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AGT Food and Ingredients Inc. First Quarter 2016 Financial Results Conference Call Transcript

Date: Tuesday, March 22, 2016

Time: 11:00 AM ET / 9:00 AM CT / 8:00 AM PT

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:

I would now like to turn the conference over to Omer Al-Katib, Director, Corporate Affairs and Investor Relations. Please go ahead.

OMER AL-KATIB:

Thank you. Good morning and thank you for joining AGT on our First Quarter 2016 Conference Call. On the line with us today we have Murad Al-Katib, President and CEO of AGT Food and Ingredients; Lori Ireland, our Chief Financial Officer; and Gaetan Bourassa, our Chief Operating Officer.

Before we get started, I would like to remind everybody 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 formation 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 a 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. Welcome to all of you on the call with us this morning. The Q1 2016 period has been another quarter of consistent performance for AGT as we see our business mature and grow and demonstrate the earnings capability we have always believed was there in our business.

The consistent performance and measured growth we have seen in the past quarters are a testament to the strategy we have put in place as a management team with our strength in origination of pulses and grains, our superior processing infrastructure, our logistics network and our risk management program to allow us to execute our sales program globally to maximize earnings while providing our customers with the highest quality pulses, staple foods and food ingredients.



There are a number of positive elements we're seeing in the upcoming quarters that I'd like to discuss with you, but first I'll ask Lori Ireland, our CFO, to give you a quick summary of the quarter. Lori.

LORI IRELAND:

Thanks Murad. Hello. AGT reported Adjusted EBITDA of \$31.4 million for the quarter ended March 31, 2016, and reported trailing 12-month Adjusted EBITDA of \$109.7 million. Total metric tonnes invoiced increased by approximately 18% year-over-year from 424,000 metric tonnes for the three months ended March 31, 2015, to 501,000 metric tonnes for the three months ended March 31, 2016, and decreased from 623,000 metric tonnes for the three months ended December 31, 2015. The increase over the prior year is due to higher volumes out of India as well as increased shipments from North America, both bulk and containerized. The decrease when comparing to the prior quarter is largely related to the timing of harvest shipments from Australia and Canada, impacting the pulse and grain processing segment.

Inventory and accounts receivable have both declined from the prior quarter due to cash collections and shipments of products received later in 2015. Accounts payable has also declined from the spike in December of 2015. This is due largely to cyclical timing of producer cheques post-dated into the current year and clearing the bank in the first quarter.

Year-over-year cash used in operating activities is consistent at \$11.6 million for the three months ended March 31, 2016, compared to \$12.1 million for the three months ended March 31, 2015. This is due to accounts receivable, inventory and accounts payable resetting from December peak periods.

AGT's business is working capital intensive; therefore, AGT feels it is important to monitor working capital efficiency. Working capital as a percentage of trailing 12-month revenue has declined from 20.35% at March 31, 2015, and 17.07% at December 31, 2015, to 14.4% at March 31, 2016.

Non-cash foreign exchange was a gain of \$24.5 million for the three months ended March 31, 2016 and includes a snapshot of outstanding forward denominated accounts receivable and accounts payable, as well as outstanding foreign exchange contracts and includes the contracts relating to the high-yield bonds. Note this is a non-cash item



and will fluctuate depending on the strength or weakness of foreign currencies when compared to the Canadian dollar and is excluded from Adjusted EBITDA calculations due to the non-cash nature.

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

AGT tracks adjusted earnings per share as it is reported exclusive of 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.

Tax expenses calculated on financial statement earnings, so foreign exchange whether a gain or a loss, impacts the tax expense each quarter. In this quarter, the non-cash foreign exchange gain was \$24.5 million, and as a result adjusted earnings per share were reduced to 20% basic and fully diluted for the three months ended March 31, 2016, compared to \$0.43 and \$0.42 fully diluted for the three months ended March 31, 2015.

The increase in general and administrative and marketing, sales and distribution expenses of approximately \$5.7 million for the three months ended March 31, 2016 compared to the prior year is due to factors such as increased average share prices which impact the share based compensation accrual and the larger global platform compared to the prior year. This includes expanded sales in India and Switzerland, as well as growth in the Food Ingredients and Packaged Foods segment and in bulk handling area. Note though that the expense is consistent with the prior quarter.

