From Producer to the World

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AGT Food and Ingredients Inc.
Second Quarter 2015 Financial Results Conference Call Transcript

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Speakers:

Murad Al-Katib
President and Chief Executive Officer

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.

OMER AL-KATIB:
Thank you and good morning. I'd like to thank you all for joining us on our Second Quarter 2015 Conference Call. On the line with us today we have Murad Al-Katib, President and CEO of AGT Food Ingredients, Lori Ireland, our Chief Financial Officer and Gaetan Bourassa, our Chief Operating Officer.

Before we get started, I'd 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 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'd like to turn things over to Murad for some comments and then we'll go to questions.

MURAD AL-KATIB:
Thank you. Welcome to everyone on our call today. For AGT this second quarter's been a positive one, with continued consistent performance in our business leveraging the strong foundation we built for our Company that is strengthened by our various diversification, operational, product and efficiency initiatives over the past periods. Our main segments, pulses and grain processing and the food ingredient and packaged food segments, are performing as per our expectations and in line with our strategic initiatives surrounding growth and expansion of AGT's business. We see many opportunities ahead as our business continues to grow. I'd like to ask our CFO, Lori Ireland, to provide us highlights for the quarter. Lori.

LORI IRELAND:

Thanks Murad. AGT reported Adjusted EBITDA of $22.2 million for the quarter ended June 30, 2015. Trailing 12 month Adjusted EBITDA was $90.3 million, an increase of 22% when comparing to $74.1 million for the trailing 12 months ended June 30, 2014.

Sales volumes were down over 97,000 tonnes overall in the quarter at 326,923 tonnes compared to 424,485 tonnes in the quarter ended March 31, 2015. This was due largely to depleted stocks in North America as well as in Australia. However, gross profit, adjusted gross profit and Adjusted EBITDA per tonne all increased in the quarter ended June 30, 2015 when compared to the prior quarter and compared to the same quarter in the prior year.

Gross profit was $107.85 per tonne, adjusted gross profit $119.20 per tonne and Adjusted EBITDA was $67.92 per tonne. While tonnes invoiced overall were down when compared to the prior quarter and into the same quarter in the prior year, tonnes invoiced in the food ingredients and packaged foods segment increased. Also important to note is that while the tonnes invoiced in the segment represent 21.5% of total funds this quarter, adjusted gross profit represented 34% of the total and Adjusted EBITDA represented 38.5% of the total Adjusted EBITDA this quarter.

Net debt improved by $3.4 million compared to the prior quarter even when considering the $26.8 million acquisition of the assets of WCRR that was closed during the quarter. 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 contracts 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. This amounted to an expense of $4.8 million for the three months ended June 30, 2015 and this has been excluded from Adjusted EBITDA and adjusted earnings per share calculations. AGT has treasury processes in place to ensure the need to purchase foreign currencies to settle debt will be minimized if it will result in cash losses on foreign exchange.

General and administrative and marketing sales and distribution expenses for the three months ended June 30, 2015 increased over the prior quarter and increased over the three months ended March 31, 2015. This is due largely to the increase in share price which impacts the share based compensation accrual in the current period.

The change in finance expenses for the three months ended June 30, 2015 when compared to the three months ended June 30, 2014 and to the three months ended March 31, 2015 is due to costs associated with the cross currency swap on the high-yield bond and are recorded in both unrealized foreign exchange and in finance expense throughout the life of the contract. Though these costs affect unrealized foreign exchange and finance expense, these are non-cash adjustments and have no impact on Adjusted EBITDA.

In addition, AGT utilizes various trade financing instruments and the costs associated with these instruments are recorded in finance expense. A normalized basis finance expense is in the range of $6.5 million to $7.5 million per quarter when considering interest on bank indebtedness, long-term debt, bond interest and various trade finance instruments.

AGT tracks adjusted earnings per share, as it's reported exclusive of the non-cash foreign exchange effects of our global business whether that means a gain or a loss because Management feels that 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. Adjusted earnings per share improved to $0.45 and $0.44 fully diluted for the three months ended June 30, 2015, compared to $0.44 and $0.43 fully diluted for the same period last year and compared to $0.43 and $0.42 for the three months ended March 31, 2015. Thank you. Murad.

