacob Bout of CIBC. Please go ahead.

JACOB BOUT:
Good morning.

OMER AL-KATIB:
Good morning, Jacob.

JACOB BOUT:
I had a question. So, you take a look at revenues, so just overall results from the company, and they were up 19%. But if I take a look at the EBITDA, it was flat year on year. Can you just talk a little bit about what happened in the quarter; is there one division that's responsible for some of the decline in margin? And maybe you can talk a bit about capacity utilization, how that has changed year on year. And then maybe talk a little bit about how things have progressed through the quarter and what you've seen in July so far.

MURAD AL-KATIB:
I think, Jacob, let me attack your question in a couple of responses. I mean, the first thing is that when we're looking at a year on year comparison, certainly we've been quite clear in our view that the macroeconomic conditions that are affecting global liquidity and regular consumption demand, you know, have certainly put pressure on margins that have compressed margins.

So when we look at this story, we've said very clearly to the street in the past that one of our big advantages, Jacob, is we're a high fixed-cost component business. That's also our big disadvantage. So as utilization is compromised because of demand flow or margins are compressed, we do have a relatively high fixed cost. We cannot easily get rid of very skilled technicians within 29 factories and five continents and still ramp up, especially if we believe that the impairment of margins and demand is a temporary impairment and not a permanent one.

So, I think when I look at the results overall, Canada and Turkey are our two largest capacity divisions. When utilization is suffering, Canada and Turkey are the two divisions that have the excess capacity and that house the greatest amount of our corporate infrastructure. So when I look at underperforming Turkey and Canada have been ones that we need to continue to see improvements.

The positive side of what we're saying is in the latter parts of Quarter 2 we saw utilization gains; we saw a product mix change where, you know, we are getting back into more, you know, quality sensitive markets, buying things like our lentils and other things. So we have a margin improvement. Margins and quality are very much correlated. I mean, Jacob, if we're playing in the commodity game, we're playing in more commodity-type margins. Now, what AGT has showed is our ability to play in the market, even if we have to on the commodity side, just to ensure utilization, to deliver some positive earnings in times of macroeconomic strife. But it's certainly not our chosen segment and where this company drives its earnings traditionally.

So, where we see the positive side, there's been a margin improvement, a bit of utilization. The demand catalyst that we see will provide, in my opinion, some headwinds or some winds that go against the macroeconomic headwinds. So, you know, we've got these winds pushing against us on the macroeconomic side. Those aren't gone yet, right. We can't say that the Eurozone crisis and bank liquidity and economic uncertainty is gone in the market because it's far from gone.

But if we subscribe to our staple foods capital thesis, which is capital flows to staple foods, we will start to see an easing of that. The positive demand fundamentals of the Indian monsoon, U.S. corn, soybean crop challenge, Russia-Ukrainian crop challenge, aimed with positive supply in our jurisdictions, that gives us a solid base from which to deliver a 2012/2013 plan.

JACOB BOUT:

Just as a follow-up then on the quality product, you know, wasn't the quality of the product that you had in Canada for the second quarter of this year better than the year before?

MURAD AL-KATIB:

Yeah, definitely it was better than the year before. So the quarter, when we look at the Quarter 2 of 2012 versus 2011, we were processing product that was very poor quality and we ended up in a position where we were certainly constrained in that period. So if you look at utilization in the Quarter 2 period last year, we were sitting at 227,000 tonnes. So we ran more products, higher quality, but more into the commodity segment. We think that will change over the next periods.

JACOB BOUT:

And then just finally, U.S. weather, how does that impact the lentil crop, especially considering, like, are things changing here with the rain. I mean it sounds like it might help with soybean crop; do you think it's going to help the pulses as well?

MURAD AL-KATIB:

I think that, in our respect, there are a couple of things. I mean people hear widespread U.S. drought and they expect that North American crops are all under pressure. I think it's very important to look at the rainfall maps and see Western Minnesota, North Dakota, Eastern Montana, Western Canada in general have had very favourable weather conditions. So certainly what I would consider to be, you know, better-than-average growing conditions over the period. So our supply side is intact.

