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AGT Food and Ingredients Inc.
First Quarter 2018 Financial Results
Conference Call Transcript

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Speakers: **Murad Al-Katib**
President and Chief Executive Officer

Lori Ireland
Chief Financial 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 very much. Good morning. Thank you all and thanks for joining our First Quarter 2018 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 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.

With that, Murad, I'd like to turn it over to you for some comments before questions.

MURAD AL-KATIB:
Thank you, Omer. Good morning and welcome to everyone on the call with us and I thank you for your interest in AGT Foods.

This quarter has been a relatively positive one for AGT after some quarters where there have been challenges in our business and pulses and staple foods markets overall. We have all been watching global pulse and staple foods markets in the recent periods, as the difficult conditions have affected not only our business at AGT but the global agricultural commodity markets overall.

There have been a number of conditions that we have identified and spoken about, including oversupply of pulses, the impact of duty and non-tariff barriers to key markets, and low prices and lowered import volumes to key markets.

We have indicated that we believe that as these conditions resolve or are assimilated into the market, that market conditions may commence normalization in terms of volumes, prices and margins, and with them, following earnings for AGT. We believe we are seeing some positive signals of this now.

I would like to speak a bit more on these factors as well, and highlight some of the performance and trends we see ahead and some of the conditions we believe that may aid to market end normalization, but first I'm going to ask Lori, our CFO, to comment on the quarterly results overall. Lori?

LORI IRELAND:
Thanks, Murad. Overall adjusted gross profit and adjusted gross profit per metric tonne improved for Quarter One of 2018 compared to Quarter Four of 2017 due to improvements in all three segments.

In the Pulses and Grain Processing segment, adjusted gross profit per metric tonne increased when comparing Q1 of 2018 to Q4 of 2017, due largely to stronger margins out of Turkey as well as slightly improved margins on processed product from North America. Adjusted gross profit decreased from Q1 of 2017 due to margin pressure on chickpeas, affecting Australian outstanding sales contracts. In addition, volumes and margins were down on sales from our Williston processing facility, and a shift to domestic sales in Turkey resulted in lower margins compared to the same period last year.

In the Food Ingredients and Packaged Foods segment, adjusted gross profit per metric tonne increased when comparing Q1 of 2018 to both Q4 of 2017 and Q1 of 2017 due mainly to improved margins out of our Minot facility that are the result of sales programs that aimed at starch fraction value improvements. Strong protein sales and stable pea prices also contributed to improved margins. Pasta margins were consistent with the prior quarter, while volumes increased. This was partially offset by lower margins from South African sales when comparing Q1 of 2018 to Q4 and Q1 of 2017. South African margins were affected by a delay in the popcorn harvest as well as a reduction in higher margin groundnut sales that were included in Q1 2017 results.

The Bulk Handling and Distribution segment showed improvements in adjusted gross profit per metric tonne in Q1 of 2018 when compared to Q4 of 2017. The results of AGT

India are included in this segment and continue to be impacted by duties on imports. AGT is taking steps to ensure that executed sales are profitable and will be collected. The margin constraints out of India were partially offset by positive earnings on the trading business through our U.K. operations.

Adjusted EBITDA for Q1 of 2018 was $16.1 million, which was a decrease from $20.1 million at Q1 2017 but an increase from $15.6 million for Q4 of 2017. The decrease from Q1 of 2017 was due to lower demand impacting operations in both the Pulses and Grain Processing segment and the Bulk Handling and Distribution segments. It was partially offset by improvements in the Food Ingredients and Packaged Foods segment, which contributed 63.2% of Adjusted EBITDA from 14.5% of the total invoiced tonnes, demonstrating this segment’s positive contribution to balancing our ups and downs in the traditional Pulses business.

General and admin and marketing sales and distribution expense for Q1 of 2018 decreased from Q1 of 2017 due to cost savings initiatives across our global platform. Interest in long- and short-term debt for Q1 of 2018 was consistent to Q1 of 2017. Trade finance instruments are utilized to improve our cash collection cycle and interest charges remained consistent with the prior year. AGT continues to utilize LIBOR-based borrowing to lower our interest rates incurred on syndicated debt.