MURAD AL-KATIB:
As you can see, our legacy business is performing well, even in a period where those stocks remained from the 2014 harvest period in North America. Buyers in AGT key consumption and sales markets were willing to buy at the higher price levels to secure the small amounts of inventory that were remaining in advance of what we believe will be a significant volume of production coming on stream with the North American harvest currently underway. The widespread media reports locally and nationally in Canada about drought conditions in Western Canada throughout the season are expected to result in decreased yields of pulses somewhat. There was lower than average moisture, yes; however, these conditions had more impact on yield than on whether there will be production or not. As reports are showing, we expect there to be significant production

levels coming on stream with yields ranging to the average to slightly above average impulse drops.

Farmers are out in the field and harvest for lentils and peas particularly is underway. From the early samples we're seeing from early harvest delivery, quality is good, yields are average and more than adequate volumes for AGT sales and processing operations are expected by Management.

India and the Turkey and Middle East/North Africa region have imported significant volumes of Canadian pulses for domestic supply and regional distribution, a trend we believe will continue. These levels of production are needed to continue to supply these markets: raw material supply to Turkey, to our customers in India for lentils, and durum wheat for pasta and other milled wheat products are an important part of our business and we expect our transportation and bulk loading investments with West Central Road and Rail to provide loading and export opportunities for AGT. We expect this to continue with the integration of these assets into our shipping systems.

These investments are focused to allow AGT's production facilities to maximize ship tonnes and margins and peak shipping periods and execute the strategy of returning value added capacity to AGT's bagged and containerized business, and therefore utilizing the most efficient transportation options available to move AGT products to markets. This is an important element of our strategy going forward.

As our sales programs grow, and with production at these levels in Canada and the United States, multiple modes of efficient transportation are needed to move product through our systems. Transportation logistics are important parts of our business and as a Management Team we are constantly evaluating our transportation options and refining our strategy in this area. Efficiency in transportation logistics can have a real positive impact on margins and therefore, earnings. We see these all as positive trends for the subsequent quarters in 2015 and 2016 periods leading up to the 2016 North American harvest.

Our food ingredient and packaged foods segment is also performing well, with increased volumes shipped in the Q2 period and positive trends developing with regards to sales and the benefits of operating leverage as we move through an increase utilization of the assets built in this segment. Test quantities in the food sector are converting to sales volumes as food company customers continue to adopt them as a part of new and reformulated products that include pulse ingredients as their own application research projects yield results.

These application research projects in many cases are being done as collaborative ones with AGT and demonstrating the flexibility and profile of the non-GMO, gluten-free high-protein, high-fibre, natural and nutritious food products that pulses can contribute to creating and the nutritional profile that pulses have naturally.

The upcoming 2016 United Nations International Year of Pulses Declaration is an interesting initiative that AGT is involved in to promote pulses and this positive profile to the world. We feel—and our food company customers appear to feel the same way given their interest in this initiative—that this initiative has a positive potential to increase the perception by consumers that pulses are good for you, and it's a message that food companies and retailers are responding to.

Enhancement and expansions at the Minot, North Dakota production facility are ongoing, with the third production line ramping up and the announced process for the deflavouring and sterilization processes on track, with construction tracking to an end of the year completion and commissioning of that deflavouring line in the first quarter of 2016. We expect these enhancements and expansions to assist in further building this business unit as we assist and support our customers in their pulse ingredient product requirements and selections. We expect these developments to positively advance the sales and distribution agreements we have in place with the partners for human food and pet food, and our increased sales volumes will be expected to increase as the business unit grows.

Our Packaged Foods business within this segment is also performing well, as retail customers are buying canned and packaged pulses and pasta and other packaged foods from AGT. As a Management Team, we're focused on this business unit, as it provides support for the segment overall and allows AGT to leverage its strengths in origination of raw materials, processing and packaging taking products from producers and delivering them straight to consumers' cupboards around the world.