Finance expense includes costs associated with the cross currency swap on the high-yield bond interest. AGT also utilizes various trade finance instruments and the costs associated with these instruments are also recorded in finance expense. On 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 and taking into account the variability in outstanding operating lines at certain times of the year. Thank you.

**MURAD AL-KATIB:**

Thanks Lori. We have been, and continue to be, focused on the development and growth of our food ingredient platform with the expansion at our Minot, North Dakota facility and our marketing agreements for pulse ingredient flours, proteins, starches and fibres. This platform is an exciting one that we believe will continue to provide significant growth opportunities for AGT in the future; however, it is in the first quarter period that the strength of our legacy segment for pulses and grains processing demonstrates the solid foundation for growth and earnings and strength that AGT has built. Overall this segment has shown strong performance with the contribution from our traditional operations and our recent acquisitions.

Pulse and staple food demand continues to be strong to key consumption markets in India and Turkey and the regional markets that each supplies. In fact, exports from Canada for lentils are at record levels, a trend that we believe will continue in the 2016 and the 2017 season. These export levels have tightened supply in North America towards the end of the quarter, leaving carry-out stocks forecast to be nearly depleted by the end of the crop year. However, we may see record levels of lentils and peas seeded in Canada in 2016, which we expect will extend positively to our business and provide raw materials, both pulses and durum wheat, for our sales programs as well for our processing operations globally.

With our traditional processing infrastructure operating as we expect and adding our bulk handling and shipping assets—added in 2015 with the West Central Road and Rail and Mobil Grain and Mobil Rail acquisitions—AGT has been shipping a lot of pulses from Canada and the U.S. This is reflected in our reported metric tonnes invoiced for the quarter. Australia has also contributed to this as well with a good harvest completed late in 2015 and strong export numbers reported.

Key consumption markets are demonstrating that demand is continuing at strong levels, with demand visibility and order book sales for a fall new crop 2016 having already begun and showing signs of robust demand. We see this as signalling that concerns with regard to 2016/17 supply are driving importers to buy forward. Some of this demand may then be deferred and filled in the latter part of quarter three, with tighter supplies in quarter two available.



Seeding is underway in Saskatchewan, Alberta and Manitoba. The rainfall over the last week is certainly expected to aid in what could be one of the largest pulse harvests in the history of Canada. In fact, seeding intentions for lentils and peas, the two primary pulses grown in Canada, are estimated by StatsCan to increase 23% over actual production in 2015. You will recall that I did call a 10-million acre lentil and pea number long before the Statistics Canada figures were revised.

We expect strong prices in the world marketplace and are likely to drive additional production in 2016 in Canada, the U.S., and Australia, setting the stage for our expectation that the utilization gains we realized in the past year may continue and contribute positively to AGT's business in the subsequent quarters.

With a crop this large expected in the fall, we're continuing to work on efficiencies with regards to transportation, logistics and loading to leverage our acquired assets and to ensure we're ready to move products to the market using the most efficient and best modes of transportation, including rail, road, containers, vessels and the use of our port facility.

AGT's other segments, and particularly our food ingredients operations, continue to show a consistent growth with volumes, margins and earnings. We're excited about the prospects for the business unit with the expansion and the additions that we previously announced; and the deflavouring line is particularly exciting.

This enhancement to our process is expected to fulfill demand for pulse ingredients with a neutral flavour—a point of feedback from our customers that we're reacting to where they have been pleased with the functionality of our ingredients. They have noted that if the flavour was more neutral, it may boost their inclusion in their own products, which we expect will result in increased volumes from our Minot facility. This enhancement line is currently installed and commissioned, and once completed the capacity will turn into commercial production in the second quarter.

We did have an opportunity to host an investor tour and it was really quite interesting to see the line installed and running for a number of our investors.

The additions for a fourth production line to allow our pet food business to continue uninterrupted as the human food business grows in 2016 and '17, and fibre processing



and milling have commenced planning and we'll update as the projects continue to advance.