Even with the rains and the soybean side, Jacob, the consumption of these crops is so massive globally that any impairment in the U.S. corn crop, what the relation is for us is it's the protein complement globally. So when we take a look at Russia-Ukrainian harvest challenges, coupled with U.S. corn challenges, and the effect that has on the feed markets in Europe, let's say Europe is feeding, you know, former Soviet Union pulses for feed now; they're using wheat for feed.

So the corn side will raise just the global base benchmark for protein, which of course has a positive effect on the fundamentals of pulse consumption. So importers feel like demand can be restored because, as prices escalate, importers have a lot of confidence they're not going to lose. They can't hedge, remember, just like we can't hedge.

OPERATOR:

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

STEVE HANSEN:

Oh yes, good morning, Murad. Murad, I just wanted to dig into the potential impact of this Indian monsoon issue just a little bit more. I understand that the kharif crop is already looking to be fairly impaired and that can often trigger imports as close substitutes, like green lentils from Canada if pigeon peas are impaired, but to look to your commentary it seems to suggest that the following crop might also be impaired to a certain degree. And I just wanted to get a sense, do you have any sort of feeling for what kind of additional or incremental imports India might need should, I guess, the first crop be impaired but even more so the second crop?

MURAD AL-KATIB:

I mean, Steve, that's the question that no one knows, but what we can tell you is just anecdotally, when you look at a country like India—or actually, let's look at pulse producing regions around the world. So we have competing origins are Turkey, Syria, India, Australia. Okay, those are really the big ones, you know. The talk of, you know, Russia-Ukraine and stuff, that's pretty much in the pea sector and certainly more in the commodity side. But let's look at the more traditional lentil growing areas and the more value-added pulses like the mung beans and pigeon peas and all that.

They are all, with the exception of North America, getting hotter as we get towards their harvest, okay. So these are dry land crops, they are moisture conserving crops, but the heat can become extreme in any one of these regions. So we're talking about Southeast Anatolia or India or Australia; we can have temperatures in the range of the high 30s to mid 40s during a harvest period. From that particular perspective, water availability in both seeding, progression through the growing season, even into the harvest season, is important.

Now, when you look at the Indian monsoon, 55% of the arable land largely counts on the monsoon for the majority of its moisture. So the monsoon does two things. It provides drinking water and it provides irrigation, water supply. When we look at anecdotally, any region of the world that has an escalating heat index as you get closer to harvest with a dramatic drought condition can take one or up to two years to recover from that drought.

And you have to think about it: next year's monsoon—again, I'm not a meteorological specialist, but common sense tells me that we've got to replenish moisture deficit and still provide the moisture for next year. So we see the potential for a two-year impact, meaning the fall crop, the spring crop and then next year's crops as well. So I think that, from that side again, the positive demand fundamental is there. We need to see how that plays out.

In terms of substitution, pigeon peas for green lentils, mung beans and chickpeas and lentils and all of the different substitutions that can happen, every crop in India will be under challenge. So that will open up the opportunity for Canada and Australia to be suppliers in more of a situation than we saw last year.

OPERATOR:

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

MARC ROBINSON:

Good morning, Murad. So just on this working capital issue, we saw working capital decline by $40 million and change, which is great, and Lori discussed this a little bit, I think, but just so we're on the same page here: we approach the back half of the year which typically sees working capital increase, what should we expect in terms of these working capital management initiatives? Couldn't we expect to see working capital continue to decline into these seasonally strong quarters?

And then just the sort of B-part to that, as a result of these lower pulse prices we're seeing now, can you talk about the effect that might have on working capital management?

MURAD AL-KATIB:

Marc, let's attack that two ways. Listen, in Lori's comments I think you may have heard a comment to say, look, as utilization increases, meaning our overall business increases, we will expect that our net debt is largely working capital debt to finance inventory and receivables. Now what our focus will be as management is ensuring that these working capital management initiatives continue to shorten the cash collection cycle and to increase the turn frequency of our inventory. So our focus metric as we go forward will be that debt should increase at a lower percentage than revenues so that we are seeing on a percentage basis, we are seeing improvement in our debt position.

So we don't want you to focus on just the absolute debt level because listen, if we end up with a— we're not saying that demand is going to be through the roof today because of the macroeconomic headwinds that are there. But the potential exists that demand can be substantially stronger than what we are projecting today into 2013. So from that perspective, I think that what we're really saying, Marc, is these are now ingrained within the management system. Each operational division is being measured on their performance related to inventory turn, related to accounts receivable management. So we're expecting that to certainly continue to show improvement.