The segment overall accounted for, as Lori mentioned, 21.5% of AGT's total tonnes invoiced in the quarter, compared to 14% the quarter before, demonstrating the opportunity that we feel the segment has for AGT, as we diversify higher margin, value-added products and transform our Company from a focus on being a commodity shipper pulses and grains to a balanced commodity company, food company and retail packaged food and ingredients supplier.

In conclusion, before we go to questions, I want to summarize that our Management strategy and focus is clear to our stakeholders and shareholders. We're building a significant global food and ingredient company that is well diversified and creating market opportunities as well as consistent earnings.

We believe our current results demonstrate that we're continuing to build from our strengths, particularly our facilities, origination, logistics and processing strengths, our global merchandising and management ability and our diversified product offering in all segments of our business.

These are major components that make AGT strong in all markets we're in and we're creating opportunities through our key investments in all our segments. We'll continue with these strategies to continue to increase shareholder value and expand our business overall.

I thank you for your interest in AGT Foods and I'll hand it back to Omer for our questions and answers.

OMER AL-KATIB:
Thanks Murad. Operator, I think we'll go to the first question please.

OPERATOR:
The first question from Jacob Bout of CIBC. Please go ahead.

JACOB BOUT:
Good morning. My first question is just on the uptick that we're seeing on the EBITDA per tonne in the food ingredients and packaged foods. If you could put it into buckets, how much is this from the increasing capacity utilization, how much is for—from the inclusion of the higher-margin feed and food ingredients? I also had a follow-up question on the deflavouring line.

MURAD AL-KATIB:

I'll take the first one Jacob. I think that certainly the growth in the tonnage in the segment reflects largely increased utilization from the third processing line, so as you know, we really started to commission that late in the first quarter and with a plan of attempting to ramp it up around five to six months. When you go into commercial production with about 35,000 tonnes of annual volume from that third line, you end up in a position when you've got about say 8,750 tonnes of utilization per quarter. Our tonnage is actually increased by about 15,000 tonnes. So you can see that actually line three was running at pretty good utilization even in the first commercial period. So we do have a contribution of it in terms of that ramp up of capacity utilization. I think we were probably running around 60% utilization on that segment even in the first quarter so I think that's very positive.

We're also seeing the uptick on our starch values, so as you start to move that starch fraction from the true feed sector, so we're talking about selling that starch into literally chicken feed markets, other animal feed markets. That is truly the lowest use of the feed ingredient. As we start to tick into pet food and human food applications we're starting to see a material lift on that starch fraction, so that's improving as well.

In addition, we said this is a very high fixed cost component business, so we're starting to see the evidence of the operating leverage. As you start to boost utilization in line three, we add the deflavouring, we add line four and line five in the future. You're going to start to see very significant contribution to net earnings. We're not replicating—we're adding scientists, we're not adding a complete R&D centre. We're adding marketing people, not an entire sales and marketing program. We're not adding a whole new food safety program, we're just ramping it up, and I think that is part of what you will see as a benefit.

So that's the food ingredients side. On the packaged food side, the Arbella pasta segment, we did announce that we're continuing our expansions in that particular area in the capital budget that we allocated. They continue to show strong margins, and part of that has been market concentration. We say probably we're distributing Arbella in 91 countries, but I can tell you there're probably 15 countries in which we're making better margins, and those 15 countries continue to be a strong focus.

JASON BOUT:
Then on the deflavouring?

MURAD AL-KATIB:
What's the question on the deflavouring

JASON BOUT:
Sorry, I wasn't sure if I was still on. So the question on the deflavouring is how much of this product are you planning on running through the deflavouring line? What products and then is this deflavouring part of the umbrella with Ingredion?

MURAD AL-KATIB:
The deflavouring is definitely under the umbrella with Ingredion on the food sector side and it is a very important initiative. The food company's feedback on the industrial trial quantities—Jacob, we haven't been sending one kilogram samples. We produced I think 10,000 pounds of product in industrial trials, I think we're now on our second or third industrial trial, done and distributed. So the food companies are also using our construction cycle in their product development cycle. It is targeted to be around 50,000 tonnes of capacity in that deflavouring line. It will be targeted at our protein fraction, the starch fraction and then also both flours, but the sterilization side of it will be largely utilized for the pulse fibre fraction. The fibre fraction, when we purify it in a re-cleaning process, we get to an 85% fibre, and the microbiological activity of a pulse crop—because it's exposed in the natural elements of the field, whether it be grasshopper parts or other types of naturally occurring field production elements, you need a microbiological kill step, and that sterilization process that we will be utilizing in the deflavouring will be used in the fibre as well.

