Alliance Grain Traders Q3 2010 Earnings Conference Call Transcript

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Speakers:

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President and CEO

Lori Ireland
Chief Financial Officer

Gaetan Bourassa
Chief Operating Officer

Omer Al-Katib
Director Corporate Affairs and Investor Relations

OPERATOR:
Hello, this is the Chorus Call Conference Operator. Welcome to the Alliance Grain Traders Conference Call which is being convened to present Third Quarter, 2010 results to shareholders.

At this time, I would like to turn the conference over to Omer Al-Katib, Director of Corporate Affairs and Investor Relations. Please go ahead Mr. Al-Katib.

OMER AL-KATIB:
Thank you, good morning, thank you for joining us and welcome to our third quarter conference call. On the line with us today, we have Murad Al-Katib, President and CEO of Alliance Grain Traders, Lori Ireland, our Chief Financial Officer and Gaetan Bourassa, our Chief Operating Officer.

Before we get started, I would like to remind everyone that today's call may include forward-looking statements. Such forward-looking statements are given as of the date of this call and involve certain risks and uncertainties. A number of factors and assumptions were applied in the formulation of such statements and actual results could differ materially.

This call may also include references to certain non-GAAP financial measures. For additional information with respect to forward-looking statements, factors and assumptions, as well as our reconciliation to GAAP measures, we direct you to our news release and our recent filings on SEDAR. I will now turn things over to Murad for some comments and then we'll go to questions.

MURAD AL-KATIB:
Thank you, Omer. Good morning, thank you for joining us for the Alliance Grain Traders Third Quarter Conference Call. We appreciate the opportunity to discuss the results of our company as well as the opportunities that lie ahead.

Third quarter 2010 has continued with the weather and timing related challenges we have seen through this season. These factors, while certainly not ideal, are a reality given the weather and environmental variables in the agriculture sector.

The third quarter is traditionally a strong period for shipments of Canadian and US new crop products from fall harvest season. This year with the record production volumes estimated, we expected it to be no different. However, as weather hindered our performance in the last quarter, it, again, compounded timing issues related to sales and shipments in this quarter.

I would like to share with you some of the challenges, what they mean for the current quarter and the optimism we have to address some of these challenges. Ultimately, we look at them as ways to create opportunities in the balance of this year and into 2011.

The heavy rainfall and cool conditions dramatically slowed Canadian harvest progress. By late September, a period when pulse crop harvest is traditionally completed, farmers were less than half completed with their harvest. Better weather through the early to mid-October period did assist farmers in rapidly completing their harvest activities, but the late availability of new crop products contributed to lower reported results than we have traditionally seen. Simply put, lower volume of product to process and ship means lower sales volumes.

In quarter two, we spoke about customers postponing their purchase decisions to replenish depleted or near depleted local market stocks in a market of declining prices and good supply. Our expectation was for a record harvest in Canada and the US after a normalization of production in Turkey. Factors such as the heavy rainfall and overall diminishing supply seen in Western Canada and the northern Plain States impacted our ability to bring what product was available into our facilities for processing. We believed buyers were hesitating to buy and that farmers were occupied by concerns over the wet conditions and the impact it would have on their crops. They were not delivering grain.

What we saw in the third quarter was a continuation of similar themes caused by a damp, cold and late harvest. Continued estimated record production levels were still being reported and from the quantity of product moving into our facilities across Western Canada and the northern Plain States, these reports seem to be correct. However, buyers continued to delay purchases this time, we believe, based on concerns surrounding the quality variance on Canadian new crop products. Farmers were unable to harvest or deliver in stock product to our facilities with the cold, damp weather while they waited for windows of good weather to continue their harvest activities.

US harvest, completed in mid-September, was somewhat immune to these issues and deliveries to our facilities and outgoing shipments continued as we would have expected. However, even with the record production in the US, Canada is a key component of our global business. Ultimately, these factors led to lower North American origin sales and erosion of earnings from our valued-added pulse and staple food business in the quarter.

Our operations in Turkey supplied Turkish market demand and shipments to fill some of the demand in end-use markets.

Our Australian operations are readying for what we hope will be a significant new crop harvest, the first in a number of years there, but all focus is on what we deliver for the balance of the year from our North American operations.

Let me first say we are optimistic about the balance of 2010 and early 2011 and our ability to overcome the timing related issues we have been experiencing through much of this year. There is a near-record crop and supply in Canada and the US, quality variance that we feel increases more opportunity for AGT and value added processing and very significant volumes, nonetheless.

