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AGT Food and Ingredients Inc.
Second Quarter 2016 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:
I would now like to turn the conference over to Omer Al-Katib, Director, Corporate Affairs and Investor Relations. Please go ahead, Mr. Al-Katib.

OMER AL-KATIB:
Thank you. Good morning and thank you for joining us on our conference call this morning. 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 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 a reconciliation to IFRS measures, we direct you to our news release, our website, as well as our recent filings on SEDAR.

I'd like to turn things over to Murad for some comments before we go to questions. Murad?

MURAD AL-KATIB:
Thanks, Omer. Good morning to all of you on the call with us today and thank you for your interest in AGT Foods. Harvest in Canada and the United States is very close to commencing—and in some areas of Western Canada and the Northern Tier States already starting on a very limited basis. In some areas harvest is a few weeks away, but overall, we're quite optimistic the harvest season is going to bring a good volume of quality pulses to fill strong demand in key consumption markets and feed AGT's system of processing, handling and shipping.

The late 2015 and early 2016 periods were strong shipping periods for AGT that resulted in raw material stocks in Canada and the U.S. being depleted or nearly depleted as India, Turkey and other global pulse markets imported large volumes of pulses.

Overall, we're pleased with the results from this quarter where we've seen supply constraints resulting in lower sales programs and temporarily lower margins in AGT's Pulse and Grains Processing segment and Food Ingredients segment. However, the results are positive and we're optimistic the conditions are temporary and they'll be resolved by the volumes and the price adjustments that will come from a new harvest season.

I would like to give you an update on what we see with regards to crop conditions, volumes and quality, discussing the seasonality in the global pulse markets and give you an update on our segments and business units, but first I'm going to ask Lori Ireland, our CFO, to give you a quick summary of the quarterly results. Lori?

LORI IRELAND:

Thanks, Murad. Adjusted EBITDA increased to $25.3 million for the three months ended June 30, 2016, compared to $22.2 million for the three months ended June 30, 2015, and trailing 12-month Adjusted EBITDA improved by 25% from $90.3 million at June 30, 2015 to $112.9 million at June 30, 2016. Metric tonnes invoiced decreased in the current quarter ended June 30, 2016 compared to the quarter ended March 31, 2016 due to significant amounts of unfarmed North American product being depleted and new crop harvest not yet complete.

Cash flow from operating activities for the three months ended June 30, 2016 was an increase of $56.2 million compared to a decrease of $11.6 million for the three months ended March 31, 2016, and compared to an increase of $44.2 million for the three months ended June 30, 2015. The improvement over the prior quarter is due largely to a decrease in inventory during the quarter, partially offset by increased accounts receivable and a decrease in accounts payable, accrued liabilities and deferred revenue.

AGT has taken steps to streamline the use of cash; however, there are still periods where inventory and sales are expected to increase and cash flows are expected to decrease. As a result, we monitor working capital as a percentage of revenue to ensure that cash is being used effectively. At June 30, 2016, working capital was relatively consistent with the March 31, 2016 numbers; however, the percentage of working capital to trailing 12-month revenue decreased from 14.4% to 13.99%, and decreased from 19.3% from the same period in 2015.

Gross profit and adjusted gross profit increased in absolute dollars when comparing the three- and six-month periods ended June 30, 2016 compared to the same period in the prior year. This is due to overall increased volumes invoiced, though much of the increase in sales comes directly related to the Trading and Distribution segment, with lower margins than other segments. Many of these sales supplement AGT's platform, especially during times when on-farm inventory is typically at the lowest levels.

When looking at the crop year 2014/15 compared to the crop year 2015/16 for Food Ingredients and Packaged Foods, adjusted gross profit per metric tonne increased from $182.93 per tonne to $205.91 per tonne, and Adjusted EBITDA per tonne increased from $113.97 to $138.28 per metric tonne, an increase of 12.56% and 21.33% respectively.

Non-cash foreign exchange was a loss of $13.9 million for the three months ended June 30, 2016 and a gain of $10.6 million for the six months ended June 30, 2016. This includes a snapshot of outstanding foreign denominated accounts receivable, accounts payable, as well as outstanding foreign exchange contracts, and includes the contract relating to the high yield bonds. This is a non-cash item and it fluctuates depending on the strength and weakness of foreign currencies when compared to the Canadian dollar, and it's excluded from Adjusted EBITDA calculations due to the non-cash nature of it.