AGT had a tax recovery of $4.5 million in Q1 of 2018 due to losses for tax purposes in Canada, Australia, India and Turkey.

Net working capital as a percentage of revenue and in absolute dollars increased in Q1 of 2018 compared to Q1 of 2017 and compared to Q4 of 2017. The total of accounts receivable, inventory and prepaid combined remained consistent at Q1 2018 compared to Q1 of 2017, and decreased when compared to Q4 of 2017; however, accounts payable also decreased. This is due to lower utilization of trade finance facilities which are costly to use for smaller sales and are used more frequently when individual sales are for higher volumes. Also, decreased accounts payable from Canada and Australia resulted from continued lower commodity prices and lower levels of deferred payments to producers. Because grower prices have dropped, the trend of producers preferring cash settlement as opposed to deferred payment is continuing. This is illustrated by a 40% reduction in deferred payments at the end of 2017 compared to those at the end of 2016.

Working capital will remain a focus and we will work towards working capital reductions throughout the 2018 year, as sales volumes are reduced and price levels have trended downwards.

Net debt was $507.2 million at Q1 2018, an increase from $473.3 million at Q4 of 2017 but a decrease from $562.1 million at Q1 of 2017. The increase from Q4 2017 is due to higher working capital levels remaining in the quarter as AGT companies become more selective on sales being made, in addition to some larger sales that were made closer to the end of Q1. Payments will be received in Q2 of 2018 for these sales. The issuance of the Fairfax Preferred Securities during the year resulted in the decrease from Q1 2017.

AGT's focus will be on streamlined and efficient operations; efficient production management, including the management of inventory and purchases; and maximizing our cash flow. AGT must ensure it has the ability to be among the first to respond when the market recovers and there are calls for more staple foods, grains and pulses.

As of March 31, 2018, AGT was in compliance with all financial covenants. Thank you.

MURAD AL-KATIB:
Thanks Lori. As you see from the results that Lori discussed, our business is demonstrating signs of recovery and the diversity that our segments have to them that are providing earnings balance in these times where markets are challenged and have affected our earnings and results in the recent periods.

We see conditions as gradually improving, which are demonstrated in part by the trends on the results we are reporting, but also when considering a number of the market conditions and factors that we believe may lead to that normalization and improvement.

We believe that earnings constraints we have seen in the recent periods are largely temporary. We believe that we may see some gradual improvements in the late 2018 shipping period which corresponds to harvest in Canada and the U.S. as well as seeding in Australia. Cyclicality in the global markets is not uncommon and supply and demand fundamentals shift rapidly in high volumes staple consumption items, such as pulses, where consumption is generally consistent in stable cycles.

In the oversupply position that global markets are in today, our key consumption markets are consuming their own local production, which has been at higher levels than we have seen for some time. This, along with the policies of duties, nontariff barriers and messaging on support of local agricultural production and prices are feeding into this cyclicality; however, this also establishes a pattern of expanding consumption in lower price cycles as lower income consumers are able to procure more volumes of food with fixed disposable incomes.

These trends, along with the global pulse sector's ability to assimilate new duty, tariff and non-tariff policies into pricing and product flows, we believe, will assist in the gradual normalization of markets and aid to the return of more traditional shipping periods and volumes.

I'd like to comment on seeding intentions for North America and production volumes overall. Farmers are preparing for spring seeding in Western Canada, and it's well underway in the Norther Tier states and in Saskatchewan and Alberta and Manitoba. Conditions are good, and in many cases seeding is well underway.

Based on the seeding intention reports, pulse acres in Canada are expected to be down somewhat, approximately 7% from 8.5 million acres to 7.9 million acres for peas and lentils. However, with carry-in, there will still be an ample supply in the market, both for export and for food ingredient business units. Other crops being seeded, like durum wheat, barley and canola that may be moved through our rail and port infrastructure provide other opportunities for AGT as well for our rail and logistics infrastructure. Production has been high for some time, not only in Canada and the US but in Australia, and with current conditions, most specifically in India and in Turkey. We see the production locally now estimated at average at best, assisting in the normalization of local supplies, which may aid in the gradual recovery of export volumes.