So there's going to be—I have a view that about half of our current production in the three lines will go into that deflavouring, which will likely warrant us to need to build line four or five, or four *and* five hopefully, in 2016, 2017.

JACOB BOUT:
Thank you, Murad.

OPERATOR:
The next question is from Peter Prattas of AltaCorp Capital. Please go ahead.

PETER PRATTAS:
Good morning everyone.

MURAD AL-KATIB:
Good morning.

PETER PRATTAS:
My questions here are surrounding the ingredients group. I'm wondering if you could provide some colour on how many food companies are using your product and are you fairly concentrated here at the onset until you have more capacity to service an expanded customer list?

MURAD AL-KATIB:
I couldn't give you the exact number but I would say it would number in the range of around 40 to 50 North American and 20 or 30 European companies are currently in the product testing pipeline. We would have a number of the large international majors that are currently involved in testing. So if you look at the pulse product launches, in—I think it's 2014 when we had around 3,600 product launches in North America that were including pulse ingredients, so that activity has been going up in terms of going off the chart in terms of the number of launches.

So when you look at the profile, let's be honest, the utilization of this in the pipelines of product development is not only because they're pulses, it's really because it's high-protein, high-fibre, non-GMO, gluten-free with a high micronutrient profile, and it's clean label. So that is it. So every food company, if you look at it, I don't know of any major food company or retailer in their private label that is not focusing on one, two, or even three of those six or seven elements that I mentioned. So that's our target, and the feedback has been quite positive.

PETER PRATTAS:
Great. Then just on the food, on the human food ingredients side, is it really once the fourth and fifth line potentially get at it that you to service that market, or will it occur, I guess more meaningfully, sooner than that with the addition of the deflavouring and sterilization lines?

MURAD AL-KATIB:
It will happen meaningfully with the deflavouring line because there is a portion of production right now. In particular when I look at the starch fraction that is going into the animal feed sector, and you know there's a number of applications that will utilize that. Like we call it starch, but really it's a pulse flour, it's still 13% protein. It's around 70% starch and it's a natural product, so the deflavouring will allow that to be utilized in things like bakery products, extruded snacks, so crunchy snacks, crackers, all of those types of applications, and we're expecting that that production, even from line three and the deflavouring line of course, is going to largely be targeted at the food companies.

Now in addition, interestingly, the pulse ingredient inclusion in pet food is getting to a level where there are some companies who are also interested in the deflavoured ingredients because as you start to increase inclusion in meat free or in grain free and corn free blends, they want to ensure that the palatability of all the product—they don't have any type of detectable taste of a number of these ingredients. So we still think that could be an opportunity.

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

STEVE HANSEN:
Good morning guys. Murad could you elaborate perhaps a little bit more on the evolving supply chain strategy that you're speaking to. By your comments, it does sound like the WCRR acquisition is only a piece of a broader rollout plan of your capabilities, and I'm sort of curious as to what type of assets you might be pursuing, whether it might be entirely domestic focused or international.

MURAD AL-KATIB:
Well I think that—good question Steve. Certainly our ability to take our farmer origination platform into value-added bagging containerized shipping, we want to return our state of the art processing plants back into that business. When utilizations were down at very low levels with the global financial crisis and significant quality issues in the crops in 2010 and 2011, we took every opportunity we could to utilize assets. As the markets have continued to turn around, these bulk shipping opportunities, and an opportunity to ship into our own production system—Turkey is a very big part of that logistic strategy where—we're at a point now with the seventh pasta line being added,

and the largest bulgur wheat mill in the world, that we are in significant user of durum wheat. So durum wheat is a focus that we did not have prior, so part of the rationale and expanding into West Central Road and Rail was the addition of bulk rail loading capacity. That bulk rail loading capacities going to need further infrastructure that could be utilized for shipping. So we're either going to put it in bulk containers, which we'll continue to do, and will also be looking at various opportunities for partnerships, service agreements, and maybe even the potential of strategic investments in port facilities and those types of things that facilitate the growing volume in our business.