Our packaged food business globally is also progressing well. We expect that it will continue to provide benefit for this segment as it grows. We'll also expect to see more synergies between our own packaged food and food ingredients business as new categories and products are developed for introduction to the marketplace that leverage our investment in ingredient applications research, development and production.

Overall, we're pleased with how the segments are performing and with the results, both in terms of financial performance and in the efficient operation of our assets and facilities globally, we continue to be optimistic. We believe that with the current conditions and trends in global markets, in demand and in production, likely continuing into upcoming periods, we are increasingly confident in the continued performance of AGT Foods and our ability to grow our business, service our customers, service our farmers and provide value for our shareholders.

I thank you for your interest in AGT Foods. Omer, we're open to take a few questions. Thank you.

OMER AL-KATIB:

Operator, we'll take the first question, please.

OPERATOR:

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

JACOB BOUT:

Good morning. I've got a couple of questions on the food ingredient results. So first off, as we think about volumes or the total tonnes invoiced, if we take a look at this quarter versus a year ago, volumes are up only marginally. Can you talk a little bit about the mix for pasta, animal and human? Then I've got a secondary question on the deflavouring line.

MURAD AL-KATIB:

Don't forget, Jacob, the segment itself is not just the food ingredients. It is including the tonnages from the food ingredients, the pasta business, and also our import and



distribution and packaging business in South Africa. So, you know, from that perspective there are a lot of components in terms of what makes up the overall tonnage. I think the tonnage quarter-over-quarter was up like 3% or 4%, somewhere in that range. Was that right? Around 3%.

What I can tell you is we don't provide the exact breakdown but to give you a notional direction, food ingredient tonnes were up, pasta tonnes—because our capacity is fully utilized, we're adding the new line now, so because we are fully utilized, the pasta tonnes are flat. Any of the volatility that we see in that is largely due just to the seasonal demand flows that we see in our Africa business.

The Africa business would make up about 20% to 25% of the tonnes that are invoiced in that particular segment. So from that perspective, I think that in overall tonnes being up only marginally, as you term it, the food ingredient tonnes were up actually according to our expectation.

So the utilization of that third processing line, I think that we did reach just around 90% utilization on that line and I'm pleased with the way it's going.

JACOB BOUT:

So the total--

MURAD AL-KATIB:

In terms of mix between—sorry, go ahead.

JACOB BOUT:

Really what I'm driving at is really what does the total tonnage look like for human consumption?

MURAD AL-KATIB:

In terms of? What do you mean "what does it look like"?

JACOB BOUT:

If you look at it kind of a year-over-year comparison, however you want to give that information to us.

**MURAD AL-KATIB:**

Listen, the human foods side, as we reported last quarter, the mix is probably around 75% to 80% pet food, so I actually don't use the word animal feed because the pet food market is really different than the animal feed markets.

So the 75% to 80% of our tonnes invoiced out of that food ingredient would go into the pet food segment, and around 20% to 25% in the human food. If I look at it a year ago, that mix was probably 85/15; it's now probably 75/25, and we have a target with the deflavouring line. The deflavouring line will add an ability to deflavour 50,000 tonnes of ingredients. What that should tell you is that we have a target to build the human food demand in the first phase to 50,000 tonnes, and that would end up—when we add the fourth processing line, which we've already announced our addition of, that would tell you that 50,000 of the 140,000 is targeted for the human food market, which would take us up to around 35% to 40%. That's our first phase target which we'll try and achieve in 2017.

JACOB BOUT:

So what has the feedback been from your clients on the deflavouring line? Then really what I'm getting at is how quickly do you expect the human food ingredients then to move with the addition of the deflavouring line.

MURAD AL-KATIB:

Feedback has been very positive. We've done large industrial trials of 15,000 pounds, 20,000 pounds trials prior to installing the new system. So all of that testing has been done. Now in the commissioning phase we've delivered out commercial quantities of products and the feedback is everybody is very happy with the flavour profile, the smell, the colour, the taste of the product. Everything is going as expected. I expect that ramp-up to happen over the next seven quarters until the end of 2017; we'll have that line running and making gains every quarter, and as we ramp it up to 60% or so utilization on the deflavouring, we'll look at the second deflavouring line.