Our facilities in Canada, the US and Australia are well equipped with the completion of capital expansion projects that we are confident will provide immediate benefits and we're optimistic about the balance of the year and our ability to develop sales opportunities in all four of our core staple food platforms from our global operations.

While we reported higher sales of $137.6 million in this quarter compared to last Q3 in 2009, we reported adjusted EBITDA of $5.2 million, down from $8.3 million in the same quarter in 2009.

Adjusted net income reported was down at $.73 million from $4.5 million. All of our third quarter financial results and notes, of course, have been filed on SEDAR and with the timing issues, are available immediately on our website, at www.alliancegrain.com.

Earlier in the year, we stated that these factors have impacted the previous quarter, diminishing as the year 2010 progressed and the year 2011 will begin. We still feel this is the case. The weather related issues really come down to timing. Demand is there, supply is now there, and opportunities are there and AGT is positioned to capitalize on these opportunities that will present going forward in the year.

I'd like to now call on our CFO, Lori Ireland, to give us a short overview of our financial results. So, Lori.

LORI IRELAND:
Thanks, Murad. Delays in the Canadian harvest significantly affected sales volumes during the quarter, as can be seen by sales of $137.6 million for the third quarter compared to second quarter sales of $149.2 million. Gross margin is a percentage of sales increased from 7.3% for the second quarter to 10.3% for the third quarter, but this increase was offset by lower volumes in Canada and the US. The result was a decrease in adjusted earnings per share.

Sales mix changed from 83% pulses, 6% pasta and 11% rice for the second quarter, to 76% pulses, 14% pasta, 6% rice, and 4% other commodities in the third quarter.

The second quarter is typically is a ramping up period of pasta and this is demonstrated by the increase in pasta sales of 8% for the quarter. Other commodities, such as sunflower seeds and popcorn are sold to capitalize on additional cross selling opportunities within our Turkish distribution channels.

Sales to Europe, Middle East, North Africa increased from quarter two to quarter three and sales to the Americas, Caribbean and to the Asia Pacific rim decreased.

The non-cash foreign exchange adjustments swung from a loss of $5.2 million at the end of quarter two to a gain of $296,000 at the end of quarter three. This non-cash adjustment is a snapshot of all open foreign exchange contracts, accounts receivable, accounts payable and loans. Both the Canadian dollar and the Turkish Lira appreciated from quarter two to quarter three with the Turkish Lira appreciating significantly from $0.66 to $0.71 versus the Canadian dollar.

General and administrative costs have increased over the same period last year due to acquisitions such as those of the Arbel Group, Parent Seed and Finora. For example, additional land taxes and insurance amounted to $1 million, commissions $1.6 million, payroll costs relating to newly acquired companies, $1.2 million, advertising and promotional and travel and trade show costs, $1.5 million, and transportation, export and harbor costs, $2.3 million.

With multiple acquisitions in the past nine months, we are currently reviewing the subsidiary classification of all G&A costs. We are developing a methodology for implementation effective January 1, 2011 to ensure consistency in the treatment of general and administrative expenses versus expenses related to cost of sales across all subsidiaries.

AGT management is continuing to look at all areas of operations for potential cost reduction and synergy savings that may result from acquisitions, scale of operations and business combinations.

Looking at the balance sheet, accounts receivable as of September 30, 2010 was $96.3 million compared to $89 million at December and $94 million in June. The increase from December and from June is due to a shift in payment terms based on markets being shipped to.

During the quarter, a larger percentage of sales were shipped on cash-against-documents basis which results in a longer period of time between invoice issuing and receipt of payment. Slower accounts receivable collection for the quarter was partially offset by the lower volumes, resulting in a similar balance from June to September 2010.

Accounts receivable balances have been reviewed and management is quite comfortable that any provisions required have been taken.

We saw inventory increase in the third quarter from $86.3 million in June to $99.8 million in September. Raw product increased $2.4 million and process product increased $18.9 million. Inventory of other products increased slightly and packaged and split product inventory decrease. The increase is a result of the late start to the harvest in product being received and shipped to trans-loading facilities where revenue will be recognized in the fourth quarter.

In addition, product in Turkey is being replenished to prepare for Turkish and regional retail markets.

Property plant and equipment increased by $14.8 million during the quarter with the building of the rice mill in Turkey and equipment enhancements in Canada, US and Australia.