As you are aware, we are already shipping via a number of terminals in Thunder Bay on the bulk side, and of course, we are one of the largest container shippers in this country. So we'll be looking at the domestic focus. I want to be clear, this is an enabling strategy. It's not the driving strategy of the business. The driving strategy of the business is more solid earnings in terms of utilization of our assets and capturing those market windows that exist. In addition, it may be that these logistics investments domestically will help us to leverage investments we've already made elsewhere, like—we've made an investment in an 180,000 square-foot distribution facility in Tianjin, China. So that is already done. We built that in 2012-2013. So those types of warehousing and distribution systems. AGT India has been launched. We're active on the distribution locally. So we will be looking at opportunities to solidify our supply chain there.

STEVE HANSEN:
Okay, that's great. One quick follow-up if I may, just on the shorter-term basis, can you just perhaps speak to the current status of the stock or the inventories available relative to last year at this time and just the relative timing of harvest as well, I guess, as we sort of contemplate Q3 here with relatively low inventories heading in?

MURAD AL-KATIB:
I have to tell you carry-out stocks this year are negligible. So I think one of the positives that we're seeing right now is—of course by the way, harvest quantities have started to arrive, so this is definitely when you compare it to last year and the year prior, in September to mid-September to late-September we barely received any quantities yet as a result of the very late planting and a very late harvest. So the current old crop stocks, what was available is now being delivered, so these drought worries certainly curbed deliveries in late May and June. Here, the national media was talking about a crop failure in Western Canada in particular in Saskatchewan. I can tell you

unequivocally this is not a crop failure. We're going to have in pulses and average to potentially slightly above average yield, and one of the things Steve that people have to recognize that an average is over a number of years. The last two years were not average harvest, they were actually bumper crops. So we forecast our available supplies based as an average yield and from that perspective I don't think we're going to be disappointed.

So stocks that are available are coming to market, there's nearly nothing left. We're projecting to have ample supply to meet last year's export pace, which I think we were record exporting last year, and we expect that we'll have a small carryout next year again to help us to transition so we won't be potentially so tight in June and July next year.

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

MARC ROBINSON:
Thanks. So just a little bit to follow on the last question. The issue here with volumes down 100,000 tonnes or so, it looks like to be solely a supply issue. So can you just comment on what the demand situation looks like, be it now and through the back half of the year?

MURAD AL-KATIB:
I can tell you we are expecting that India—India is of course a driver in terms of the demand picture and monsoon rains have continued to be in deficit for next year's crop or this October and for next March. As a result of that, last year India had a record import of Canadian lentils, we're expecting the potential they will exceed that this year again, so we will set a new record. Turkey and the Middle East region, Turkey had an average crop at best, and with such a large asset base there you'd think that could potentially be negative for AGT, actually we would prefer an average crop there. It means we have good local supplies to utilize when we need them, but we import and we distribute. That's the strength of AGT's infrastructure in Turkey, so we are expecting very strong demand from the United Nations programs for Syria, Iraq. We see continued strong demand in North Africa from Egypt, Sudan and the Middle East market in general. Interestingly, we are expecting that the deal on the nuclear situation with Iran is

going to have a positive demand impact on Canadian pulses. Iran is a major market for Canadian green lentils. In fact, it's emerged as—from year-to-year it can become the largest green lentil market in the world, and the easing of restrictions, the free flow of currency and the utilization of the Emirates as a trans-shipment point and also direct shipments being able to resume to Iran at some point in the future, we view as a very strong opportunity for us.

So Marc, again I use the word strong a lot. We're expecting to have quite a robust demand over the course of the year, good supplies available and we have more capacity this year, so as a result of that, we're projecting it to be a potentially positive end of quarter three and of course, quarter four, quarter one will be solid periods for us.

MARC ROBINSON:
Okay, great. Then shifting here to food ingredients. Just so I'm clear, did you say that the utilization on line three was at 60% in the quarter?

