From Producer to the World

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Alliance Grain Traders
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Speakers:

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President and CEO

Lori Ireland
Chief Financial Officer

Gaetan Bourassa
Chief Operating 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 or afternoon and thank you for joining us on our First Quarter 2014 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 reconciliations 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 AL-KATIB:

Thank you, Omer. Thank you for joining our call today. Our Q1 2014 results are building from a positive improvement, expansion and diversifications that we have been seeing in our business, many of which took place in 2013 and ones that we expect to continue in 2014.

In our current position, with our legacy business continuing to show improvement and our new Food Ingredients and Packaged Foodss segment continuing to develop and grow as we expect, we feel we have a strong foundation for AGT. Our unique mix of global assets, market access, origination strength, international and local management and access to capital are critical tools to further our goal of building our business into a dominant player in the global food sector.

We expect these successes to continue demonstrating why these investments and strategies are important to the continuing growth of AGT, creating new opportunities and capitalizing on the ones already before us and maximizing their potential. A number of the highlights with regards to our Q1 2014 quarterly results illustrate the positive improvements in our business. I'm going to ask Lori Ireland, our CFO, to discuss some of these highlights. Lori?

LORI IRELAND:

Thank you. Hello. This quarter, the Food Ingredients and Packaged Foods segment includes the results of our newest subsidiary, AGT CLIC Foods Inc., which contributed revenue of $7.0 million and net income of $631,000. In addition, we are pleased that the second line in the Minot, North Dakota plant began commercial production during the quarter.

Overall gross profit, adjusted gross profit and EBITDA per metric tonne increased to $79.89 and $44.17 for the three months ended March 31, 2014, compared to $67.82 and $38.87 for the three months ended December 31, 2013. Contributing to the increased per metric tonne earnings were improvements in the Pulses and Grains Processing segment to $60.29 and $40.38 adjusted gross profit and EBITDA per metric tonne for the three months ended March 31, 2014, compared to $58.79 and $37.90 per metric tonne for the three months ended December 31, 2013. In addition, Food Ingredients and Packaged Foods showed adjusted gross profit per metric tonne and EBITDA per metric tonne of $159.71 and $105.01 for the three months ended March 31, 2014 compared to adjusted gross profit and EBITDA per metric tonne of $121.06 and $90.77 for the three months ended December 31, 2013. The Trading and Distribution Segment showed lower adjusted gross profit and EBITDA per metric tonne of $43.91 and $15.40 for the three months ended March 31, 2014, compared to $49.60 and $22.22 for the three months ended December 31, 2013. This was largely due to fewer food aid tonnes being invoiced in the recent quarter.

We saw the accounts receivable turns for the three months ended March 31, 2014 decrease to 48 days compared to 53 days for the same period last year. Inventory turns slowed down to 78 days for the three months ended March 31, 2014 compared to 68 days for the three months ended March 31, 2013. A buildup of inventory related to food aid family parcels in Turkey contributed to this, as well as the addition of packaged food and other inventory purchased with the acquisition of AGT CLIC. Also, inventory turn slowdowns occurred in Canada due to railway issues experienced during the quarter.

Consolidated inventory and accounts receivable turns for the three months ended March 31, 2014 totaled 126 days, which was consistent with our turns in the 2013 year.

Non-cash foreign exchange includes a snapshot of outstanding foreign denominated accounts receivable and accounts payable, as well as outstanding foreign exchange contracts and includes the contract related to the high yield bonds. Note that this is a non-cash item and will fluctuate depending on the strength or weakness of foreign currencies when compared to the Canadian dollar. On the Statement of Comprehensive income there are two foreign currency numbers. The gain of $7.1 million relates to mark to market adjustment on accounts receivable, accounts payable and intercompany balances. The other comprehensive income of $10.6 million relates to the foreign exchange differences on our foreign investments.

AGT has a treasury process in place to ensure that the need to purchase foreign currencies to settle debt will be minimized if it will result in realized losses on foreign exchange.

AGT tracks adjusted earnings per share as it is reported exclusive of the non-cash foreign exchange effects of our global business. Early on in our reporting as a public company, we decided to ensure that these effects were clearly stripped out of our results. Inclusion of both gains and losses that result from snapshot non-cash IFRS effects do not accurately reflect the cash flow generating ability of our business.