OPERATOR:

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

**STEVE HANSEN:**

Good morning guys. Murad, just want to get some context or colour around the idea that the bins are going to be a bit empty here through the balance of this sort of crop year. Just trying to get a sense for—this was an issue that surfaced last year as well, but the financials barely reflected that. I'm just trying to get a sense from your perspective how we should expect that to impact the results or the volumes through the balance of the two quarters before the new harvest arrives.

MURAD AL-KATIB:

We're certainly expecting volumes to be impacted in our Canadian platform, but we do have a very diversified global business now, and you know Australia and Turkey, during the period—like, late in quarter two, Turkey will go into a new harvest. So we are expecting that Turkey will help us to pick up some of the volume.

You're hitting the nail on the head. Theoretically, as supplies tighten, margins can actually improve, so we showed our ability to do that last year and we'll be working on a combination of two things: augmenting our lentil shipping program with more peas, more faba beans, more canary seed, more other commodities, and also with such a large acreage seeded, we're expecting that a lot of product was held back for seed, and once farmers are done seeding they will sell the balance quantity that they've left in their silos. Farmers seeding intentions, Steve, really are very fluid right up until seeding, depending on the subsoil moisture, if it's early or late. Farmers have choices in their rotation. I'll give you an example.

I was talking to a farmer last week, and he had both pea and lentil seed and he hadn't decided right up until the time he seeded which one he'd actually decide to seed. So from that perspective, they keep the flexibility, because also farmers in their area have experience. If it's early seeding they have better luck with this crop over that crop. If it's later, they go with this one. Depends on crop insurance premiums. There are so many factors that play into a sophisticated, multi-million dollar farming enterprise that the seeding intentions aren't nailed right until the end.

I can tell you my view is that the lentil and pea acres did go in the ground. The early seeding was a positive factor. Crop insurance premiums were very high—payouts were very high for lentils, which is going to aid that as well.



You know, I'm expecting that we will have—seasonally, quarter two is always going to be a weaker quarter because we are at the end of the North American crop season, but what we've done is take steps with the packaged food, food ingredient and other geographies to augment that to make sure that the effects are only smaller, they're not catastrophic. So I think that we'll be fine.

OPERATOR:

As a reminder, if you have a question, please press star, then one. The next question is from George Doumet of Scotiabank. Please go ahead.

GEORGE DOUMET:

Good morning guys.

MURAD AL-KATIB:

Good morning.

GEORGE DOUMET:

Can you provide us a breakdown of the contribution of organic versus acquisitions in the quarter?

MURAD AL-KATIB:

Well, I guess depends when you want to go back to, George, in that question. I mean, the acquisition, if you're referring to the Mobil Grain/West Central Road and Rail acquisition—

GEORGE DOUMET:

Correct.

MURAD AL-KATIB:

...I would say that the contribution of that asset was very minimal in this quarter. With supplies getting tighter, we have very plentiful container supply available. Frankly, our terminal in Thunder Bay, of course, isn't open in the first quarter. Thunder Bay is shut down for the winter as a result of freezing of the lake. So, I don't think we had any material bulk shipments.

**GAETAN BOURASSA:**

No, we didn't. That area, in particular, last year wasn't probably the best because of the quality of the durum, so the tonnes we're expecting, I guess, a better crack at it this season.

MURAD AL-KATIB:

The strong margins are really as a result of the performance of our value-added processing assets, so it was that and our ability to take product mix and to capture all different kinds of windows in the market. I mean, one of the things that we've always said to our investors is that as markets function relatively as expected, I guess, without some basic major macro-economic events, AGT has good margin potential because we pick our markets. We don't want to supply everything to every market around the world. We would rather supply to all 120 countries instead of just 12 countries. So, we pick our spots and I think that this quarter is showing that.

The pulse segment—strong performance. This quarter was really a contribution of three geographies. It was Canada, it was Australia and it was Turkey. So, those three, in unison, gave us an ability to have a really good result.

OPERATOR:

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

MARC ROBINSON:

Thanks. Just two questions as it relates to this potential record crop coming in the fall and what that might do to crop prices. So, let's assume then that this huge crop is going to drive prices lower. Can you comment on what you think that will do to working capital management, number one; and number two, what sort of impact do you think that might have on margins or volumes, or sort of the P&L impact as it relates to declining commodity prices?