MURAD AL-KATIB:
Yes, it's running about 60%. So it's doing quite well. It's actually ramping up probably a little bit quicker than our expectation and part of that is just—I think the strategy is right. I mean we're building demand, we're building an urgency for demand so when we put new lines into production we're able to utilize them quickly. I think the one thing people have to recognize is 35,000 tonnes of ingredients per line. That's not a small undertaking. Companies work years to sell 35,000 tonnes of ingredients. We're launching a line and selling it out in six or eight months. So yes, I was quite happy with the utilization in the first period here.

MARC ROBINSON:
A final here, has there been any change in the preferred pulse feedstock within the food ingredients business as a result of the testing work that's been done by Ingredion and by their customers?

MURAD AL-KATIB:
You're going to have to clarify the question, Marc, I didn't quite understand it.

MARC ROBINSON:
I think originally the pea was used as the feedstock, so has there been any change in what customers are using as the feedstock or the preferred feedstock?

MURAD AL-KATIB:
Peas, of course, are the cheapest pulse, and so as a result of that, a lot of the initial work by the isolate companies, guys that are doing chemical solvent isolate as extraction, so not natural ingredients like ours. They've been focused a lot on the pea largely because some of these companies were in Europe and they were using French peas. The issue with peas is they do have a natural kind of a bitter flavour to them and so we immediately had started targeting lentils, faba beans and chickpeas, and I can tell you that those three products are all having very significant uptake. The faba bean in particular has a very neutral flavour, quite a pleasant flavour even from a starch. It's a higher protein than a pea or lentil from a starch and AGT happens to have a proprietary variety that was developed by the University of Saskatchewan by Dr. Bert Vanderberg, and we are commercializing that variety on an exclusive basis in Western Canada. So it's been a positive part of the ingredient platform. We're expecting great things out of those three crops.

OPERATOR:
Our next question is coming from Keith Carpenter of Canaccord. Please go ahead.

KEITH CARPENTER:
Good morning. I have a question that has been posed by some investors, so I'll ask it this way. On your ramp up of the food ingredients, this expands what you just said to Marc's question as well. Can you speak to lines four, five and six at Minot, more specific timelines associate with those lines and can you speak to why you aren't building those expansions faster to have them ready if you believe the growth will be there when needed? Meaning once line three is fully ramped, let's assume that line three is fully ramped by the end of this year, would you not rather have line four already built and ready to go in January? I'll just leave it there.

MURAD AL-KATIB:
One of the key things to recognize, Keith, is that in the expansion of the deflavouring line, we are building all of the associated infrastructure that will be able to house line four, five, and six. So from that perspective, that is the lead time. So there is nothing

that won't be in our control to order a line for, if needed, later in 2015 and have it commissioned in the earlier part of 2016. So just to recognize that the leads times becomes like the lead times on line one, to line two, to line three which is around—there's around a six month lead time to order and receive all of the equipment. So with that you're in a position where when the building is built and all the associated infrastructure is built, it's what I call a plug and play manufacturing system. Plug it in, connect it and play. So the time to ramp will be able to be shortened.

We're keeping our eye on the sales program. I mentioned earlier, a little bit of shortage of availability creates demand urgency from the food companies. We want to ensure that we maintain that pace and we're building a whole new business here. It's at small little piece, but it's transforming a little segment of the food industry's ingredient profile. We want to make sure we are targeting the right applications, we're having good success and good traction with the large food companies, because success breeds additional opportunities with the same companies. So when you are dealing with the General Mills, Post, Kellogg's, Nestlé, Unilever, those types of companies, Maple Leaf Foods—those types of companies, you don't go in a single pursuit, you go with one or two or three really strong pursuits that can lead to four or five or six other pursuits, so we want to make sure we do it right.

KEITH CARPENTER:
Do you guys see—when you look at line four, is it your view that you wouldn't be surprised if that is up and running and producing in Q3 of 2016 and then followed by line five shortly thereafter?