General and Administrative and Marketing, Sales and Distribution expenses have increased over the prior year due to the increased global platform and increased volumes. Current year results include expenses related to the operations in Russia, Ukraine, India, China and Switzerland, as well as costs related to the new AGT CLIC acquisition. The General and Administrative and Marketing, Sales and Distribution expense for the quarter ended March 31, 2014 include costs associated with market development and accounts receivable allowances as well as start-up costs related to AGT CLIC.

EBITDA for the three months ended March 31, 2014 was $17.1 million, compared to $13.6 million for the three months ended March 31, 2013 and compared to $18.2 million for the three months ended December 31, 2013. AGT Management is happy with the EBITDA growth and improvement of EBITDA as a percentage of revenue to 5.49% for the three months ended March 31, 2014, compared to 4.91% for the three months ended March 31, 2013 and compared to 4.85% for the three months ended December 31, 2013.

Net debt increased from $318.5 million at December 31, 2013, to $369.4 million at March 31, 2014. The increase is due to lower accounts payable levels typically experienced in the first quarter of the year, as producer settlements that were issued in the latter part of the prior year are cashed in the current year, therefore drawing on operating credits. This seasonal cycle, along with the buildup of inventory due to food aid requirements in Turkey, the slower inventory movement from Canada due to railway issues and the additional inventory related to the acquisition of AGT CLIC have resulted in increased credit utilization in the current quarter.

Metrics continue to be calculated for each facility and performance targets are being tied to inventory and accounts receivable turns at each plant and country operations level. We feel that continued focus on cash collection as well as seasonal increases of accounts payable levels will help AGT decrease net debt in coming months.

Of total operating credits available of approximately $182 million, approximately $141 million was drawn at March 31st, 2014, leaving approximately $41 million available to draw. AGT and its subsidiaries are in compliance with all covenants at March 31, 2014.

Thank you.

MURAD AL-KATIB:

Thanks, Lori. Our Food Ingredients and Packaged Foods segment is certainly the segment of our business that we feel provides the greatest future potential. After commissioning our Minot, North Dakota plant in June 2013 and adding a second line of production around the tenth of March of 2014, this platform continues to track positive progress towards demonstrating its growth potential and earnings.

Our sales programs for pulses flours, proteins, fibres and starches, both with our partners and through our own global sales system, are developing as we expected they would.

Our R&D initiative focusing on collaborative research with customers as well as baseline and application work is generating customer interest in our proteins and fibres and increasingly in our high viscosity flours and starch products. This is expected to result in assisting in the conversion of test quantities to real commercial sales in both human food and pet food sectors for AGT.

In general for this segment, market trends are shifting towards lower cost and higher volumes of plant-based alternatives as a result of rising costs of other ingredients, growing from dietary preferences such as gluten-free, high fibre and high protein and consumer demand for healthier and sustainable GMO-free ingredients.

In part, these trends demonstrate the potential market opportunities pulse ingredients may provide, not only in North America and Europe but around the globe, supporting our thesis and belief that our well-structured, strategic entry into the pulse ingredients sector may provide significant growth opportunities and increased earnings potential for AGT.

Of course, continued growth in the packaged foods platform is an important component to this segment overall, not only for North America and Europe but around the globe as well. Synergistic trade opportunities, particularly in markets where we have retail business and distribution or where we are packaging for retail, assists us in capturing opportunity to utilize our asset base and maximizing sales opportunities in all our segments. We expect these opportunities may positively impact our capacity utilization globally, developing new customer relationships that translate to sales and therefore positively impacting our margins and profits.

Increases to capacity utilization and volumes in our high fixed cost environment will have a positive impact on our margins and earnings as well, whether in support of the Food Ingredients and Packaged Foods or our Pulses and Grains segments. This is certainly contributing to our analysis regarding the feasibility and costs of conversion of existing available underutilized assets and capacity to the food ingredient platform in 2014 and 2015 as well as potential for line three in Minot as sales dictate.

In our legacy Pulses and Grains Processing segment, the continuing recovery with regard to volumes and margins certainly will continue to be important as well, with the asset base we have globally in this segment. This past quarter showed improved results from our operations in Turkey, which we view as a real positive signal that markets are potentially moving towards a return to traditional seasons and activities in the pulses and grain export business.