With our view that earnings constraints are seen largely as a result of this oversupply, this illustrates the reason that global markets will need to work through these oversupplies and that the market dynamics to resume traditional and normalized business will come gradually.

While imports of pulses to India specifically from Canada have slowed, exports to other destinations are continuing. We believe this demonstrates that the demand profile for pulses does remain unchanged, the global pulse exports may indeed normalize to past volumes, and that things will ultimately recover.

A key part of AGT's ability to continue to deliver on earnings expectations are though management initiatives that have been implemented that are focused on strengthening our balance sheet, continued diversification of our segments—including, of course, our Food Ingredients and Packaged Foods segment which has performed particularly well—and our investments in port facilities and agreements and rail and logistics assets.

Earlier, we shared with you some of the specifics of the performance of the Food Ingredients and Packaged Foods segment with the opportunities in pet food, human food, and the efforts to monetize all fractions of production. AGT's branded Retail Packaged Foods segment, including pasta, canned and dry pulses, and staple foods, is also providing a much needed boost in a time of constraint. We believe our work aimed at further growth in this segment is expected to yield success in coming quarters as the new enhanced products are available to meet customer demands and requests.

Our R&D initiatives are providing support for the Food Ingredient business unit and a continued expansion of our Retail Packaged Foods business, adding that diversification. While this segment has its own dynamics with regard to sales process duration and customer profiles, it does provide an opportunity for AGT to smooth the earnings over full years while creating opportunities for potentially higher margin business compared to the core commodity business, driving revenue, margin and growth.

In addition to all of these factors, we believe that we've also set up, in a time of constraint, solid relationships with our banking and investment partners. AGT's balance sheet and liquidity have been improved as a result of recent transactions for capital planning requirements. Debt maturities, as you know, have been pushed out to as far as 2021 with the $200 million high-yield notes issued that were completed in late 2016, and the recent Fairfax Financial Holdings 99-year, no-call preferred securities in the amount of $190 million provided capital that was also used to extend our debt maturities. Bank agreements were amended and extended, and the covenants modernized to suit the cycle of the business, with covenants moving to simple interest coverage, tangible net worth-based ratios, reflecting the strong securitization of our debt and the effects of the

Fairfax capital injection. The facility was reduced to $400 million from $440 million and uncommitted accordions were put in place and increased to accommodate future needs as the market cycle reverses.

Before we move to questions, I want to conclude by saying that as a company, we continue to believe in the fundamental earnings power of our business, including the strategically located assets on five continents, our strong origination platform, the critical market intelligence and access to markets we possess, and the experienced Management group we have guiding the direction of AGT as we navigate these market conditions. We believe our business remains strong when considering the diverse business segments, the competitive position—and we will be one of the first to respond, as Lori mentioned, when the market calls for more staple foods, grains and pulses, which we believe will allow us to capture that value and the growth for our shareholders. We will remain thus vigilant, patient, and deliberate in all of our actions to ensure we can manage through this cycle.

I want to thank you for your interest and I'll turn it over to Omer to start our Q&A.

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

OPERATOR:
Our first question comes from Joel Jackson of BMO Capital Markets.

BAHAD FOR JOEL JACKSON (PHON 16:02):
Hi. This is Bahad on for Joel. Thanks for taking my question. Food Ingredients performed really well in the quarter, highest earnings in the Company's history. Can you talk a bit about your expectation for the earnings level for the rest of the year? Also, what opportunities in Food Ingredients are you most excited about monetizing this year? Thanks.

MURAD AL-KATIB:
Yes. Well, I mean, as you guys know, I don't give earnings guidance in terms of full-year pictures and things like that, but what I can tell you is that we're very optimistic that the Food Ingredient segment will continue to perform well for the duration of the year. We have the dynamics now in place where available supplies—I mean, with the constraints

that are happening in the export side, ample supplies in the local markets at year in terms of availability of peas—in particular, peas are the largest product that we're using in the Food Ingredient business—the stability in the raw material pricing, our ability to renew our contracts for 2018, those are largely done now, so the cycle of that would've been into this period here. We've just kind of tipped into the new contracts that will extend likely through most of this year, so continued positive performance is what we expect, so that's going to give us a bit of a balance to keep going forward.