MURAD AL-KATIB:
I can't comment on the exact timing, but I can tell you when we build and we've even said in our disclosures—we are planning expansions to line fours and line fives in 2016 and 2017, so watch for us to continue to update you along next quarter, and we're certainly will not sit there with full capacity and not moving. We don't have a capital constraint, we don't have an infrastructure constraint and we're creating the markets, so you can be sure we're going to be reacting as quickly as needed.

OPERATOR:
Our next question is coming from Stephen Aldrich of BMO Capital Markets. Please proceed with your question.

STEPHEN ALDRICH:
Good morning everybody.

MURAD AL-KATIB:
Good morning.

STEPHEN ALDRICH:
Lines four, five, six have been built in Minot as well?

MURAD AL-KATIB:
Right now the physical space is being built there. We've made the decision to consolidate all of our operations on the pulse food ingredient milling side there as a result of the food safety programs, the production systems and everything else. Stephen we'd have to replicate a lot of infrastructure to move to another plant location. We will be looking though at—as the European opportunities ramp up, we'll be looking at whether or not Turkey is the right spot for a production system for servicing Europe or whether or not there is somewhere right in another country within Europe, but Turkey of course could make a lot of sense for us on an expansion at some point in the future.

With Turkey we don't have to build all the physical infrastructure. We have buildings, we have splitting lines, dehulling lines, so we have a lot of the associated ancillary infrastructure, storage handling, that can just basically—we can plug and play in Turkey as well if needed. But, at this point, Stephen, we expect that Minot is going to continue a ramp up because the North American opportunity is playing out quite nicely.

STEPHEN ALDRICH:
This is the International Year of the Pulse, is it going to be costing AGT money to contribute to it?

MURAD AL-KATIB:
We've made an announcement—or the industry made an announcement that the Government of Canada, under the Western Diversification Program, approved a $3.5 million grant for the International Year of Pulse and AGT made a $600,000 commitment in over three years total, so it's around $200,000 a year that we will be—we're the largest industry contributor to that program and we'll be targeting our money at the

Brand Awareness Campaign and we'll be driving the Social Media Campaign, Stephen, utilizing social media to build awareness on pulses.

OPERATOR:

The next question from Greg Coleman of National Bank Financial. Please go ahead.

GREG COLEMAN:

Hi, Murad. Just a quick one here. Wanted to come back to the crop that we're seeing coming out this year. Very good comments and I appreciate your clarity on the size relative to the average versus last year, which were bumper crops, but I'm wondering if we could talk about quality for bit. In your opening statement you said early samples indicate that quality is good, yields are looking not too bad either. But, I would like you to talk to us a little bit about, is there a risk from this point on until you see it coming in of the replication of the poor quality crops that we saw in 2010 and 2011, or are we at a stage of the growth here where that risk is largely behind us and it's pretty much in the bag it will be high-quality crop?

MURAD AL-KATIB:

Listen, the only thing I can't do, and I'll ask the powers that be for that power to predict that weather, but today I can tell you that the crop advancement—we're in the advanced stages, and if you look back at the 2010 crop issue, it was literally a rain of five decades. So this is not a normal event. I think we received nearly an annual rainfall of moisture in 21 days at harvest. So we have to go back decades and decades to find another incident like that. My assessment today is the normal weather occurrences whether it be thunderstorms, those types of things should not have a material effect on crop quality. In fact, Greg, we were last week, 80 millimeters of rain fell in Saskatchewan over the course of around 36 hours, and we can tell you that we don't feel there was a material effect on the crop. So we're looking in pretty good shape and you know what, today it's 34 degrees Celsius in Regina, and I'll tell you harvest starts to move pretty quickly when it's so hot, so it's great weather for harvest today.

GREG COLEMAN:

That's exactly the colour I was looking for. If we could dive in a little further on the other side of it, so that's the part you have no control on, but it sounds like things are looking pretty good absent some ridiculous fifty plus year event. But talking about the parts you can control, we know that your sourcing has diversified from a corporate perspective today versus 2010, getting more inputs from elsewhere in the world and not solely reliable or heavily reliable on Canada as in the past. What other changes structurally have internally on that core pulse processing division which, if you do see a drop off in quality, would mitigate the impact of the margins just in the event that does happen?