Demand in important markets is expected to continue, as it appears that local production in India and Turkey are impaired; however, with less than reliable reporting of stocks and production volumes, the true measure will be seen in the export data from Canada and Australia throughout this year, particularly in the coming quarters.

Our Canadian operations have of course been impacted by the transportation and supply chain issues that are creating problems for export shippers of commodities and goods from Western Canada. The Government of Canada and all participants in the agribusiness supply chain appear to be working together to assist in clearing the backlog of shipments created during the quarter and during the harsh winter conditions, and this will certainly help Western Canadian farmers and exporters move their products to market.

For AGT, these issues and delays certainly manifested themselves as impacting our ability to ship volumes of product through ports in Vancouver and Montreal. This resulted in timing-related issues surrounding our sales and shipments, and certainly manifested itself as a real earnings impact in Quarter One.

Some of the shipment volumes from the ample stocks of pulse products available in Canada that would have traditionally be completed in the first quarter may be shifted to traditionally slower periods of second quarter and into the summer months as equipment availability and weather improves. With alternative freight options being utilized when available, we are optimistic in our ability to manage our delivery chain and capitalize on market opportunities.

Farmers in Canada and the U.S. are getting ready for seeding. Moisture levels appear adequate early in the season in Australia and we expect another strong pulse production season that will add to the relatively average levels of global supply, but the estimated seeding intentions can change at this time of year. Overall, we’re expecting ample supply to execute our program, and we expect margins and volumes in our pulses and grains segment to track as per our expectations, inclusive of the transportation issues. We believe we're going to see further improvement in 2014.

Before we go to questions, I want to add that as AGT's business segments grow and improve, margins and earnings are expected to grow with them. We forecast that the ingredient platform growth may be for the potentially higher margin, less volatile food ingredient sector business, focused on ingredient flours, protein, fibres and starches derived from pulses and packaged retail foods segments, complementing our legacy commodity export business for pulses and grains.

We are excited and optimistic about AGT's ability to grow business operations and strengthen shareholder value in the long-term, though these new segments and a stronger legacy business will create opportunity for sales, earnings and margin growth in our coming periods.

I thank you for your interest in AGT and I'll go to questions, Omer.

OMER AL-KATIB:

Operator, can we take the first question please?

OPERATOR:

Our first question is from Jacob Bout with CIBC. Please go ahead.

JACOB BOUT:

Good afternoon. I'm going to ask a question on margins like it did last quarter—and I know it is difficult—but it's difficult for us to understand exactly on an apples-to-apples basis because we don't have the historical of what is driving some of this, but when we take a look for the Pulses and Grains Processing, we are below where we were last year at this time and I thought at this point, with higher volumes, we would start to see the margins start to improve. So how are you thinking about that right now? What are some of the drivers? And then maybe just as a follow-up, when are you thinking about converting some of the plants in Western Canada to handle—for the processing of food ingredients?

MURAD AL-KATIB:

I'm going to attack that question in two parts. The Pulses and Grains Processing segment—just remember that apples-to-apples comparison you are talking about, when you take a look at the pulses and grain segment from the first quarter of 2013 versus first quarter of 2014, the 2013 results in the first quarter included the value-added pasta business, so that was in that segment before. That's now all been stripped out. And so when we look at it, certainly we are seeing again a positive margin improvement from the fourth quarter to the first quarter, even with the addition of what we would consider to be fairly material additional costs related to supply chain issues in the first quarter. For instance, shifting production to—or shifting shipping to East Coast destinations versus West Coast even at the sacrifice of higher freight rates. These all contributed to potentially dampening the margin that we showed. So we still showed an improvement in that particular segment.

JACOB BOUT:

Isn't part of the plan or if we go back historically, we were at double-digit margins. Is the plan still to get there at some point here in the future?