I think the thing that we are most excited about is the opportunities that exist with the monetization of our starch. Really, this business—I mean, selling protein has been the relative easy part of this Food Ingredient business. Selling the starch and the fibre and increasing the value, we've been very successful at selling every pound of starch and fibre that we've generated out of this business, ramping up to 130,000 to 150,000 tonnes of production. I remember early on in this segment, markets and some analysts and participants thinking that we had mountains of starch laying around and nobody could ever find them because we always had a chance to sell them. What we're doing now is improving that value. We're looking at the opportunity now to get into the production of single or limited ingredient extruded products, so the ability to monetize pulse, flour streams and by-products streams in the production of pasta, pellets, crisps, those kinds of things.

I mean, we are a pulse ingredient producer. We're also a pasta manufacturer. We are one of the larger extruders of flours in the world, so we know how to produce semolina, we know how to produce consistently granulated flours, and we know how to extrude products and market them. I think that the convergence of the Food Ingredient and Packaged Foods segment is the opportunity that we are most excited about in the rest of 2018, but really for 2019 and 2020. That ability to have the cross-pollination of the two sides of this segment in partnership with the larger retail partners that we've established in the world, that's the biggest and most intriguing opportunity to truly transform this company as we go forward.

OPERATOR:
Our next question comes from Jacob Bout of CIBC.

JACOB BOUT:
Good morning. I was hoping to get a few more details on the Food Ingredient and the Packaged Foods. Of the 74,000 tonnes that you invoiced, maybe help us with three buckets what the volumes would be for pasta, pet foods, and human food ingredients. Then maybe talk a bit about your margins as well for each of those segments.

MURAD AL-KATIB:
Yes. I mean, the segment is kind of running on a relatively consistent pace. The Food Ingredients volumes were certainly up in Minot, so we had very high utilization of our lines. So roughly, looking about 40% of our volume is in the Food Ingredients segments, roughly about 35% of our volume would be in our pasta, and 25% of the volume would be in South Africa and the balance. From that perspective, margins were quite consistent in the pasta side, although volumes were up there too. So when we look at the incrementality over quarter-over-quarter, both pasta and Food Ingredients were up about equal amounts, but the big thing that we saw in this quarter was the improvement of the margins on the Food Ingredients side. That is almost entirely as a result of increasing our starch value.

Part of what we've been able to succeed in doing is convince a few clients on what we would call kind of a trading program. It's almost like starch credits. You buy a unit of protein, you've got to buy some starch, and if you buy some starch, you get a better protein price; if you don't buy some starch, you get a higher protein price. Bottom line is that you can't just produce protein, you produce protein and starch, and so we have to ensure that our marketing programs reflect that. If we have clients, though, that just want to buy protein, which we do have, then we have to find a use for the starch, and that's where things like the ability to put it into gluten-free or highly nutritious, pulse-based flour blends and pasta pellets and crisps—I mean, these are opportunities that we think are well within our grasp, so we're going to see that going forward, Jacob, as we look forward over the next four to six quarters.

OPERATOR:
Our next question comes from Steve Hansen of Raymond James.

STEVE HANSEN:
Yes. Good morning, Murad. Just a quick question on the core business, and just a couple of questions related to it. First is just what were the real constraints in the

quarter? I think you mentioned them briefly that you had some logistics constraints, but as it relates to that, how should we think about the seasonality effects this year? The recent stats kind of reports that you have a pile of volume still in farmer storage, and rail service does seem to be improving at this point, so I'm just trying to get a sense of how the cadence should flow as we move through sort of less traditionally or non-peak periods—but it looks like there's a lot of volume still stuck there so I'm trying to figure out how we get some sort of release of that volume if you see that coming, or is it going to dwell right through it until the next harvest? Thanks.