MURAD AL-KATIB:

Let me start with aspect one. I mean, we are talking about the potential of materially different crop prices from last year to this year. Now that being said, let's just put it all in context. Today, with cereal grains running around \$6.00 to \$7.00 a bushel, red lentils—last year, in our peak period, we were paying on green lentils, I think we went all the way up to—I'm just going to do just a quick calculation here, just to make sure I'm giving



the exact right figure here. We went up to over \$43 a bushel for green lentils. So, that shows you the kind of magnitude. Now, the average price, I would say over the last five years would have ran in that \$13 to \$16 a bushel range, and red lentils were running for most of the year at \$24 to \$34 a bushel, and new crop, we're back to around \$18 to \$20 a bushel, from our peaks of up to \$40 a bushel.

So, the material effect on working capital will be—when we look at quarter three, quarter four last year, we had very high utilization; in fact, we were functionally running at full utilization. So, even with adding the bulk assets, Marc, we expect to be able to reduce working capital consumption in the fall period as a result of the initiatives that we have taken in place. Lori gave the figures. Working capital as a percentage of revenue came down from 20% quarter one of last year, down to 14.4% this year. That is a good measure for us in terms of looking at working capital per dollar of sales, and so if we can continue to maintain that efficiency, sales dollars will come down as will working capital, but that ultimately doesn't mean that earnings won't still be very, very positive.

MARC ROBINSON:

That B part, actually, it's a good segue. I'm obviously not looking for details, but I'm wondering what you think a declining commodity environment does to the volume outlook or the margin outlook.

GAETAN BOURASSA:

Well, I guess, as Murad mentioned, we do have the new assets in the West Central, so margins could be a little tighter, but we'll pick up some of that with maybe a bit more volume. The fact is that India is going to need a lot of pulses. The old story was a 4 million tonne shortfall. Well, a lot of people think that may be closer 6 million, 7 million, maybe even 8 million tonne shortfalls being recorded in the coming years.

MURAD AL-KATIB:

I think, Marc, you know what, what we've done with the acquisition of the bulk platform is give us an ability to preserve our value-added processing plants for the value-added opportunities, and to scale up the bulk program as the windows in the market allow it or require it. Those bulk assets we expect from August to January every year are going to be really, really busy, and for the rest of year we have a very low-cost, low fixed costs, meaning that we will be able to do business opportunistically, so what we are expecting is working capital to come down. Margins could come down slightly, but when we look



at the volume availability and gains, dollar margins we expect to be strong, margin per tonnes could be a little bit more flat. I think it's still a very positive outlook, though.

OPERATOR:

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

GREG COLEMAN:

Thanks. A lot of my stuff addressed, but I just want to piggyback a bit on Steve's questions. Murad, understanding of course that we're looking through to the more robust volume environment with this crop coming through, but on the short term, can you help us out to understand what kind of sensitivities we should be looking at for the volume decrease, given the diversification of your supplies? I mean, we were still up 18% year-over-year overall in Q1. We're kind of looking for that to moderate in Q2. Could it be flat? Is that impact of Canada? I mean, I guess my real question is what portion of your overall volumes is Canada right now?

MURAD AL-KATIB:

Canada is usually running around, say 45% of our volume, somewhere in that range, and so when we're looking at—your question, Greg, is it specifically around the quarter two impact, is that what I'm hearing you say?

GREG COLEMAN:

I guess it would be two rolling into three. I just don't want to be caught offside on that, but I—

MURAD AL-KATIB:

Listen, Greg, I've got to be honest with, the—I mean, as you guys know, I've said to you guys, you know, all of you for the last nine years—and a lot of CEOs say, you know, you can't manage quarter to quarter, but at the same time demand—you know, this is staple food demand. If we end up short of our ability to meet that demand in Q2, as an industry, not just as AGT, that demand will get rolled into Q3, it doesn't disappear. So, from that perspective, we expect it just to be a bit of a quarterly shift. We expect that—you know a couple of factors.