MURAD AL-KATIB:

We certainly expect pulses and grain margins to continue to track positively upward. So when we look at that, there two things we are measuring. Obviously the segment ones, pulses and grains and food ingredients-packaged foods are our two segments of concentration. Trading and distribution is opportunistic; it comes and goes, and that may scale up, scale-down depending on the opportunities that present itself, but we also look at the consolidated position of overall margin per tonne and we're going to be tracking back to have a balance effect as Food Ingredients and Packaged Foods ramp-up. We expect that as pulses and grains improve, our consolidated margins overall will improve quite dramatically. So we are positive on the trend that we see. We expect that the pulses and grain segment in '14 as we go into second, third, and fourth quarter, the supply-demand imbalance is largely resolved. So we end up in a position now where supply is matching a lot more closely with the demand profile. We don't have a big overhang of supply. We expect that that's going to improve margins, and as we move forward, capacity utilization increase is another big part of boosting our overall returns on our invested capital and our margins. So the conversion decisions are going to be evaluated here in '14; we'll be looking at line three addition in Minot, and then conversion of some Canadian capacity. Likely if sales programs track expectation in 2015, we should be in a position where we are looking at material conversions to be able to capitalize on that growth opportunity we see.

JACOB BOUT:

Then I would assume you have seen a lift in capacity utilization over the past couple of years. Are you happy with the resultant gross margin in the increase capacity utilization?

MURAD AL-KATIB:

Certainly. If you look at the capacity utilization we are back to pre-crisis levels now, so the ramp-up is going to come in the second, third, fourth quarters this year, where we can start to show some of the benefits of the diversification programs we have in place both on products and markets. So, I think the answer is I'm glad to be back to pre-crisis levels. Am I happy with where it is? No, it's going to get better and we're going to keep driving that.

JACOB BOUT:

All right, thank you.

OPERATOR:

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

STEVEN HANSEN:

Oh, yes, good morning. Murad, just another follow-up question here on some of the utilization studies that you are performing at Minot, or I should say some of the feasibility studies. What are the key factors you need to see to really allow us to get better visibility on the conversion opportunity? Is it really just the sales side or what are the key indicating items we should be looking for?

MURAD AL-KATIB:

I guess Steve, the first thing was, certainly the sales side is going to drive the conversion. So one of the things we were very clear about in this strategy is we had to take the leap of faith to build the first line, and there was a big price of admission to get in the game here: roughly $30 million to get in and build that first line of processing. But from there, we've made it very clear it's going to be a ramp-up strategy based on full utilization of capacity. So we used the term, and I know you would love something a little more quantitative but when we see true visibility on the full utilization of that line, meaning we have an existing customer base that we have forecasts of their purchases and sales, that we are in a position where we are comfortable the product is going to be moving, only then will we begin the next lines of production additions.

So what we're focusing on right now is ramping the sales program, and the biggest worry at the beginning was the movement of the starch, the high viscosity flours. That's the biggest fraction and you have to create opportunities for that. Those are moving. So that is probably one of the most important aspects of ramping the sales program. We were very confident in our ability to sell the protein and our ability to sell fibre. It was the high viscosity flour starch fractions that we need to ensure we had the marketability. Those are tracking as per our expectations. As we get more into food uses of those high viscosity flours, we are expecting the margin profile to also improve that. So, you know, the feasibility work, we planned already for the third line to be able to be added to Minot. Basically, we have to pull the trigger and within three months of pulling the trigger—say three to five months, that line will be installed and running. In terms of the feasibility of Regina and/or Turkey, we've started costing exercises and so we are doing both design and costing exercises so that we're ready when the sales program warrants the expansions.

STEVEN HANSEN:

Okay, great. Just as a follow-up then, how should we think about the current mix of business for the ingredients just in terms of the end markets? The shift we're seeing on starches and flours, is that into new verticals and new end markets, whether it be on the human or food side, and does the conversion basically imply that you need to be shifting certain amount of volumes into some of the higher value human consumption markets or can it still be satisfied strictly by more the broader commoditized markets?

MURAD AL-KATIB:

Certainly—I don't consider pet food to be that commoditized market. The starch fractions would be going into a mix of pet food and also just the basic commoditized feed sector. The protein side is going largely into the pet food sector today, but that was expected on line one with the Cargill agreement. As we continue to ramp lines, we're expecting the utilization to be 50% into that pet food branded feed ingredients and 50% into the human food markets. So we're tracking well on progress on sales on the food segment itself. We have a number of large household name clients that have taken product, tested it, even are incorporating it in products that they are producing today, and not only are we meeting their spec, but they are reordering. So the quantities are starting to gain some momentum. That's the positive trend that we see that gives us confidence to move forward.

OPERATOR:

The next question is from Keith Carpenter with Canaccord Genuity. Please go ahead.