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.

AGT also tracks adjusted earnings per share as it is reports this exclusive of the non-cash foreign exchange effects of our global business, and that is whether it is a gain or a loss because Management feels the 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 basic earnings per share were $0.56 and $0.55 fully diluted for the three months ended June 30, 2016, and that compares to $0.45 and $0.44 for the same period in 2015. Thank you.

MURAD AL-KATIB:
Great. Thanks, Lori. As I mentioned, I'm pleased with the results from the quarter, even with the effect of the low remaining stock levels that that had on our processing shipment volumes and margins. Again, we view these conditions to be temporary, with a harvest coming in the coming weeks.

Really, at the pulses and grains segment for AGT—our legacy segment—we view the current conditions as a return to the traditional Q2 reset period, where local production availability in places like India and Turkey and output in key consumption markets increases, while harvest in North America—and markets are looking forward to our harvest. This allows the reset to reconcile local availability with future stocks that are going to come to market.

You just need to look at the record level of exported levels from Canada—2.6 million according to Statistics Canada in 2015, with record levels to India and Turkey—to see the impact that we had on our crop availability. Record exports are coupled with record production and the trend that demand in local markets continues to outpace local production widens the supply-demand gap and necessitates the need for imports. We expect this trend will continue in places like India and Turkey. We need to make no mistake: local gains in their production will happen. Incomes, though, will rise and populations will continue to grow. It is government's job in these countries to report their efforts to increase local production and to curb food inflation, but imports will continue to be an important part of feeding the population's demand for global protein.

Regarding production, Statistics Canada and the U.S. Department of Agriculture are estimating about 10 million metric tonnes of lentils and beans expected to be produced, and 11 million metric tonnes of pulses overall in North America. These are significant quantities that are needed to fill global market demand.

Australia and Russia and their production, which is growing, is also a part of AGT being able to capitalize on these origins with both processing facilities and origination opportunities that are established and will be a part of our global distribution network.

Prior to the start of the harvest—as I mentioned, in the next few weeks we expect it to be substantially underway—the Saskatchewan government has been estimating good to excellent conditions for the majority of the pulse crop, conditions we expect are similar through Western Canada and the Northern Tier States. The rains reported in July are expected to have an effect on production, with some acres lost to disease and flood-outs in fields, reducing certain outputs and yields. The full impact is something that we're monitoring closely; however, the large seeded acreage and the expectation of yield improvement over 2015 is expected to result in a good-sized crop for this season, and of course AGT has good processing, shipping and bulk handling systems in North America to deal with the volumes expected for both bulk and containerized products, as well as the processing capacity, infrastructure and value-added capability to deal with variability in quality that may appear.

The levels of production are important to AGT not only for our legacy business but also for our Food Ingredient business in Minot. We saw increased volumes in metric tonnes invoiced in the quarter out of our Minot plant, and results overall have benefitted from growth in metric tonnes of our pulse ingredient products including flour, protein, starch and fibre marketed to pet food manufacturers, food companies and aquaculture users around the globe. We continue to see incremental growth and progress in this business unit and it's really centred on the three production lines in operation and the new enhancement line, the deflavouring, installed and commissioned, along with other announced expansions of the fourth production line and additional flour milling capacity that will maximize the current production capacity and output of Minot later in 2016, into 2017 and of course continuing in 2018.

The deflavoured products produced in Minot started commercial production in Q2, with customers taking sample quantities to evaluate and test in their own production systems and application research. The feedback on output products has been positive with product meeting Management's targets on capacity, flavour profile, and most importantly, functionality.

This business unit was affected though by similar temporary supply constraints as our legacy segment. However, as raw materials for production are now available in South Dakota and North Dakota, we expect a return to normalized margins, volumes and product mix for starch, protein, flours and fibres.

Our Packaged Food business has also been performing well, with growth in market opportunities, particularly in pasta, with facilities operating at full capacity. The expansion and addition for the long-cut pasta production line we announced earlier in the year is now complete and this line will start to produce in Q3.

We've also, as we've mentioned, added American lasagna and specialty vermicelli nest and noodle pasta, which are also beginning production in Q3.

We expect our bulk handling assets in Canada and the production of durum wheat, the raw material for pasta, to be strong in the same growing in origination area that AGT is located in in Western Canada for pulses.