MURAD AL-KATIB:
Well, we didn't dwell on it in our quarterly commentary, but certainly the rail performance was dastardly, to say the least. I mean, it was among the worst performing periods in Quarter One that I think we've seen in the history of our business in the last 15 years, worse than 2013. Even with a short line railway infrastructure, I mean, we were able to perform well within our short line, but at one point we had over 564 cars sitting in our interchange, and so that did affect the ability to drive any volume. Even the sales that we had, we were having trouble executing. So, that was very disappointing. I think there was the potential, even, of a bit more demand in some of the periods through the quarter that we couldn't capitalize on.

The problem in our flow now is that there is product on farm, but we're into the Q2 period now which, again, with even just an average harvest in India and an average harvest coming in Turkey at best, this is not a traditional export period. I mean, we had a relatively strong Q2 last year, I think, but the Q2 period has seasonally been our weakest quarter for the history of this business and we expect that to be, in terms of volume—now, we think margins may be okay with the balance we have now, so no sounding off of a massive problem for Q2, but we don't see the volume recovering in the near term. It's going to carry into the next crop, and what that's going to do is, with reduced acres, we have a little bit of an ability to have a bit of normalization to supply.

Now, the final numbers on seeding still aren't determined. The estimate was that pulses will be down 7%. There's also a forecast of a reduction in canola acreage and a large increase in cereals. Some analysts are feeling that that's not correct, that we're actually going to see an increase in canola, we're going to see a further decrease in pulses, and some analysts have pulses coming down as much as 20% to 25%, not 7%. The relative price performance and the ban on imports of peas right at the seeding time now, certainly could have farmers looking at correcting their rotation. Farmers have been pushing pulses. They've over-pulsed their rotation actually over the years, and so we've certainly been encouraging farmers to correct that rotation, get a crop in the ground that may not be pulses to be able to ensure that they're ready for the cycle when it comes back.

OPERATOR:
Our next question comes from Greg Coleman of National Bank Financial.

GREG COLEMAN:
Yes. Thanks very much. On the CapEx side, Lori, on the Q4 calls we talked about $20 million as the budget for the year. We've seen net spend in Q1 of just under $13 million and an additional $4 million with the Arz purchase subsequent to the quarter which brings us up to about $17 million. Is it safe to say that the H2 spend will be pretty close to zero with only about $3 million remaining between that number and your total budget, or are we looking at the larger capital spend for 2018?

MURAD AL-KATIB:
Hey Greg, just to clarify one thing. On that $13 million cap spend there was a $7 million land purchase which is a deferred payment purchase, so it's actually payable over seven equal instalments over seven years, so we have to account for it as a purchase today but it's not a cash outlay on the budget. When we turn around, look at the free cash flow impact, we'd estimated a $20 million cap budget so we should still be relatively aligned with that. The big cap spend this year is the completion of the inland CN Rail terminal at Regina which is located about 350 metres from our front door here, and that will be a fully functional container intermodal terminal, bringing to the Regina plains Mediterranean shipping, Maersk, CMA CGA, ZIM Israeli Navigation. So, as we look forward to our recovery and the ability to have additional shipping options, both for our bag programs and our bulk programs. This is an important 20-year agreement with CN Rail, and so that project will complete by around October/November this year and that's the big spend.

In addition to that, we've just got a few projects in Minot looking at adding a few things. At the end of the late 2018 to 2019, the cap budget forecast to be around that $20 million, again, will be focused on two buckets: the Delisle project, which is our rail consolidation centre related to our show bulk shipping platform, that'll be a 2019 project that will start late in ’18; and then we’re looking at expansion of our Food Ingredient extrusion capability, and we’re looking at a need to expand our canning capability in Laval, Quebec. So, most of the spend will be focused on the Food Ingredient with a bit focused on a couple of years cycle over the bulk platform.

OPERATOR:
Our next question comes from Cihan Tuncay of GMP Securities.

CIHAN TUNCAY:
Hi. Good morning, team. I'm just getting a little bit more detail on the working capital situation. It looks like about $80 million of working capital was consumed between the fourth quarter and the first quarter. I'm just wondering if you think, as we go into the seasonally lower period of the business, do you think we’ll be able to recover that entire amount or a little bit more than that over Q2 and Q3 of this year, and how it’s shaping up so far in Q2? Thanks.