Accounts payable increased from $91 million in June to $96.1 million at September. This is due partially to increased producer, deferred checks as the year progresses, as well as additional purchases related to accounts payable as inventory is replenished.

Bottom line on financial results is that our volumes in Canada were down. Quarter two was a slow quarter for Canada and our sales volumes were down over 25% quarter-over-quarter.

I will turn it over to our COO, Gaetan Bourassa, to give a quick market update.

GAETAN BOURASSA:
Thanks, Lori. I would like to take you through a quick discussion on each of our key geographies. I would like to note that references to any statistics discussed can be found in the outlook section of our third quarter, 2010 MD&A.

Our North American operations were hindered with major weather events though the spring with very wet weather effecting seeding and progress. With the pulse harvest traditionally ending around mid-September, farmers were delayed in their progress because of wet conditions and frost.

In a typical year, mid to late-September will show near completion of harvest but with these conditions, we found progress only reaching 43% in this period. We were fortunate that windows of better weather conditions in late September and early October assisted farmers in rapid completion of harvest by mid-October.

The wet weather, through the whole season, also affected our ability to pull grain from 2009 carryover stocks into our facilities throughout Western Canada, ultimately affecting our ability to process products in our plants. This meant less tonnage processed, which translates to less tonnage shipped, impacting our overall sales volumes.

We saw this result in our Q2 volumes; however, it continued to impact our volumes in the third quarter as well. Our September shipping period is traditionally a strong one for Canadian pulses. These weather conditions were felt to a lesser degree in our US operations, with harvest complete there in mid-September period and farmers delivering product to our North Dakota facility as expected.

Overall, we expect the production volumes to deliver one of the largest pulses on harvest on record. Canadian lentil production is estimated at 1.5 million metric ton with increases in production of virtually all pulses except peas, which are returning to more historical levels. Some very positive estimates from the US shows record lentil production levels of 655,000 acres for over 396,000 metric ton of lentil production and similar trends as Canada, with increases of all pulse production except for peas.

These reported acres and production reaffirms our view the long-term viability of pulse crops business in North American and our expansions and acquisitions in the region. The weather did not just impact ability to deliver grain, the wet condition and frost at harvest has resulted in higher incidence of quality variants and downgrades in available product from Canada and, to a lesser degree, the US.

International markets have historically readjusted their buying criteria to match in line with available product with adjusted pricing. However, with blending, color sorting and splitting technologies in our North American facilities, the quality variance can become an opportunity to allow for margin gain on the limited quantities of premium product available and all our other grades of pulses as well.

Current production samples have been dispatched to our markets, at all our major importing markets. It's important to know; however, that the quality variance we see this year is viewed as specific and as something that will not affect our marketing, processing business long term.

In Turkey, we are seeing normalization of lentils production, reported to 510,000 metric ton. Even with these positive production numbers, Turkey is estimated to continue lentil imports through 2010 to meet domestic demand.

Additionally, global markets are looking to Turkey to fill gaps in export shipments in the period between Turkish and Canadian harvest, especially this season with the late harvest in Canada. We continue to estimate at local market stocks and end use markets are fully or nearly fully depleted and our Turkish operations provide excellent opportunities for prompt shipment to many of these major markets.

Other commodities grown in Turkey that are components of AGT's offering are progressing positively, supporting our view of the opportunities from the Arbel acquisition. Durum wheat production is reported as returning to historical levels of about 2.7 million metric ton, with good growing conditions for the 2010 crop year.

Rice paddy production is pegged at about 750,000 metric ton. However, with these production levels, Turkey looks to continue to import rice to meet domestic demand for 2010 and 2011 crop year. This is viewed as positive with respect to our announced construction of a new rice mill in Turkey.

Pasta facilities are running at near capacity, which is projected to continue with strong demand for our Arbella Pasta in the new markets.

The announced expansion at our pasta facilities, with the commissioning of the fifth pasta line, is expected to boost production and support our cross-selling strategy for long and short cut pasta. We also expect demand for our other milled wheat products like bulgur and semolina in the Turkish domestic market to continue. These reported returns to historical production levels are positive with regard to boosting of capacity utilization of our Arbel assets in Turkey, both for domestic and export markets.

Short term price volatility in the end use markets caused by uncertainty in North American production is expected to lessen with Canadian harvest complete.