The thing that I focused on when we looked at the results is you'll see a significant decline in packaged inventory. That means that finished products were produced and they're shipped out. Okay, that's more… we want to be more just-in-time production, okay. We look at our receivable side; we actually only saw a very small decline. We think that that will continue to show improvements because we are shortening cash collection cycles by cutting credit terms.

LORI IRELAND:

Yes, and certainly as a management team we're not taking our eye off the metric. As I indicated, it's one of the, you know, a monthly metric that we share with the management teams at the various subsidiaries and they're being measured on that. So as we grow and get busier, obviously we'll be using more working capital. But at the same time we're going to remain focused on keeping those metrics in order.

MURAD AL-KATIB:

Marc, listen, my target would be to achieve relatively consistent, but on a percentage basis we should be continuing to see improvement in the coming quarters.

MARC ROBINSON:

Okay, so the absolute dollar may increase but the turns should continue to decrease.

MURAD AL-KATIB:

Absolutely.

MARC ROBINSON:

And then in terms of the…?

MURAD AL-KATIB:

If we succeed in our ability to shorten the cash collection cycle by tightening up credit terms globally, and by the way we're not the only ones doing this, right. We're fortunate in the strength of our balance sheet and the lack of long-term debt that's on our balance sheet, so with borrowing-based facilities, meaning that we margin inventory and receivables to borrow, we have access to credit. Many of our competitors globally are choking from working capital constraints. So from that perspective we're tightening, so is everybody else, so it's not putting us at a competitive disadvantage. That's something that I think is very important.

OPERATOR:

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

ANOOP PRIHAR:

Yes, good morning. First of all, the inventory number on the balance sheet is about $144 million. Can you give us a rough sense as to how much of that is presold?

MURAD AL-KATIB:

How much of that is presold? Anoop, I'd be giving you just an estimate, I guess. My estimate would be probably about 60% to 65% of that inventory is always at a sold position. So when you look at revenue recognition policy, it remains in inventory until it's in a position where the international INCOTERM of sale transfers the risk from seller to buyer.

So, for instance, if Carrefour in Europe is buying pasta from us, we may have the penne sitting on the floor at Arbel. It's sold, it's priced, it's done, but it's still in inventory until it's called out and invoiced to Carrefour. If we have product in rail cars, which as you know our rail capacity, as we boost utilization, we can have up to somewhere in the range of, say, 15,000—10,000 or 15,000 tons a week in transit to Montreal or Vancouver. That's all sitting in inventory but it is presold.

ANOOP PRIHAR:

Okay, that's fine. And the second question is: did the CP strike cause you any material loss of business during the quarter?

GAETAN BOURASSA:

I think that we lost—this is Gaetan here—I think we lost one or two spots. It wasn't that material.

ANOOP PRIHAR:

What does that mean, one or two spots?

GAETAN BOURASSA:

A few of our facilities in the south that are on CP Rail, they missed the rail spots, so I'd say it would be, you know, 20 to 30 cars were missed, not that material in the big picture.

MURAD AL-KATIB:

So it's 20 to 30 cars with a couple of thousand tons, and we have probably tried to find other methods for that, so some intermodal, some containers, so no big material effect for us.

ANOOP PRIHAR:

And just a last quick question, have you seen any increase in the sale of unprocessed products from your—or any increase in demand for unprocessed products from your customers, particularly as it relates to your customers in Southeast Asia?

GAETAN BOURASSA:

Yeah, we don't do farm-dressed as a company. There's a bit of that trade done out of Australia. However, we have had added equipment for machine clean that's just come on-stream. Some of that's not… we run into all sorts of problems with phyto-sanitary issues and quality complaints and whatnot, so it's something we stayed away from and brand ourselves accordingly.

MURAD AL-KATIB:

What we're seeing actually is the trend reversing. We're seeing that with the quality variability of the past seasons, you know, our traditional pulse crops that we handle, the lentils, the chickpeas, the beans, those ones, green lentils, those, they are, relatively speaking, a high value commodity. They are further processed on the red lentil side when they go to millers, let's say. You know, they're not interested in variability because variability in product is yield loss.