KEITH CARPENTER:

Hi. A couple of questions. The first one, on your segment breakdown in the Food Ingredients and Packaged Foods, you had similar tonnes invoiced in Q1 and Q4 but obviously much higher margins. Can you talk to what happened during the quarter? If there were some tonnes that were lower margins and that was replaced by higher margin, or was it just one piece of business that had higher margins in Q1 versus Q4?

MURAD AL-KATIB:

There is one change, Keith, that you have to be aware of. The CLIC segment was included in Quarter One, not in Quarter Four, and of course the CLIC business—AGT CLIC—it's not a metric tonne business the same way our pasta and the rest of it is. So it does not necessarily track profit in that—retail packaging and canning business does not run the same as just bulk wholesale metric tonnes shipped. So that's one of the reasons where you see a lift, and you do have the data in your MD&A as a result of accounting standards that we have to disclose certain information about that acquisition because we limited the scope of the disclosure because it was a new acquisition. So this is in our internal control certifications. Being that it's first acquired now, we limit the scope, we do our internal controls work, we give you more info to make sure you can understand the effect of that. So CLIC certainly had part of the effect of that lift where I think that that's obviously contributed. You probably had a little bit less pasta, a little bit less of the South African segment, a little more on the CLIC side to basically give you just a modest improvement in profitability. I think that the key thing to take away is second consecutive quarter we delivered one line of food ingredients and margins seem to be stable to improving. As we ramp-up to a second line and a third line, the contributions to earnings in that segment is going to be high because we had a huge burn of cost to do the first line. All the staff, two shifts, trained, ready to get the second line, research and development, testing, all of these things are costs. As we ramp-up, it's largely positive margin contribution.

KEITH CARPENTER:

Can I ask you from a—do you have a figure or approximation of the cost impact perhaps to EBITDA from freight issues of moving product east versus what if you would've moved it west in Q1?

GAETAN BOURASSA:

This is Gaetan here. We did a quick calculation and we think it would be somewhere around $800,000 in extra costs for moving more product east via intermodals and hopper cars.

MURAD AL-KATIB:

And then if we combined the rail spots and the container strike and the movement east, west is 1.5 to 2 million total, Keith.

So it was a material impact, but I think one of the things that everyone keeps pointing to is it was only a rail issue. It certainly wasn't. It was a supply chain issue. So you had cold weather, you had rail, you had a truckers' strike. You really had a disastrous combination of effects. So we are really positive on what we see with the cooperation from the railways and other supply chain participants. It's getting a lot better a lot faster.

KEITH CARPENTER:

Perfect, and just a final question, if I can, for Lori. On finance expenses, we are almost at $8 million in Q1. Can you just talk to what you would think the run rate is for a 2014 figure?

LORI IRELAND:

Yes. I think on the $8 million that we're pretty close to loaded right up on our debt right now, so I don't foresee that quarterly number going too much higher.

MURAD AL-KATIB:

In fact, Keith, remember you've got finance expense and also trade finance fees and expenses. I mean, we disclosed the relative debt levels and you know our relative interest rates on our debts because they are all consolidated into a syndicated facility on the Canadian side in the bond issue. So from that perspective, you will likely have somewhere around $18 to $20 million of interest that's made, and then the balance if you annualized that $8 million down to say, $7 or $7.5, you are probably looking at the balance of those being trade finance fees and expenses, letter of credit discounts, letter of credit fees, documented collection fees; these are all finance expenses.

OPERATOR:

The next question is from Christine Healy with Scotiabank. Please go ahead.

CHRISTINE HEALY:

Thanks. Hi guys. I just wanted to first add on to just Keith's last question there, just on, I guess, the rail and weather issues in Western Canada. So given that you expect some of the tonnes will get pushed from Q1 into Q2, do you expect that EBITDA in the second quarter may not be a seasonal as normal?

MURAD AL-KATIB:

I think that certainly you still see the seasonal effect in Q2 but certainly we will end up with some of the improvements that we saw, especially in the latter part of March will roll into April. So there's kind of a combined effect. You never get back a shipping day and a shipping slot; once it's gone, it's gone. But you know, we are hoping that the spillover, Christine, will give us a little bit of improvement in the second quarter.

CHRISTINE HEALY:

Okay, thanks. And then just one quick one, just a question on your Subsequent Event Note. So the fire at the facility in Alberta, can you just clarify? Your note says that operations ceased. Is that just a temporary closure and they're back up now? Just colour to clarify that.