Australian crop season is reported as progressing well with generally good moisture conditions and estimates of about 4.7 million acres of pulse reported. Our facility in Victoria has undergone some additional storage enhancements. We have a positive view of the opportunities. The announced acquisition intensions we have for facilities in South Australia will bring the regard to storage, processing and shipment.

Pulse production in India for Kharif season has been reported as up but accurate and reliable reporting on harvest potential and seeding intentions are difficult to obtain. Based on customer communications and published Indian government estimates, our internal estimates are that the positive demand fundamentals for Indian markets will continue, resulting in imports at similar levels as previous years.

The ban on Indian exports and lack of regional competitors is viewed as benefiting AGT with opportunities in the region. We are continuing our investigations for an expanded presence in this important market with warehousing, processing and distribution.

In summary, the demand fundaments for pulses and staple foods are estimated as strong in virtually every end use market. Buyers are feeling pent-up demand for supply for the new crop products of Canada but also looking forward to Australia, India and Turkey. Importers and international buyers must complete buying decisions as stocks are available to bring into market and satisfy consumer demand pulses, staple foods and protein.

With harvest in Canada only being substantially complete in the second half of October 2010, there is potential for the remainder of 2010 to be affected by generally slow post-harvest deliveries caused by growers assessing the quality of their harvested crops and buyers in the world assessing pre-shipment samples that will form the basis for future receipts of Canadian new crop shipments.

The market season of Canada pulses may be slowed for a short period to allow the analysis of the quality parameters by growers, buyers and sellers, but, we reiterate that the effects are timing related and that these issues will work themselves out through the global supply.

I'll turn it back over to Murad.

MURAD AL-KATIB:
Thanks Gaetan for the overview. Overall, the factors that will enable us to overcome the challenges and capitalize on opportunities come down to the following.

First, the depth our distribution channels, AGT has always stated that our margins are driven by our ability to find attractive and consistent margin opportunities in all the products we process and ship. There is a significant amount of product supply that's going to be available in the world, particularly Canada, US, with record production in lentils, when you combine Canada and US together.

There are significant volumes any way you look at it. Poor harvest conditions; however, not only affect the delivery of the volumes, but they also affect the quality of the product. Quality variance and downgrading was more prevalent this year than in other years. The product delivering into our facilities, though, is entirely within management's expectations with regard to quality. It is an entirely marketable product and does create opportunities for us to utilize our blending, color sorting and value added splitting technologies and processes in our facilities.

This is why we equip these facilities with these types of technologies. The quality, location and efficiency of our facilities will give us an advantage over competitors to maximize sales opportunities.

Quality variance requires readjustment and end use markets on their expectations of their buying parameters. In past years where quality variant has been seen, similar readjustments have been the norm. Really, this comes down to the fact that the staple food items produced by AGT are need to haves; they're not nice to haves. People have to eat quality protein. This is their staple protein and they will buy the best quality foods that are available to them at any given time.

Because of this, we see potential for prices for premium quality products that are available to move higher as buyers speculate on the lower availability compared to historical levels. This, too, provides opportunities for margin gains to offset lower fluidity and velocity and our facilities as they deal with the quality variances in delivered products.

With these North American results, our global pulses business is in a position of strength on a go-forward basis. Turkey is recovered to normalized levels, Australia looks great. Demand in India looks to continue to be strong. These are all positive indicators for the replenishment of global supply and a return to normal supply and export levels.

The supplies will find their way into the consumption markets they are destined for as buyers will have to fill local market demand for pulses and staple foods. Our multi-origins strategy and the quality of our assets were put in place to capitalize on these types of conditions, as well as to protect us from crop shortfalls in the inevitable years that these conditions happen in some regions.

The second point that will help us to overcome these issues is the geographic diversity of our assets, as well as the move towards diversity in our offerings. Our core assets in the US, Turkey and Australia help us to offset the challenges faced in Canada with the weather related harvest issues.

An area of growth that will assist AGT in realizing the type of sales results we expect is our investments in other key pulse growing regions like South Australia, where we clarified the closure of the Balco and Northern Yorke transactions last Friday and, also, in China, with our acquisition of Poortman's and the establishment of the bean facility.

A new platform for year round bean and chick pea business will be a key component as well of growth for our pulses business.

Additionally, our announced construction of the new rice processing mill in Turkey and the fifth pasta line will, we feel, further bolster our position in the global bean, rice and pasta markets.