MURAD AL-KATIB:
Yes. I mean, we’re expecting a Q2/Q3 period with lower shipping volumes and the payable side had come down both in Q4 and Q1 as a result of the cash cycle related to farmers wanting to be settled in cash. You mentioned $80 million. I'm not sure where you’re getting that figure. When we look at the overall net of accounts receivable inventory and payables, we have about a $16 million increase. But, anyway, no matter what, we’re going to see, we believe, is a reverse of the working capital cycle. We don’t expect, with price levels stable and volumes ramped down—we expect that those receivables that were generated with larger sales maybe towards the end of the quarter will monetize and reverse and won’t necessarily be deployed. We’re looking at the optimization of the working capital allocation to underperforming business units like India, Australia, where we are having very material margin constraints related to the desi chickpea platforms. We’re going to scale those back, so we’re expecting a return of capital there, which should allow us to manage working capital levels to a reduction by end of Q3, which we’re targeting to be in that $30 million to $40 million range. We’re hoping that that will have a very positive impact on the overall cash flow from operations that the Company will generate as we go forward.

OPERATOR:
Our next question comes from John Chu of Laurentian Bank Securities.

JOHN CHU:

Hi. Good morning. Just on the CapEx spending, it sounds like no plans for line number five. Then I guess the second question would be you stated that you've got this five-year goal regarding the Food Ingredients and Packaged Food platform representing over 50% of earnings. Any timeline when you think we'll get to that?

MURAD AL-KATIB:

John, just repeat the end of that question again, when we get to what?

JOHN CHU:

Yes. You had a five-year goal about the Food Ingredient and Packaged Foods division representing over 50% of earnings, and so I'm just curious what year are we in for us getting to that target.

MURAD AL-KATIB:

Well, John, just to answer that question first, I mean, that's when earnings normalize. If we end up getting back to—when we get back to the earnings levels where we were prior to this cycle, I mean, we were running at about $118 million EBITDA, Food Ingredients were running about 30% to 32% of our earnings at that point, so in that $40 million range. When we get back up to those levels, we want Food Ingredients to be 50% or more as we continue to go forward. We're actually, today, in Year Two of that Year Five, and you're seeing good gains, actually. So, when I look at forward of CapEx spending, we do expect that part of the potential of the extrusion capabilities and lines that we're going to be looking at adding in 2019 and beyond, may need to include additional production lines to ensure that we can fractionate.

Again, when look at the overall production capacity, I want to remind you that we have flour production, we have uniform granulated semolina production, we have fractionated products, and now we're going to have the production of not only deflavoured but also extruded value-added products from those flour streams. So, while we at the beginning focused on Line 1, 2, 3, 4 which gave us a critical volume of 140,000 tonnes, the incremental investments now will be on additional production to boost that up to maybe a couple hundred thousand tonnes in the next couple of years, but really we want to monetize all of that production to dramatically increase the overall margin that we are generating.

I think that's a really exciting journey to look forward on. Then as I mentioned, the cross-pollinization between our Packaged Foods and our Food Ingredient is where we're looking in particular when we look at the pasta side of the business.

OPERATOR:
Our next question is a follow-up from Steve Hansen of Raymond James.

STEVE HANSEN:
Yes. Could you just go back to, very quickly, on your Ingredient—in particularly your pea contracts that you're mentioned, I think you had said on your Ingredient side. I'm just trying to get a sense for how long you've locked in for on the Ingredient side. Can you just remind us how those rolling contracts work and what kind of impact that has on the margin profile? There's obviously a good amount of product out there right now, so can you lock in for an extended duration right now or do you continue to match it relative to your existing contract structures?