MURAD AL-KATIB:

No. This facility, this was actually our smallest production facility in North America, and it was an add-on facility to the acquisition of Finora, so when we bought that there were three facilities. Gibbons, Alberta was a pea processing plant doing entirely bulk peas into Asia almost exclusively, and that facility, we are expecting that it's a total loss. There are certain aspects of it like the steel silos that look to be still standing, but all of the structures related to the processing have been lost. We are insured at that facility. The production that was planned for that has been absorbed by the other facilities in our system, so we do not expect a material impact to any of our operations and we are continuing to cooperate with local authorities and the insurance company, and then we have to make decisions on rebuild and those types of decisions as we evaluate the situation, Christine.

CHRISTINE HEALY:

Great. Thank you.

OPERATOR:

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

ANOOP PRIHAR:

Most of my questions have been answered but just to confirm one point, but did you say the impact on the rail issues in Q1 was about $1.5 to $2 million in EBITDA or revenue?

MURAD AL-KATIB:

It was in EBITDA actually. Gaetan had mentioned about $800,000 of additional cost, so that would have been a direct cost of sales impact or an increase, and we estimate about $1.5 million in true earnings effect. $1.5 to $2 million.

ANOOP PRIHAR:

Okay, thank you.

OPERATOR:

Our next question comes from John Chu with AltaCorp Capital. Please go ahead.

JOHN CHU:

Hi. Good afternoon. Just a quick couple questions here. The wording in your MD&A says "partial or full conversion of some capacity in Canada, the U.S. or Turkey," so I'm trying to understand the wording of that partial or full conversion. I'm assuming you're just referring to the excess capacity, or is there consideration of something more to that?

GAETAN BOURASSA:

This is Gaetan here again. For instance, our Regina factory, right now the legacy business that we run through it would be our red split lentils. If we do a conversion of the factory for the ingredients, we may leave one line or potentially just add capacity for the fractions and leave the legacy business going as well with a plant expansion. So those are the decisions we have to make as we move forward.

MURAD AL-KATIB:

That's why we used the word partial or full, because, John, there is excess capacity in certain assets that could be converted later, but if we choose, let's say the Regina splitting plant, as the first one, we will have to do that analysis of whether you convert it fully. If you convert it fully, you do lose a value-added processing capacity that we may not want to lose all of, so let's just say hypothetically, if you had 100,000 tonnes of production capacity, you could decide to convert 75 of it and then augment and keep 50 of the old use and 75 of the new use by a much more limited investment. So those are the decisions that have to be made in the conversion feasibilities.

JOHN CHU:

Got you. And what was the capacity utilization rate that you exited Q1 with?

MURAD AL-KATIB:

Probably, I think I calculated it out on the new revised capacity, so for our analysts, remember to refer to your AIF now. It was refiled March 31st, because we have actually clarified the capacities, because now we have converted certain assets to different uses. We are using this plant as a chickpeas plant, this plant is a bean plant, so the old stated capacity may be different depending on the products we are truly intending for those assets to use, so if I look at that, we're running about 70% utilization.

JOHN CHU:

But your target for the end of the year was 70%, correct?

MURAD AL-KATIB:

No, I think if I look at—I have to remember what we said in our MD&A, but I think we said it was 70, moving by 3% this year. So we actually are doing slightly better than we projected. I am just flipping through to see — I think we are running at 70 and we were going to target for 73. I see here on page 12 of our MD&A, "'capacity utilizations are to achieve 70." Okay, yes, so to achieve 70. So you are correct. We're actually running at our target right now.

JOHN CHU:

So you are ahead of schedule on that?

MURAD AL-KATIB:

We have to see. It's only first quarter. Let's see how we do second, third, fourth quarters yet.

JOHN CHU:

Right, and then Lori, for the run rate on G&A and the marketing side, can you give us some insights on the run rates we are seeing in Q1?

LORI IRELAND:

Yes, we had non-recurring expenses of about $800,000 included in the Q1 numbers. So assuming those aren't reoccurring, I think that our run rate for G&A would probably be, you know, slightly below 9 million. Marketing, Sales and Distribution is fairly close to regular at about 5.5 to 5.8 million.