These are all strategic investments. They're part of the pillars of our focus on staple food and provide, in part, our optimism with regard to the positive future effect on our earnings. We feel these investments will also assist in the continued focus on smoothing the seasonality of our current business.

I remain unwavering in my commitment to these investments and these pillars. The final factor, I think, I just want to draw your attention to, is our processing expertise and the depth of our management team. We've always been focused on strategic acquisitions to support our global sales activity, the facilities we operate around the globe are modern, state-of-the-art, and well situated close to key growing areas and freight handling. This is key component in years of quality variants, such as we're seeing in Canada, where the ability to maximize the margin opportunity is needed through blending, color sorting and splitting.

It is also needed when significant crop volumes are potentially available as forecasted in the Australia and in the US.

These conditions require experienced management who have seen these types of situations in the past and who have been successful in navigating through these issues to see and capture the opportunity. We feel AGT is in a position of strength with regards to our competitors, as I mentioned earlier, both globally and regionally, and we will execute on opportunities in all market segments.

The demand profile is strong, supply is high, local market stocks remain low. These factors, taken together, in combination provide the opportunity to drive our global capacity and execute our sales plan.

Continued growth in Turkey, the completion of the integration of Arbel; Arbel's close proximity to Middle East, North African markets, and the continued growth of non-traditional pulse markets in North America, such as the chickpea demand in humus, beans, year round consumption, these are all drivers for our business going forward.

Let's not forget Gaetan's comments about the Indian subcontinent demand. We feel it's going to continue to be high with the supply-demand gap widening as we move into future years of production.

The agricultural sector does bring challenges potentially not faced by other sectors; however, with strong experienced management, well located and well equipped facilities and continued robust demand, the challenges ahead of us will provide the basis for our continued growth plans we have established and will continue down the same path. It's the right path.

I thank you for your interest in AGT. I'm joined by the other members of my executive management team. We'd be pleased to answer some questions.

OPERATOR:
Thank you, sir. We will now begin the question and answer session. In order to accommodate as many callers as possible, one question from each person will be taken.

If time does not allow for a response to all of the questions, Alliance Grain Traders Investor Relations Group will follow-up after the call.

The first question is from Robert Winslow of Wellington West Capital Markets. Please go ahead.

ROBERT WINSLOW:
Good morning. Great, thanks. Given your global diversification, it's a strategy you've been unveiling now for several quarters, I was surprised to see the magnitude of the impact in this quarter which, I think, we all anticipated to be quite soft, but it was the magnitude that caught me a little bit off guard.

I wonder if you could tell us, please, what the Turkey EBITDA was in the quarter in relation to Canada. Did we have negative EBITDA in Canada, I guess, this quarter?

MURAD AL-KATIB:
Well, first thing is that we don't segment out the EBITDA by geography. We don't report that, Robert, quarter to quarter, but what I will tell you is that the results were certainly magnified

because of the magnitude of the weather event. We got hit with not only significant delays in the harvesting but because of the severity of the rain in certain geographies within Western Canada, product deliveries were also hampered of the products that were harvested at the time.

For any of you who are familiar with the psyche of farmers in any jurisdiction of the world, not just in Canada, when you are faced with the risk of substantial loss of your entire crop due to a weather event, you are not marketing the crop that is in your silos. You are spending every available moment on a tractor, in a harvester, trying to get your crop off. So, what we found is with the magnitude of this weather event, deliveries were hampered, production was hampered, all of those things were certainly there, but we couldn't even utilize carry out stocks and weather that storm.

The Canadian earnings, I can tell you, were not negative but they certainly were not very positive this quarter. For us to tell you –- the one thing in Lori's summary was quarter two was slow, quarter three in North America was 25% less volume than quarter two. Shows you the magnitude of what we faced.

In Turkey, volumes did ramp up starting into July-August, but with the magnitude of the weather event in Canada, prices in Turkey were volatile and the volatility of pricing and the fact that it's a physical goods market and not one where you can go out and buy from farmers in the field and things like we do in Canada, with price volatility comes the risk of temporary margin erosion and we did see some of those effects of parts throughout the quarter.

So, overall, you ended up with a much more significant impact with the weather event. That's the bottom line. Temporary timing effects.

ROBERT WINSLOW:
You don't segment by geography but, maybe, let me ask that question in a different way then. Can you give us a sense of what the trailing 12-month EBITDA is for Turkey? Is it on track with the $25 million or so that you'd anticipated when you made the acquisition?