And so you know, for instance, as Gaetan mentioned, in Australia, we're now offering machine-dressed products out of Australia, meaning machine cleaned. And you know, that processing infrastructure was relatively unavailable in Australia until we built a large scale processing plant in South Australia. That was commissioned about maybe four or five months ago and so we're thinking that that dynamic will continue to change.

OPERATOR:

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

CHRISTINE HEALY:

Hi, guys. It was good to see some improvement in net debt this quarter. It looks like the ratio to trailing 12 month EBITDA is still a little high at six times. I'm just wondering, do you have a target for debt EBITDA or net debt EBITDA that you want to reach or a level that you're comfortable that you can share with us?

MURAD AL-KATIB:

I would say those measures are certainly still being considered, Christine. I don't have a measure that I'm able to kind of share at the top of my head. So we'll be looking at, you know, achieving further reductions, as I say. You know, when we look at our comments related to the net debt of attempting to ensure that the debt utilization increases are less on a percentage basis of revenue. So as revenues and earnings increase we're not seeing debt levels dramatically increase.

I think that we'll see a marked improvement in the debt-to-EBITDA levels coming up in quarter 3, quarter 4 and into 2013. Our target right now is on continued reduction of those metrics, but we don't have a target that we're publishing.

CHRISTINE HEALY:

And do you feel comfortable that you're going to get to where you want to be in time to put the $50 million Canadian pasta and ingredient plant back on next year?

MURAD AL-KATIB:

You know what, Christine, we've been really clear. Until we see a return of profitability margins, so some margin recovery, we see the macroeconomic situation in the world starting to show us some demonstrated trends of stability, that we are deferring any large scale capital.

And so, you know, as a board, we sit quarter to quarter. We have discussions on capital plans. We'll do a further discussion on the 2nd or 3rd of November to make sure that we're on stream and, if things improve, we'll look at starting our expanse of the game.

Until then, though, I want investors to be very confident. We are in the mode of asset utilization, earnings growth, margin improvement and efficiency development that's related to our costs and all of those things. That's where our focus is. We have a compelling global footprint. We haven't been able to show the earnings power. That's where our focus is today.

OPERATOR:

The next question comes from Sean Pratt of *The Western Producer*. Please go ahead.

SEAN PRATT:

Hi, Murad.

MURAD AL-KATIB:

Hi, Sean. How are you?

SEAN PRATT:

I'm good. I came to the call late here, so I apologize if I'm asking you to repeat something you already talked about, but sort of a three-pronged question here, I'm just wondering how much of a reduction you're expecting in Indian kharif pulse production. And the other two questions are both Turkey and the U.S.: at the Canadian Special Crops Association meeting, there was a presenter who said that Turkey's got plenty of lentils and doesn't need any imports for quite a while until it chews through supplies. I'm interested in your take on that. And also on the U.S. bean crop, what kind of shape it's in.

MURAD AL-KATIB:

Let's start with India, I guess that we're going to see India and we want to comment on India, Turkey and U.S. beans.

SEAN PRATT:

Yes.

MURAD AL-KATIB:

If we want to start with India, I mean, Sean, at this point, the monsoon rain deficit, I think published report this morning was June 1-August 2 data is showing a 19% reduction on the 65 year average of moisture.

Now some analysts or prognosticators are saying if you look at the 20 year average versus the 65 year, because of climate change patterns, the monsoon rains have actually been more variable in the last two decades compared to the last 65 years; that deficit may actually be higher than the 19%. I think that there are two main effects that you're going to see in the harvest period in October.

I'm not prepared to give you a percentage decline because, frankly, no one in the world knows that. So I think it would be very counterproductive, but two effects that we see, one is unseeded acreage. We're seeing seeding progress down significantly. We're also seeing a substitution of crops. So if you look at the moisture deficit, planned pulse acres may go into crops like sorghum or other crops that may be either shorter cycle crops.

Even in the pulse crop side, you're going to see shorter-season pulses because, as I said, when you're escalating in terms of heat units, you're in a position where you ultimately are very conscious of short moisture and heat units. So we expect there to be a significant impact on seeded acreage and yields.