MURAD AL-KATIB:

If you look at the average, John, of 2013, you are looking at—you've got 17-18, 26, about 36, so you are running on average about $9 million a quarter. We expect it to be very consistent. I mean there is no reason we are expecting large G&A increases as we ramp up utilization.

OPERATOR:

Our next question comes from Stephen Ottridge with BMO Capital Markets. Please go ahead.

STEPHEN OTTRIDGE:

Hello everybody. Just a question on the pasta business. You mentioned it was down a business in the quarter, so how much is the pasta business part of AGT, what percentage? Also, you mentioned that you were not consolidating it with, I guess, the flours and things.

MURAD AL-KATIB:

You know, Steven, the segment of Food Ingredients and Packaged Foods was only launched as a reporting segment in the fourth quarter. So the pasta business was in the results, it was just combined with the Pulses and Grains Processing segment prior. So if you look at our pasta business overall, it contributed in the—we have our segmented information, the notes to our financial statements, and it was about $44 million, which was our pasta, semolina and bulgur, so that's the milled durum wheat business. So it's running about $44 million of our $311 million, and so we are running about 14-15%. When I said it was down, it was not down materially; it was maybe down one or two thousand tonnes. You have to recall, this is a snapshot, March 31st, so if you had inventory sitting there on April the 3rd and you shipped 3,000 tonnes, it just doesn't get included in this quarter; it gets included in the next. So, our pasta business is running probably 10% of sales and we're running at very high utilization rates. So we are expecting that to continue.

OPERATOR:

Our next question comes from Marc Robinson with Cormark Securities. Please go ahead.

MARC ROBINSON:

Hey, good morning. So there's been quite a bit of R&D work that's been, that's gone on at the Minot facility and my understanding is you come up with some perspective products that then get pitched to food companies. Can you give us a sense of what the sort of aggregate expenditure has been in terms of R&D, or what it looks like sort of on a run rate basis, and what the success rate has been typically when you present some of these ideas to these food companies?

MURAD AL-KATIB:

Yes, just to clarify one thing, Marc. The ideas that we're pitching are almost exclusively ingredients, not actual products. So, you know, we would be, let's say we're being asked to take a meatball application where they're using breadcrumbs and a meat company will come to us and say, 'We'd like to replace 7% inclusion of breadcrumbs to make a gluten-free meatball." So what we'll do is we'll present to them a formulation of pulses-based flours and proteins to be able to replace that breadcrumb and to give them the data of the texture, the taste and mouthfeel. We actually have machinery that simulates the human mouth chewing that gives you a texture profile or a mouthfeel profile. So those are the type of things that we do, and we're spending about $1 million a year in our R&D budgets. So we have currently about a million dollars allocated this—in this calendar year. We augment that with certain research grants that we receive from both the Saskatchewan and the federal governments, the North Dakota State government, and also the contributions of our food company partners. So, you know, we actually have large household name food companies contributing into the project in which they're asking us to work on.

We've had a good level of success of introducing concepts, actually making sales, and we made the comment in our MD&A that we take test quantities and we convert those into commercial quantities, and then once they order, when they reorder, and they order and ramp up the volumes, that's commercialization success. So that's where we're optimistic about where we are going on the food side, is that line two is ready. We now have the quantities available. Now we're really pushing the marketing program to be able to deliver and we are optimistic this is going to materialize in Q2, Q3 and Q4 of 2014.

MARC ROBINSON:

Okay, and just a quick question, and if you've answered this I apologize, but we are two months post the commissioning date on line two. So are you willing to provide a bit of an update on what utilization looks like at line two at present?

MURAD AL-KATIB:

Yes, I would say that line two, it started commissioning the 10th of March, so in Quarter One you had very little contribution of that, as we were ramping it up and testing and ensuring the product quality met all of our specifications. So starting in April, end of May, we are probably running about 50% utilization on that line. We had a target to be at two-thirds utilization by the end of the quarter. So then we would be—if we can achieve that, Mark, we will be on target for the same as we did on line one, which is five to six months, full utilization, you know, announce the expansion to line three and continue to ramp up three to four months after we announce that. So by end of calendar year, we may be in a position where we have line three announced and hopefully getting ready to commission.

MARC ROBINSON:

Good. Thank you.

OPERATOR:

The next question is from Keith Carpenter with Canaccord Genuity. Please go ahead.