We continue to work on new products that bring together our Food Ingredient and Packaged Foods businesses, such as specialty pasta categories; pulse, protein and fibre enhanced pasta; gluten-free pastas, particularly entirely from pulse ingredients or nutrient enriched pasta through a blend of durum and pulses.

The segment is advancing as we expect with regards to the metrics tonnes shipped in the margins. Further growth in the segment is expected, and we'll continue to grow that business as we grow along.

Before we go to questions, I want to conclude by saying we're expecting strong periods in the latter parts of the year, after harvest, with quality and quantity of pulses available. We view supply-demand fundamentals in key markets as positive for AGT, and overall, the positives are further strengthened by growth in our Food Ingredient and Packaged Foods segment, and strong performance from our Trading and Distribution segment, which demonstrates the ability that the diversification initiatives that we've been working towards, we feel, have had a great positive impact and benefit to our business overall.

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

OMER AL-KATIB:
Operator, we'll take the first question, please.

OPERATOR:
The first question today is from Jacob Bout with CIBC. Please go ahead.

JACOB BOUT:
Good morning.

MURAD AL-KATIB:
Good morning.

JACOB BOUT:
I wanted to dive a bit into the Food Ingredient results. Perhaps you could help us and give us—what was the contribution from pasta versus CLIC versus the Minot plant? Then within Minot, what were the volumes for pet food versus food, and perhaps looking at it from the EBITDA perspective.

MURAD AL-KATIB:
Well, Jacob, as you know, we don't exactly break out the composition of the segment, just for commercially sensitive reasons, but if I look back at historical comments I've given to you and others, I think what I can do is give you a general view.

The overall tonnages in the Food Ingredient side were up in the quarter and we would expect that as the third line basically ramped up to a full utilization scenario from that 85% to 90% utilization rate, and we did start to produce some deflavoured ingredients. The pasta segment was up slightly, so the reduction in tonnage overall, or what kind of cap the real next step-up in that segment, was the South African business.

South African tonnage, they're actually going through the worst drought in the last 100 years there, so their margins were actually quite strong, but their tonnages were down.

So if I look at the segment overall, from a handling perspective you're probably looking at about 25% of the handle is in the Food Ingredient segment—sorry, pulse ingredient; about 35% of the volume would be in the pasta segment, and about the remaining would go between CLIC and the South African—CLIC is not a big volume business, as you know. It's really a retail packaging business. That's not volume; that's a totally different business entirely.

When I look at the segment overall and why we felt some constraint, really it was actually in all three of those business units. South African handle was down although margins were up. Pasta, we were actually in the scenario where the durum wheat harvest in Turkey only came at the very end of the quarter, so margins were a little bit tighter in that segment. But the big drive down in our margins sequentially this quarter was twelve-dollar-a-bushel peas that were the only peas available in the North Dakota, Eastern Montana region. So we depleted the pea stock in Canada and in the U.S.

What you'll see, Jacob, is you'll see sales that are made—let's just take it very simply. If we make a sale in April, a new sale to a pet food manufacturer and it's six months in duration, we have to price that six-month duration on a fixed price contract. If the prices are unusually high for the first two months, we may take a lower margin in the first two months and a higher margin in the last four months on a blended average price of that pea. That's what you're seeing here, is a timing effect where high priced raw materials are the first in and they're the first out in our accounting system, and now in July and August and September and October, new crop peas from South Dakota and North Dakota have been bought now at levels that are materially below the May/June levels; margins are back improving.

So I think that what you're going to see is a sequential margin return back to that profile that we were seeing in the prior four quarters prior to today.

I would not comment that there was any material change in food versus pet food in this quarter. The deflavouring line only became commissioned I would say around the first or second week of May, and it only started shipping out the latter part of the quarter, so I'd say we're still running at that 75/25, 70/30 type range, weighted more on the pet food side, but we're expecting that to start to show some gains in Q3/Q4/Q1 as we ramp up the deflavouring.

Last part of this is: line 4 is on track to meet our expectation of commercial production in Q1 of 2017. So, that line is on order. We're expecting it to come in Q4 and start installation and commissioning.

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

STEVE HANSEN:
Good morning guys. Murad, can you just maybe give us a bit better sense or colour for the volume that you were able to source in the quarter? Certainly most of the stats and indicators that I think many of us look at suggested that volumes were—scarcity of product was widespread, yet your volumes were actually quite resilient relative to that, in both the Pulse and Grain Handling as well as the Trading and Distribution side. Maybe just get a better sense for how the volumes were so good. Thanks.