Also, let's not forget, corn—sorry, soy beans and wheat and oil seeds, wheat, all these other crops are at historical highs. And so we're going to see continued substitution into some of those crops in some of the areas that aren't as drought affected. So overall we expect imports to be a lot--there's a lot more potential for imports.

On Turkey, we're—our MD&A is clear to say our expectation is 350,000 to 400,000 tons from the crop this season. If you look at an anecdotal view of the industry in Turkey is that consumption locally is around 300,000 tons per year. If you look at 300,000 tonnes of split lentil consumption, meaning it has to be peeled and split, that's about 350,000 to 360,000 tonnes of local consumption. Now that does not take into account what's happening in Syria, Iraq, Libya, Sudan, Egypt, Middle East; all of these other neighbouring markets and their consumption where they count on Turkey for that supply.

So we continue to feel that Turkish imports two years in a row were in the range of…

GAETAN BOURASSA:

Yes, I mean it's been around 200,000 the last four years, I think. So…

MURAD AL-KATIB:

Right. So 200,000 tons a year, Sean, there's no reason for us to expect that there's going to be any change in the Turkish import side.

On U.S. beans, we're seeing positive trends in both Manitoba and the U.S.. If we look at overall drought condition like compared to the Midwest side, you see a marked improvement when you get into that western part of Minnesota and into the eastern part of North Dakota. We're expecting yields to be average and acreage is up. So we're expecting there to be a good bean crop supply compared to last year where, you know, we had acreage declines, we had flooding issues in North Dakota and we had variability in yield.

So we're expecting the U.S. bean side to have a good recovery and we have our new plant in Minot, North Dakota, that will be a food ingredient plant, but it also has a been processing line. So we'll be more and more heavily involved in that U.S. bean sector as we go forward to complement our Parent Seeds division in Southern Manitoba.

OPERATOR:

The next question is a follow up from Steve Hansen of Raymond James. Please go ahead.

STEVE HANSEN:

Oh, yes, I just wanted to follow up on the renegotiation of your localized credit lines in the, I guess, the global facility. Do you have a sense for the timeline on the Arbel process and when you should wrap it all up? It sounds like the savings are fairly material even in the South African level, so I imagine the corporate level they've got to be quite significant.

MURAD AL-KATIB:

Yeah, you know what, Steve, processes are ongoing. I mean obviously there's a lot of complexity to looking at global syndications with your foreign operations in five continents, including emerging markets. So the strategy development on that continues to be in progress. Discussions are ongoing.

You know, I don't want to give you a commitment on that, but we're continuing on progress for later this year and into the early part of 2013 to ensure that we're ready. And, frankly, it is our desire to continue to show positive earnings improvement so that when we negotiate with our bankers on global terms of longer periods for our working capital and our term debt, we're going to achieve very favourable terms.

And so from that perspective, listen, I'm not in a hurry. We've got a balance sheet that's very strong. When you look at our total interest bearing debt, I'm going off my memory here, I'm not looking at the numbers here, but about $264 million of interest bearing debt and $330 million of current assets. And if we believe strongly that Export Development Canada mitigates our receivable collection risk and our inventory is mark to market and we do book-to-physical reconciliation every month, not every quarter, we believe in the quality of those current assets.

We have a global footprint of assets of 29 factories that are unlevered, meaning we have a very strong balance sheet in order to achieve those terms. So we'll be in a position where I think that progress will continue… the South Africa facility with a little standalone. I got done the end of July, thanks to HSBC, and from that perspective it shows real earnings per share impact. And I've got to make the comment, I always say it; don't forget management, meaning management and insiders, we own 30% of the outstanding stock of this company. We're not only focused on EBITDA. We're focused on earnings per share.

So real cash outlay is of interest. Optimization of our debt, it's high on our radar screen as is cost reductions.

STEVE HANSEN:

Great. Thanks very much.

OPERATOR:

The next question comes from Christine Healy of Scotiabank, a follow up. Please go ahead.

CHRISTINE HEALY:

Thank you. Thanks for the follow up. Murad, I just wanted to ask about your segmented sales. There's a significant increase of sales to Asia this quarter. So you've talked about the Indian Sub coming back to market so that makes sense. But sales to M.E.N.A. were the lowest we've seen in about a year. Can you tell us what you're seeing in that region or are issues in Egypt, Syria causing sales decline in that region?