Early seeding should mean an early harvest, as well. We usually don't have new crop available until the third to fourth week of August, which really means that you have



around two weeks of new crop that actually get invoiced and included in the third quarter. We're expecting, with the seeding—I would anticipate that in west central Saskatchewan, as an example, the pulse seeding was probably around 60% to 65% complete already as of the Monday rain, so that is really early, and the rain coming literally couldn't have been more timely in terms of that availability. So, I think that what you're going to see is you're going to see a bit of a small constraint in quarter two, but you'll see that spill over and quarter three will be quite robust.

OPERATOR:

The next question is from Safwan Choudhry of Metroland Asset Management. Please go ahead.

SAFWAN CHOUDHRY:

Thank you very much. Murad, you had specifically spoken about India, and clearly AGT is leading on growth for India strategy. If you could add a little bit more colour to—given that's a very competitive market, what's the strategy for market share capture and would it be under the AGT brand or would it be generic?

MURAD AL-KATIB:

A really good question. Gaetan, our COO, and myself and our Executive Chairman, we spent a week in India together, all three of us, the first time all three of us had ever went to India together, a month ago, really assessing the strategy. The strategy entry point was—we established AGT India three years ago, so really two-and-a-half years ago. So, this was the second full year of operation of AGT India. We really approach the business in two ways. We have AGT India, who is importing pulses and distributing, and buying local products and exporting, but then, really, the great majority of our business today is just directly with Indian importers. So, this is not a new business for us.

If we look at our sales, if we include Canada and Australia together, we're looking at likely in the range of \$100 million to \$150 million a year of our revenue is direct sales into our India customer base.

So, the strategy has been we're very competitive on the bulk red lentils in containers, machine dressed, commercially cleaned, and we're now just in the stage of starting to introduce some of our brands into the wholesale market. So, maybe Gaetan will just give you a quick thing on the branding program and what we're trying to do there.

**GAETAN BOURASSA:**

Sure. So, in India, we have a few moving parts. They're doing some local trade, they're establishing relationships with some of the small millers, so we're taking some of the product to be shipped over there for a second touch and putting it into branded AGT India bags. That has just kind of launched as our step into India.

MURAD AL-KATIB:

Then, from Australia and Canada, the branding side?

GAETAN BOURASSA:

Yes, that has been a slower start than some of the other countries, but is definitely there and growing as well.

MURAD AL-KATIB:

Yes, we're committed, I think, long term to getting our brand into the wholesale market. An example is, you know, we have an eagle-branded U.S. green pea that go under the AGT brand. It's a really beautiful laminated branded bag. We're going to continue to try and build value for our business as a result of that kind of strategy. But, India, no doubt, in the next decade, is a major part of the growth strategy of this company. So, when we look at the fact that 22 million tonnes of pulse consumption, and growing—so incomes are rising, so that Asian middle-income effect—people talk a lot about China, but it's really China and India driving that. It's more income means more disposable income, means more protein consumption, and we obviously like 400 million vegetarians in India.

OPERATOR:

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

STEVE HANSEN:

Yes, hey, guys, just one follow-up. As it relates to the deflavouring line, Murad, and I guess even the sterilization and other add-ons that you've made at Minot, how should we think about the incremental margin opportunity for you guys? You're not necessarily producing more tonnes, per se, but a higher value tonne. How should we expect that evolution to unfold?

**MURAD AL-KATIB:**

Yes, and you know, Steve, I think what you're going to see over quarter two, three, four, into quarter one next year, is you'll start to see the incremental effects of that, because the pasta business is going to add some tonnes, but it's really quite a consistent margin business, and South Africa, tonnes go up, tonnes go down, but it's a consistent margin business. So, the margins gains today are largely due to two things that we're trying to work on. One is, you know, valuation or the value that we're receiving for our starch fraction, in the fractionation, and two is the incremental margin we can receive for the deflavoured and sterilized flours and fibres.