MURAD AL-KATIB:
It's a good question, Steven. I think it's something that fundamentally we don't talk enough about and that is really the foundation upon which AGT was built, which is the origination platform. I'll tell you that we have extremely strong reach into the farm level origination, so we're not relying on other companies to source our raw material. I can tell you, if we're down to drips and drops of pulses in Canada, we know where they are and we know how to find them. Now, the fact is the prices might be high and margins might be constrained, but at the same time my factories are still running.

One of the things that's interesting to me—it kind of links into your question, Steve. We've had comments from some analysts or some investors that there's a lot of moving parts in this business. The reason you see such strong volumes is we have a lot of moving parts in this business and I will prefer to run a diversified business that we've built than being a one moving part business. Because you know, Steve, when one moving part stops, the Company stops, but when there are many moving parts you're able to build volume. So, some of the volume you'll see is like Trading and Distribution volumes went up; we were very active in markets that we're not always active in, like sugar, like rice. We were very active in segments that we're not usually as active in; whole pea shipments were up on the quarter. So we ended up in a position where we pieced together a business that allowed us to deliver out in earnings, but let me make no mistake about it; I'd rather be into the new crop and we're getting into it really quickly. When product is available and demand is as strong as it is, AGT does well by using its assets to find the best margins.

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

MURAD AL-KATIB:
Good morning, Peter.

PETER PRATTAS:
Good morning. How much visibility do you have in your Processing margins into the second half of the year? Is it a case where you can lock in your spreads now and your volumes, they're largely committed, which gives you that confidence in improved margins for the second half? Thanks.

MURAD AL-KATIB:
I could probably go on for two minutes or I could just say, "Yes."

Peter, certainly with the acreage that was planted and our large reach into the farmer origination side, we have a very material book of contracts on the purchase side already and I can tell you that September, October, November volumes in almost our entire platform, we've got good visibility into our sales already, good visibility into our origination; our FXs are hedged, and so we have a relative level of confidence that we're going to have an ability to return to more normalized margins.

In the Food Ingredients segment, because the volumes are much smaller, I can tell you that I have very good confidence because I sold the product on long-term contracts; I have now bought all of the product and I'm now just waiting to ship. So, when I make the commentary that the Q2 Food Ingredient margins were a temporary blip, I feel with a great level of confidence that Q3/Q4 will return back to more sequential margins.

OPERATOR:
The next question is from Greg Coleman with National Bank Financial. Please go ahead.

MURAD AL-KATIB:
Good morning, Greg.

GREG COLEMAN:
Good morning, Murad. How are you?

MURAD AL-KATIB:
Fine, thank you.

GREG COLEMAN:
I just wanted to dive into the smaller on an earnings part of the business, the Trading and Distribution, but versus our estimates, that's where you saw a lot of the outperformance in the quarter. The margins that you ended up posting there were some of the highest we've ever seen since you've been disclosing sort of the detailed segmented analysis. Can you give us a bit of insight there as to what exactly is going on there? Is that something that we should expect as more of a norm, or is it one-off?

A related question, is that where you're holding your rail business and related entities from the segment's disclosure, or is that totally off base? I'm not on the mark there.

MURAD AL-KATIB:
No, you are on the mark there, Greg. Just to be very clear, we have made a decision on a go-forward basis that pulses that are handled in our bulk handling system in the rail business, will

still go into the Pulse and Grain Processing segment, just because it is part of our integrated supply chain, but other commodities that are handled in both our bulk rail system and our bulk handling container system in Australia, so commodities like cereal grains, sorghum, oilseed crops, those will go into that segment. I think that one other very important business that is in that segment is AGT India is in that segment.

As we continue to build out these supply linkages between Canada, Australia, Turkey, Russia, India and Myanmar, this is—initially Trading and Distribution for us was a place to put what we would term to be relatively non-reoccurring, opportunistic business that was done only for customer service, but I think you will see over the next four and six and eight quarters a normal maintenance and definition of a reoccurring business line in that particular segment.