MURAD AL-KATIB:
None of our earnings for this year are on track with our projected. So, Turkey is running the same type of scenario. These markets are not segmented by geography where one necessarily has escaped the effects of a very significant transitional year in our sector.

We've talked about weather volatility affecting the demand profile on a temporary basis causing timing effects. Turkey's seen the same type of timing effects. Do we see these as fundamental changes to our earnings forecast going forward? Absolutely not. I used about the strongest words I could, Robert. I'm unwavering in my commitment to the strategy and I'm unwavering in my commitment to the moves that we're making to build out this geographic diversity strategy.

ROBERT WINSLOW:

Got it. Thank you.

OPERATOR:
The next question comes from Max Vichniakov of Octagon Capital. Please go ahead.

MAX VICHNIAKOV:
Good morning, guys. How would you describe your current throughput in your processing plant? Is that satisfactory or below historical average? Can you give us some color on that?

MURAD AL-KATIB:
Are you talking about currently as of today, you mean?

MAX VICHNIAKOV:
As of today, yes.

MURAD AL-KATIB:
As of today, I would say that product is being delivered into facilities now. The quality has been assessed and we're seeing a return to normal processing activities. Still, obviously, a bit of a slow start to the harvest season because of the delay, but we are seeing a return to throughput through our facilities.

MAX VICHNIAKOV:
Okay, great. And, Murad, in terms of quality, what do you see in terms quality of the crops, of the harvested crops?

MURAD AL-KATIB:
The quality of the crop is as per our expectations. We were expecting a variable crop. I think that probably — let me adjust that statement a bit. Probably a slightly higher percentage in the lower two grades. Number threes, extra threes, compared to number two and number one. So, maybe a little bit worse than what we had expected, but much of the crop is marketable quality.

We'll be using our technologies to be able to ensure that the products do meet the customer expectations. And, you need to recognize one thing, it's all about — a lot of the raw materials we handle, let's say red lentils, for instance, one of our biggest products. It's all about the conversion of a sub-quality product into split lentils around the world and at what conversion you can dictates the price.

All of these stocks are marketable and with the depth of our distribution channels, we'll find markets and we'll make our margin. That's the position.

MAX VICHNIAKOV:
Okay, got it. And one quick question for Lori, probably. On the January administrative expenses, $10 million, is that sort of like a level we should expect going forward or is it just the one quarter we see a little bit of a spike there?

LORI IRELAND:
Well, as I mentioned in my summary, we're going to be going through the costs in detail and doing some reallocating. So, I don't think that $10 million would be a go-forward number to use. With IFRS, we have to revamp a lot of our expenses in our income statements, so, we thought that January 1, 2011 would be a great time to look at all the subsidiaries and figure out what should be in general admin, what should be in selling, what should be in costs to goods sold, etcetera. So, probably the short answer is no, that won't be a go-forward number.

MAX VICHNIAKOV:
Won't be repetitive. Got it. Okay, thank you. I'll jump back in the queue.

OPERATOR:
The next question is from Christine Healy of Scotia Capital. Please go ahead.

CHRISTINE HEALY:
First question is on your margins. If we look into Q4 and into 2011, can you give us some kind of sense as to how much higher we can expect your margins per ton to be? Are we looking at back to the 2008 level or potentially higher than that?

MURAD AL-KATIB:
I think there's a couple of answers to that question. We're certainly expecting –- quality variance will certainly affect our throughput to our facilities, but when we're talking about buying product that is at a lower quality and converting it into a product that's a higher margin product, then you'll have an offsetting effect of lower throughput to higher margin. So, from that perspective, management expectations today are that we'll be successful in our attempts to have that wash out in terms of our overall results.

Our margin profile over the last couple of quarters is not what we have projected as a normal margin profile. We did see an improvement in the quarter three in terms of a gross margin percentage quarter over quarter, with a return to more of our normal products. So, we were doing more of our lentils, chickpeas, beans, split peas, value added peas, and less commodity type peas. And, so, from that perspective, you saw, I think it went from around 7.2 up to about 10.3 or something.

But, again, this game is margin but it's also a volume game. We need the facilities to be running the throughput to be able to deliver the type of earnings that we expect.

CHRISTINE HEALY:

Okay, but, you were saying to Max that the throughput's now increased. You're getting deliveries from farmers; facilities are running fairly well right now. So, assuming that that continues for the next couple months, can we assume that your margins are going to be above average and, maybe, go back to 2008 levels? Is that safe to assume?