MURAD AL-KATIB:
Yes. Let's attack that on the two sides, Steve. You've got the raw material purchase side. We're obviously doing what we can now to buy raw materials on extended duration contracts. But farmers are only willing to sell into so long. I mean, they want to get cash in their pockets, so we'd be buying about four months forward now into the new crop cycle now, so you'd be buying today May, June, July, August. What you're buying today, the guys want off their farm before they harvest again, and then we've got a very active program for September, October, November, December. Matching these spot purchases of old crop and the new crop purchases, we're able to potentially lock our raw materials out largely through the end of the calendar year.

The contracts that we're talking about in particular on the pet food side, the larger volume contracts, would largely be 6-month to 12-month duration contracts. You're looking about kind of a lock out to the first quarter of 2019 on the sale side, and on your raw material side you're relatively perfected. We're quite optimistic in the stability of our margins and that cyclicality that we saw over the last couple of years with a bit of margin constraint. We got back to where we were and we said we would when things stabilized. Volumes have been good; we expect them to continue relatively speaking, so pretty positive story overall on that side of our business.

OPERATOR:
Our next question is a follow-up from Greg Coleman of National Bank Financial.

GREG COLEMAN:
Yes. Thanks. Just wanted to dive in on some of the CapEx stuff again. Can you give us a little bit of colour on the benefit of the Arz group that you picked up just subsequent to the quarter? I know it's not a huge thing, $4 million out there, but just wondering what the, either tangible or intangible benefit of that acquisition was.

MURAD AL-KATIB:
Yes. It's a good question. It was actually a purchase from Loblaws Companies and so we completed that acquisition last Friday. What we were able to do was we were able to sign an agreement with Loblaws to purchase their Middle Eastern ethnic line of business under the Arz brand. But we have an agreement with them to also explore successor brands that will be launched nationally across their platform. The successor brands and the business unit, the Middle Eastern brand, which of course includes very prevalently lentils, peas, chickpeas and beans in both dry retail packs and cans, this is a very important partnership for us. I mean, Loblaws is the largest national retailer, and with the Shoppers Drug Mart platform and the national reach of the real estate of Loblaws, we have an ability to get our products out to every corner of this country.

In addition to purchasing the business from them, we actually signed a 20-year exclusive supply agreement on their control brand for the Middle Eastern segment. We will be producing, to put it in very simple terms, a President's Choice control brand-type Middle Eastern brand. It'll start with the Arz brand and it'll look at successor brands being launched and a complete line of Middle Eastern products in every one of their stores across this country. So, very exciting; it goes well along with our platform where we have a deep supply chain relationship with Loblaws Companies, and they've been a tremendously strong partner for us and they'll be continuing to be a strong partner, not only in the Middle Eastern market but also in our Food Ingredient and Packaged Foods cross-pollination that we keep talking about.

The launching of gluten-free pasta produced in our Minot plant or as a result of the streams from our Minot plant will be marketed in partnership with Loblaws. So, they continue to be a very strong retail partner for us. Pretty excited about that small deal which we think, I believe, is going to be a very material deal for us as we go forward.

OPERATOR:
Our next question is a follow-up from Joel Jackson of BMO Capital Markets.

BAHAD FOR JOEL JACKSON:
Hi. This is Bahad again. You initiated an NCIB recently, the share buyback program. Have you repurchased any shares; and, if not, why not? Thanks.

MURAD AL-KATIB:
Yes. We put the NCIB in place and it's there and it's ready and it's filed, and we'll be looking at opportunities as they present themselves to go forward. It is a controlled bid from our side and at this point we've had good strong buying. I mean, very little liquidity in our stock right now. I mean, if you look at the fact that you have very large holders of our stock. We have a filing shareholder now in Letko, Brosseau & Associates, a great long-term partner for us. You've got Fairfax Financial filing now when they're purchasing, and so Management hasn't seen the need to go in and buy at this point. We've been focusing the capital that we have on some of these small expansions. But the NCIB is there. Management feels strongly that, as large shareholders, that our stock is undervalued and as capital and cash flow improves, we're certainly going to be using that NCIB to retire shares and to continue to create value for our shareholders.

OPERATOR:
Our next question is a follow-up from John Chu of Laurentian Bank Securities.