MURAD AL-KATIB:

Let's attack it as two parts. I think you asked about Egypt, like North Africa, Middle East and you asked about Asia. Is that right, Christine?

CHRISTINE HEALY:

Yeah, no, Asia is straightforward. The sales went up so we know the Indian subcontinent's come back to the market, but M.E.N.A., we saw a pretty significant decline, the lowest we've seen in a while. So really the Middle East, North Africa, if you could talk about what's going on there.

MURAD AL-KATIB:

Yes, let me start with the political side and then I'll maybe hand it over to Gaetan to talk a little bit about the market side. But, listen, politically, it continues to be a time of transition and crisis—but we're seeing a bit more stability now. I mean, the Egyptian elections are complete. We have the military council and the new president coexisting. So we're seeing a bit more stability in the Egyptian pound.

We're seeing the post-conflict transition in Libya taking shape, whereby—we had our chairman, Huseyin Arslan, was in Libya last week and his commentary to the management team was, you know, it is a country where we don't have necessarily a government or a rule of law, but there seems to be some relative stability and they focus on food security.

So we've said this in the past, Christine, that when we look at post-conflict Syria, which we believe will be coming, and we look at Libya and we look at Egypt and we look at Algeria and Tunisia and the list goes on and on, Sudan, South Sudan, all of these areas of Turkey, around Turkey, Turkey becomes a strategic asset base. It's a geopolitical financial center for the region and food security will be a basic building block of what we call civil obedience.

Okay, from our perspective in Canada, we always think of democracy and we think of civil liberties. Well civil obedience is an important aspect of building institutions and democracy. And so food and opportunities for AGT and basic staple foods because, if you look at the region, if we look at Egypt, the basic commodities that the military was importing post conflict was sugar, wheat flour, faba beans, lentils and vegetable oil, so two of—and rice, I guess there were six commodities. Three of those are commodities that were involved heavily in. So we see that continuing down the path.

Gaetan, do you want to make a comment on Egypt, Turkey, Algeria, the region, in terms of demand?

GAETAN BOURASSA:

Yes, I guess over that period, you know, those markets were well-stocked and there were some kind of liquidity problems. So we saw markets like Algeria abstain on their high stocks, the same with Egypt. Morocco didn't buy at all. So these are big volume markets for us and we're starting to see some of those markets come back now to the trough so hopefully we'll see improvement in this quarter.

CHRISTINE HEALY:

Great. Thanks so much, guys.

OPERATOR:

Once again, anyone who has a question may press star and one at this time. The next question comes from Stanley Behrans of Stanley Behrans Living Trust. Please go ahead.

MURAD AL-KATIB:

Hello.

STANLEY BEHRANS:

I'm a plant-based eater. My name is Stanley Behrans and I would like you to comment on the quality of protein for human consumption in the future versus animal products, which are negative for disease, like heart disease, cancer and diabetes in terms of the quality and growth of your products, which would be, I think, paramount in the future.

MURAD AL-KATIB:

Well, Stanley, let me make a comment on that. I mean, well when we look at our food ingredient initiative, we've launched a research center which we announced in our MD&A where we built a pulses food development center in Saskatoon, staffed by in-house research specialists working collaboratively with food companies on product development, working with pet food companies, aquaculture companies on ingredient utilization of pulses.

We're talking about high protein, high fibre, lower glycemic index of foods. We're talking about a vitamin and mineral profile, gluten-free non-GMO—so I sound like a buzzword person who's just throwing out all these positives—low allergenicity compared to corn and soy, all of these things will lead to what we see as an emerging trend in North America and Europe, that is going to lead to substantial food ingredient opportunities.

And so, yes, while we will not forget about our traditional markets, it's time to take the origination processing expertise that we have and put it into that. So there are health and human clinical trials going on now on pulses consumption and diabetes management, heart disease, the fibre benefits, all of these things.

So, you know, certainly we agree with your comments, Stanley, as an individual investor and we're quite excited about the opportunities.

OPERATOR:

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

OMER AL-KATIB:

Thank you very much, operator. I'd like to thank you all for joining us today. As well, I'd 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, thanks 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.