Again, our rice business is in that segment out of India. Our sugar business is in that segment. Our bulk rail business is going to be in that segment. So we are expecting it to be a three-pronged growth strategy and the earnings growth that we are expected by you as analysts to deliver on sequential EBITDA growth in the second half of ’16, ’17 and ’18 will be delivered from normalized margins and earnings from our Pulse and Grain Processing segment, which is of course the foundation of our business. Trading and Distribution is actually an ability to monetize that sales program in pulses with other commodities and a bulk handling system that we’ve now acquired and built out, and the Food Ingredient and Packaged Foods is our upmarket strategy.

Again, I get back to this analogy of the moving parts. I like three moving parts, and even moving parts within the moving parts, because it gives us very good balance where, again, when you have supply constraints in North America—I look back at 2009/10/11/12. We were heavily reliant on lentils in Canada and if we’d have been in that position today, Quarter Two would not be the earnings that we just showed. It is the balance of what our pasta business—what India did; what Canada did do; Australia contributed; the U.S. contributed; Food Ingredients contributed. So, from that perspective, that gives, I hope, you a little bit more of a view that we do expect things to continue in that particular segment.

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

ANOOP PRIHAR:
Good morning. Just a couple of quick follow-ups. Just kind of, first of all, back to the whole Trading contribution, $4 million of EBITDA. Was Food Aid a big part of that number?

MURAD AL-KATIB:
It's a part of it for sure, Anoop. The Syrian Refugee Program with the United Nations continues and we don't see an end in sight, unfortunately, as it is truly a humanitarian disaster. But from the perspective of that particular segment, Food Aid is a part of it.

In addition, Anoop, we are seeing a number of government tendering contracts that we've been successful on, and that's for a number of other staple commodities: sugar, rice, lentils, wheat. These are the type—we did a tender recently on potatoes in North Africa. So, these are all related to commodity price, or really food inflation and price stabilization programs of sovereign governments. You know, we have such a strong relationship with governments in North Africa, the Middle East and in India that we are benefitting from the longevity.

A number of people think of AGT as only a company that's eight years old because we went public eight years ago, but we can't forget that companies that we own like Arbel and the Arslan family have been in this business for—we're into nearly our seventh decade in this business, so we benefit from those long-term relationships.

ANOOP PRIHAR:
When do you expect the bulk rail–

OPERATOR:
The next question is from Greg Coleman with National Bank Financial.

GREG COLEMAN:
Just a quick follow-up…

MURAD AL-KATIB:
Greg, before you go, I'm going to get you to hold because Anoop got accidentally cut off there and he said when do I expect the bulk rail segment to start contributing. So, I heard three-quarters of the question, so Anoop, if that's not your question, get back in the queue, but I'm going to answer that question quickly. Is he back?

OPERATOR:
Anoop is back on the call.

MURAD AL-KATIB:
Anoop, go ahead please. Sorry, you got cut off by accident I think.

ANOOP PRIHAR:
I was just going to ask when does the bulk rail system kick up into full capacity? Then lastly, the CapEx in the quarter was about $21 million. Can you break that down a little bit, please?

MURAD AL-KATIB:
Sure. Okay, let's start with the bulk. The bulk rail capacity, you know what? We're going to see our first step in integrating that bulk rail capacity in, of course when the harvest starts, so we'll expect late in Quarter Three and then of course Quarter Four, Quarter One we'll start into shipping on our pulse side and on some cereal programs. So, I'm expecting that to be good contribution as we go forward in 2016 crop year and 2017 crop year.

The second part of your question, CapEx, I have. Was there one other part? I forget.

LORI IRELAND:
I think that was it, and CapEx.

MURAD AL-KATIB:
CapEx, Anoop, when we look at the CapEx side, half of the CapEx in the quarter was the completion of the deflavouring line. It was really the deflavouring line. It was the finalization of the expansion at Minot. So that was about $8 million of the $20 million. Then there was about $5 million of it was in the rail project that we're completing outside of Saskatoon, and then the balance is just odds and sods through our entire system.

LORI IRELAND:
CapEx and maintenance.

MURAD AL-KATIB:
Yes, and maintenance CapEx is in there as well, of course.

So when you see the capital expenditures at $20 million, a portion of that would be maintenance CapEx that is extending the useful life and it's capitalized.

OPERATOR:
The next question is Greg Coleman with National Bank Financial. Please go ahead.

GREG COLEMAN:
I want to apologize in advance for this question because I think I just missed it, but did you just outline your 2017 capital program for us?

MURAD AL-KATIB:
I did not, Greg. That was the 2016 quarter one. The 2017 cap program, we're looking at running in the range of about $15 million to $20 million, so relatively modest compared to what we had been spending in the past.