You've touched on—you know, deflavouring is really important in the flour market and in the protein and starch market. So, really, that's our granulated flours that we sell into the food industry, but the sterilization is really important when it comes to the fibre. So, the sterilization is the killing of the microbiological counts on the outer seed coat of the pulses. The fibre fraction, as you know, is the outer seed coat, and if you can appreciate, the outer seed coat of a pulse is what is exposed to microbiological collection when it's sitting in a farmer's field. So you've got all kinds micro-organisms and insects, and all of those things that kind of accumulate on the outer seed coat. So, once we take that, we need to sterilize it to be able to use it in the human food market.

We expect that the margin gains can be material, and we're testing those boundaries now, but one of the things that we would target is we would target over time to build it to be nearly another margin that comes on top of each tonne that we do. So it's almost like our strategy in our other business, it's like a two-touch strategy. Your raw ingredients, the margin profile you see is what you've got now. Your two-touch strategy should be materially higher because it really is a different product that we're marketing, and we're actually going to market it as a different product.

OPERATOR:

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

ANOOP PRIHAR:

Good morning. I noticed in your MD&A you said that you had instituted a Shareholder Rights Plan. I'm just curious to know, can you talk a little bit about the timing on that and why you thought that was a good idea to do it now?

**MURAD AL-KATIB:**

Anoop, you know, ultimately, there's a couple of things. One of the things that we actually—as we continue to move towards that billion-dollar market cap, one of the things that we are very focused on as a company is on our financial management. We've already done our internal controls, internal audit processes, all of that is working and quite robust, but we undertook a complete governance review of the Company, and so we're improving board processes, we're improving our committee structures. We are actually adding two new directors, and so our Management Information Circular will go out soon. So when that goes out for the Annual General Meeting in mid-June, we're adding two new independent directors into the fold, as well.

So, part of that was we've obviously been watching the OSC guidelines around takeover bids, the change from 35 days to 105 days, and that actually came into effect just recently. So, what we looked at was a compliant Shareholder Rights Plan. We believe strongly in the concept of our shareholders all having equal rights to value that we create. As you know, even from day one, Anoop, we never had preferential voting rights for the founders of this company, or anything like that. This Shareholder Rights Plan will give us the proper time to evaluate any type of a takeover bid, it will eliminate the ability of a potential acquirer to go outside of the Canadian takeover bid rules, and it will ensure that all shareholders have the right to share in the value that we create when a takeover bid happens. So, I think it's good governance, and from that perspective, we're going to put it to the Shareholders for a vote.

The timing is just as a result of the fact that our Circular goes out and the OSC rules just kicked in, so it's just as a matter of getting that out so that the shareholders can vote on it in mid-June, no other special reason for it being right now, Anoop.

OPERATOR:

The next question is from Jacob Bout of CIBC. Please go ahead.

JACOB BOUT:

Murad, I just wanted to follow up on the balance sheet. We've seen debt levels building here and we're not seeing an appreciable amount of free cash flow. Can you comment a bit about how you're looking at the amount of debt you're carrying?

**MURAD AL-KATIB:**

Well, you know what, our leverage ratio improved from 4.7 to 4.6, so you know what? We're going to continue to work on working capital conversion in quarter two, into quarter three. That'll happen as a result of the commodity prices starting to normalize. We're focused very much on a very targeted CapEx program this year. The Minot deffavouring is done, we announced a couple of small additions of lines which are going to be just under \$10 million of CapEx there, and we're going to focus on delivering out a very strong 2016 calendar year which is going to show improvement in our free cash flow.

So from our perspective, the debt structures that we have, we can't forget that we have working capital debt set up on a borrowing base facility. We are securitizing the debt on a borrowing base lending program, so it's really an asset-based lending approach. When we look at the amount of debt that we have on our balance sheet, I'd also like to point you to the \$1.2 billion in assets that we have on the balance sheet, as well. So, we're comfortable with the debt levels, we'll moderate with the commodity prices, we'll continue to work towards our 3 to 3.25 total debt to EBITDA targets, and we'll get back to that with the commodity price moderation, and that's where we're focused.

OMER AL-KATIB:

Thanks, Murad. This brings us to the end of our questions for this session. I'd like to thank all of you joining us for your time on the call. I'd like to also remind anyone 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 more than happy to follow up with you. Again, thanks for attending our conference call and we wish you all a very good day.

OPERATOR:

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