KEITH CARPENTER:

Just a follow-up question on the Trading and Distribution. You guys have stated in your MD&A that the margins have declined quarter-over-quarter because of fewer government tender contracts. Can you comment on whether there were—I don't know if there were abnormally high contracts in Q4 or abnormally low contracts in Q1. Do you see any rhyme or reason to those in any given quarter or is this just kind of come as they go?

MURAD AL-KATIB:

This is certainly our opportunistic segment, Keith. What I think we are going to see going forward in second, third, fourth quarters is more of the tenders—we are actually receiving more tenders overall but they are much more in the products that we actually produce, which by the way, is a good thing, not a bad thing. The Trading and Distribution segment is products that we were being awarded that we were not even producing. So, you know, we had some large scale sugar contracts to government agencies and—we can divide it into two things: food aid or what we call food stability programs. So food stability would be governments importing in order to ensure availability of basic commodities. So we were seeing that with Libya, Egypt, Algeria, Kuwait, all of these countries were starting to or continuing to do that. We are seeing a bit less of that. That probably contributed to less earnings in that particular segment. Am I bothered by that? Absolutely not. It’s opportunistic. It consumes capital, less turn or less duration than our legacy businesses, of course, but I would much rather ramp up the utilization of my own assets then continue to trade more.

OPERATOR:

Our next question is from Steve Hansen with Raymond James. Please go ahead.

STEVEN HANSEN:

Just quickly a follow up on the ingredient margins, Murad. You referred to the cash—pardon me, the margin impact on the initial ramp-up of line one and leading to margins getting better here as line two ramps and certainly I would suspect line three. But can you give us a rough framework or idea of the margin per tonne that you are looking for to ramp up through Minot, and whether or not that would differ at all as you go through a conversion opportunity?

MURAD AL-KATIB:

I think the quick answer to that is no, I can't give you any more guidance on that Steve. But what we have given you is we've given you a segment margin now where you see an EBITDA per tonne over $100 a tonne. That is of course a long way from our legacy business, and we certainly want it to—we want to see, as we continue to ramp up this segment, you can be rest assured I'm not expecting margins to come down. I certainly want to maintain and build on the positive margin performance that we showed even on reporting two quarters. So you can hypothesize that as I mentioned, we are burning a million dollars on R&D. We have a significant amount of cost in marketing, sales, trade shows, travel, production staff. Like, we were running double the number of employees for the last say six months because these are not unskilled labour positions, right? We are talking about very highly specialized processing compared to what we do in our legacy business, and as a result of that we brought staff on, we trained them. We are running double people on shifts to be able to have people available to run second and third shifts. So as a result of all of that, the burn rate on our margins side has been significant. Line two and three will certainly have a positive contribution and then certainly we're going to see that as we go ahead.

OPERATOR:

Our final question comes from John Chu with AltaCorp Capital. Please go ahead.

JOHN CHU:

One quick question: just wanted to clarify the decision process for production line three at Minot. Do you need to see the second line being fully ramped up and at full capacity utilization, or do you need to see roughly two-thirds of commitments from potential customers before you advance and go ahead with line three? Or is it a bit of both?

MURAD AL-KATIB:

You know what, John? I think that's going to be almost the same time. If I keep to the idea of what I said earlier, which is if we expect the second line to be at two-thirds utilization by the end of this quarter, and we said we want to ramp up line two on the same pace as line one, we ramped up line one in about five months or six months of production time, so that should foreshadow to you. If the same program goes according to plan you may see a conversion announcement by say quarter three or so. So we want visibility, meaning that we don't want to guess whether we're going to sell a third line. We want line two to be pretty much a slam-dunk and then we want line three to even have sales queuing up as we are installing it. This is the way that if momentum builds, it will immediately lead again after the third line to the plans accelerating on a conversion in either Regina or Turkey. So we are optimistic that the dynamic momentum is going to continue and that we're going to be able to show a very material ramp-up in the next 18 months.

OPERATOR:

I will now hand the call over back to Mr. Al-Katib for closing comments.

OMER AL-KATIB:

Thank you very much, Operator. Thanks, Murad. That brings us to the end of our questions in this session. I'd like to thank you all for joining us on the call. I'd like to remind everyone that's still on the call If you do 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'd like to wish you all a good day.

OPERATOR:

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