With a very strong Management focus on free cash flow—and really the big projects are done—you can almost assume then Greg that you're going to end up in a position where about half of your CapEx budget, so somewhere between $7.5 million and $10 million, will go into the Food Ingredient, which really makes sense as we continue to ramp up a line by line. Every line is around $4 million to $6 million. That gives you about a line and a half every year, which gives you an ability to stagger between one year to the next to do basically two lines every 15 months. Then the balance, $10 million is just, as we say, we've got 40 factories around the world so, odds and sods efficiency projects. So, pretty modest in terms of what we've been spending in the past.

OPERATOR:
The next question is from Sarah Hartshorn with Rainbow Fund. Please go ahead.

SARAH HARTSHORN:
Good morning. Would you please comment on the EBITDA improvement that we should see now that the deflavouring line is up and running? If you could just comment on for the human food versus the pet food, do you get 20% more EBITDA? Forty percent more EBITDA? What is that looking like?

MURAD AL-KATIB:
Sarah, all I can tell you unfortunately is because we don't give the earnings guidance—what I can tell you is that we do feel like once there is a true appreciation by the food industry of the modification that they're getting in the product, which is really two-fold, of course the dramatic flavour node reduction is one part with the protein preservation, but the second part is a microbiological significant reduction. If I look at the plate counts on wheat flour versus our pulse flours, when they're running at around 100,000, we're running at around 10,000. So from that perspective, very significant microbiological reduction allows our flours to be much more suitable for other applications.

All we've been able to say, Sarah—and I know I'm not going to answer your question—is we do expect there to be a material margin improvement in the Food segment as we continue to monetize those applications.

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

STEVE HANSEN:
Yes. Thanks, Murad. So Murad, in your remarks, you did address the crop quality issue to some degree but I just want to circle back on it and make sure we understand it all that well.

MURAD AL-KATIB:
Sure.

STEVEN HANSEN:
Just trying to understand, so the crop quality has deteriorated I think since earlier in July when it was looking really good, and so just from your perspective, how do you plan on managing that from your perspective and how should we think about that as it relates to margin impact, if any?

MURAD AL-KATIB:
Good question, Steve. So, for those of you who've been in this story for a long time, as soon as we start talking about quality issues, you may shudder because you remember back to the 2010 crop. Let me be very clear. The crop quality problem in 2010 was done as a result of 400 millimetres of precipitation that fell in the span of 18 to 21 days during the harvest period. So it was a complete inverse of the expected quality in a large crop coming in Canada at the time. When we expected 75% in the Number 1 and 2 grades and 25% of the bottom grades, we ended up getting 82% in the bottom grades and about 18% in the top grades. That is not what we're talking about this year.

This year the quality issues that we're talking about were caused by rains that were happening in the July period which was really during the flowering and podding and setting stage for the plants. So, one big impact, Steve, was drown-out. Crops that were attempting to grow and set flowers and pods had excessive moisture and through sitting in that moisture they were not able to remain viable and those plants actually died. So that was acreage or crops, plants that were lost to the excessive rains.

The second problem that we see is that the canopy, the large vegetative growth which was very material—if you look at vegetative maps, I think, Steve, at one session you and I were at together, you'll remember vegetative maps showing vegetative growth which exceeded the 100th percentile of 2013 which was viewed as one of the highest vegetative growth crops in the last 30 years. That vegetative growth with excessive moisture, when farmers applied fungicide or they sprayed for diseases, the canopy actually covered the bottom parts of the plants. So with that inability to apply the fungicides, some pods actually aborted; they didn't form pods or they didn't form seeds in the pods, so that's again a yield loss.

We at this point are still expecting the relative quality to be quite good. We expect the reduction that people are talking about and the crop quality problems really to be much more based on yield. Now, I'm still saying that I think that the yield is higher than the yield per acre last year, and with acreage at a record level, even with lost acres we're still going to end up with a larger crop than last year. Is that clarified?

STEVE HANSEN:
Yes, it's very helpful. Thanks.

OMER AL-KATIB:
All right. Thank you very much to everyone on the call. Thank you for joining us on this session today. I'd like remind everyone and anyone who's still on the call, if you have any follow-up questions, you can feel free to contact us at our Regina head office and somebody from our team would be happy to follow up with you. I thank you for attending our conference call and I wish you all a very good day today.

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