MURAD AL-KATIB:
Just to be very clear, we actually like to have some quality variants. So a perfect quality crop is also never the best case scenario for AGT because we've invested heavily, Greg, in value added processing technologies, peeling, splitting, colour sorting—so optical colours sorting. We'd be the largest utilizer of that technology in the pulse world in terms of a company. So we're expecting this year that we are going to see what I consider to be a normal distribution of grades, so what I would say in the lentil side, a normal distribution of grades would be somewhere in the range of around on red lentils, you would see around 80% of the crop in a number two or better quality. We are expecting that to be the case this year.

The areas that are affected on an extra three or a three are likely to be at the high end of the low grade if that makes sense. On the green lentil side, we're expecting a distribution of around say 15% or so, 20% to be in the number one grade, a big chunk to be in the number two grade and then around say 15% to 20% maximum in the lower grades. I think that one of the things we've done to ensure that we can meet a variable quality crop, that we have better capability is, we have more colour sorting and we just have more capacity in general. Part of what happened, Greg, in 2010 was because we had to run the product two and three times to achieve the outcome that we needed to market the product, utilization went way down as well, and—so I think that one of the things is West Central Road and Rail acquisition, our bulk shipping program will go through our bulk system now. Our processing plants are available to deal with value-added processing as needed and we'll actually create margin as a result of that. I think that's a big difference of this Company today versus where we were earlier. I feel pretty resilient in terms of our ability to deal with quality variance in a normal circumstance when it comes.

OPERATOR:
Next question from Anoop Prihar with GMP securities. Please go ahead.

ANOOP PRIHAR:
A couple of questions please. First of all, what was system-wide utilization in Q2?

MURAD AL-KATIB:
Anoop, it was running around about 74% in the pulse and grains segment. The pasta utilization again would be around 97-98% and as I said on the food ingredients side, utilization on that third line was around 60%. So we were running it quite good utilization.

ANOOP PRIHAR:
So 74 was system-wide then, is that correct?

MURAD AL-KATIB:
Sorry, what was that?

ANOOP PRIHAR:
74% is the system-wide number?

MURAD AL-KATIB:
That's right. Down from around 87% the quarter before. So I think that one of the top line stories in this is, you know, again the diversification of our product mix within the legacy business and of course, the addition of the food ingredients. Here we are with nearly 100,000 tonnes less to handle in the quarter as a result of a temporary supply disruption and yet earnings were flat quarter-over-quarter. I think that's a good news story for us.

ANOOP PRIHAR:
Secondly on the production you had out of all three lines on the ingredient side, what's roughly the volume split between what goes to human food and what goes to pet food?

MURAD AL-KATIB:
It would probably be around 70% to 75% into the pet food side, maybe 25% in the food side today. We expect of course, with the deflavouring line addition we want that to go to a mix of, we hope around 50/50, by the end of 2016 to early 2017, so you're going to see quite a—we believe the deflavouring line, Anoop, will have a material impact on food company adoption and inclusion rates.

ANOOP PRIHAR:
My last question. Can you remind us please, what's the timeline for the deflavouring and the sterilization lines coming on?

MURAD AL-KATIB:
Construction completion of the building is scheduled for end of November. Installation will begin in December, January we should be in testing and production later in the quarter in quarter one. So you'll have it producing some quantity in quarter one and then by quarter two we should have it into commercial production. Now, the ramp-up of this one will be--just the sales program will ramp it up. We're not anticipating a technology ramp-up issue. It's quite a proven system, and we've now, as I've said, run three large industrial trials and so we're very confident in our ability to integrate this quickly.

ANOOP PRIHAR:
Thank you.

OPERATOR:
Our next question is coming from Steve Hansen of Raymond James. Please go ahead.

MURAD AL-KATIB:
Yes, Steve.

OPERATOR:
Steve, are you there? I guess Steve is gone. There are no more questions at this time. I would like to turn the call back over to Omer Al-Katib.

OMER AL-KATIB:
Thank you, Operator. That brings us to the end of the questions in the session today. I'd like to thank you all for joining us. I'd like to remind for those still on the call if you have follow-up questions, you can feel free to context 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 we wish you all a very good day.