JOHN CHU:
Hi. Just on the Food Ingredients segment, you mentioned you're looking for gradual margin improvement for the rest of 2018 and in the 2019 period. Just curious, what's driving that? Is it pricing? Is it mix? Is it a bit of everything there? Then. are we getting close to the maximum margin potential for that segment?

MURAD AL-KATIB:
Well, let me start with your last question. I mean, the Packaged Food and Food Ingredient segment, the maximum margin profile is that the sky's the limit. As we continue to go down the true integration of the Food Ingredient and the manufacturing

side in both co-packing and distribution of single ingredient or limited ingredient food products, that's a totally different ball game. We're going to go down that path in a controlled fashion and where we want to dominate this segment globally, so we're going to continue down that side.

The gradual improvement is driven by starch and fibre monetization. I mean, we've been saying that for a few quarters. You're going to see it continue and that's where we're going to be focusing our effort, is continuing on that. It's really a product mix and starch and fibre monetization side of things to go ahead and deliver that gradual improvement.

The raw material stability also helps, John, in that we have very ample supplies and hot commodity markets and volatile commodity markets in the past, because we were unable to match the long-term duration of the buyer contracts to the shorter-term window that farmers wanted to play on, caused a bit of volatility in the margins. We're not seeing that now and we don't expect to see that over the next couple of years.

OPERATOR:
Our final question comes from Kyle McPhee of Cormark Securities.

KYLE MCPHEE:
Hi, guys. I know you already amended your credit terms and got some extra room on things like your interest coverage ratios. Wondering if you see any need to do that again this year to get more near-term breathing room? Then maybe quickly just some colour on what the one-time add-back EBITDA were this quarter.

MURAD AL-KATIB:
Yes, let me take that. You know what? Listen, we've got a very positive working relationship with our bank syndicate. Scotiabank is the lead agent and I think nine banks in our syndicate, including all the major Schedule I banks. The fact that we've kind of shown the trough and we've shown a recovery, we're not sure we're going to need anything further but, you know what? We monitor it very, very closely and carefully. We're in a strong, active dialogue with our banking partners who are completely behind us. The one thing that always helps in all those discussions is a strong equity that we have in this company, and the equity treatment of the Fairfax Financial injection of $190 million gave a very strong asset and very strong securitization of our debt.

Our total debt-to-tangible net worth, which is a major leverage covenant in our credit agreements, declined dramatically. We're at around a 1 or a sub-1 at the consol level and I think that the one thing we've got to recognize is that interest coverage ratio at the borrower—we're at an OpCo borrower level—is very, very strong, like our ratio is really, really covered—that's Canada, U.S., Australia. Where we always end up a little bit more tight is at the consolidated parent level, because we have the bond interest and the other things there.

We'll continue to monitor. We don't have any—I can tell you I'm not losing sleep over anything. I have strong relationships with our banks and from that perspective we definitely do have an ability to continue our dialogues, if needed. But we think that we're in pretty good shape.

On the one-time costs, Kyle, a couple of big items here. We're undergoing a restructuring of the China operation right now, and so we are exploring the possibility of selling off the warehouse and factory in Tianjin. Part of the business flow that we're looking at now on the protein and the starch businesses that we do have in China are focused in other port cities, not in Tianjin. There's around $600,000 of one-time costs related to the restructuring of that operation. We've dramatically reduced the staff count in China. There's also some severance and other related restructuring costs in our one-times related to about close to 100 full-time staff laid off over the course of the last quarter. Then the one-times will be focused as well on the final tranche of the duties and the write-downs in India related to cargo that was sold and invoiced out in the January period in the first quarter. They were the November-Decembers that were in last quarter and then the small amounts left over here. Those have all relatively washed themselves through, so we're not expecting any of that to be recurring.

OMER AL-KATIB:
Thanks a lot, Murad. This brings us to the end of our questions in the session. I'd like to thank you all for joining us on the call this more. I'd like to remind anyone who is still on the call, if you have any follow-up questions, you can feel free to contact us at our Regina Head Office and we'd be more than happy to follow up with you. Again, thank you for attending the AGT conference call this morning and we wish you all a good day.

OPERATOR:

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