MURAD AL-KATIB:
Yes, that's, obviously, our expectations. You would expect that off-grade product can run 10% to 15% slower through our system so that we end up in a position where you have to ensure that you have a margin that compensates.

We run our facilities on a revenue-per-hour basis. So, it's not about margin per ton. So, when we have slower throughput, we expect higher margins. We attempt to differentiate the products and find market segments that accept that into that margin profile.

So, from that perspective, we end up in a position where we're able to deliver our results and that's what we expect going forward.

There are fairly significant spreads between the different grades of commodity and, so, when we look at number three lentils versus a number one lentil, there's a very significant grade spread between them. If we can take number three and create extra three, we create margin. And, that's what we do with the technologies that we have in our factories.

So, again, when I use terms like, "You know what, we're committed to the continued growth of our processing platforms," years like this confirm our investment in technologies. In our Canadian operation alone, we added five Sortex Z4 plus color sorting lines this year and I can tell you guys that management that waits for quality variants doesn't have the ability to react. These were not added post-harvest. These types of additions take three months of planning and three to four months of implementation and these were commissioned and in place for new crop harvest.

So, some would consider us lucky, I consider us forward thinking.

CHRISTINE HEALY:
Okay. Now let's look at StatsCan. Their last estimate for lentil production in Canada was about 1.5 million tonnes, so, flat with last year. Now, me personally, I don't have a lot of confidence in that number, just given that StatsCan surveyed the farmers the first week of September. So, the harvest is only about 20% at that time.

Now, what is your sense on how much is the lentil production in Canada this year? Is that 1.5 million tonnes realistic? Is it higher than that? What's your view?

MURAD AL-KATIB:
It's very tough to give any kind of a definitive view of the production. I will tell you that if you look at historical levels, we look at the historical performance of Statistics Canada data, and I believe four of the past five years we've ended up going into negative stocks of lentils as a result of their inability to peg the exact number of yield.

For us, anecdotally, we continue to hear independent analyst reports of higher canola yields than expected, higher cereal yields than expected. So, there's no reason to assume that lentils under perform. In fact, they usually perform at or higher than some of those crops.

And the frost effects on lentils –– remember, cold weather acts as a desiccant and a desiccant means these are continually growing crops. They need to be killed prior to harvest. So, the frost can affect lentils less than they can affect canola and other crops.

So, that's a long answer to a short question. We think is potential, Christine, that yields could come in higher than the statistical figure today. With higher acreage –- and we look at the 2009 statistics, 1,387 pounds, this year down to 1,127. Pretty far drop off in yield. We'll be very surprised if the carry out stocks aren't a little bit higher.

CHRISTINE HEALY:
Okay, so, in short answer then, you think that StatsCan's number is low and that the production will come in higher than what they're looking for?

MURAD AL-KATIB:
I'm saying there's potential, but there's more production there than statically accounted for today.

CHRISTINE HEALY:
Okay, so, if that is the case, then should we see more lentil supply going into Q2, Q3, so that we don't run into this situation again where there's no supply and it's difficult for you to get –-.

MURAD AL-KATIB:
That's what we're expecting. I mean, listen, timing effects mean, and times out of one quarter into future quarters. So, while we cannot gain back all of the lost sales that account from losing four or five weeks of production, there is certain a positive effect on supply and go-forward quarters. We are not expecting the sellout of the Canadian pulses harvest in 2011 to not allow us to bridge to a new crop. That's not our expectation.

On the other hand, if demand is really affected by a weather event in India, let's say, we still could be faced with that, but that would be positive for quarter one, quarter two. There's no doubt.

So, supply will spread into the period where we've been scratching the surface trying to find stuff to do.

CHRISTINE HEALY:
So, we could see less seasonality in earnings next year going forward?

MURAD AL-KATIB:
The whole goal of our investment strategy and growth strategy is to see alternate geographies to smooth the seasonality and I think that people shouldn't lose sight of the fact that only one year ago, we did the transformational acquisition of Arbel and that was the baseline of building a platform, which was a multi-year, geographic diversification and product diversification strategy. We will smooth the seasonality through these moves.

CHRISTINE HEALY:
Okay, and one last quick question. I know that in Turkey, the farmers are right now planting again. What's your expectation for lentil acreage in Turkey? Are you expecting it to be average?

MURAD AL-KATIB:
That's a question no one would be able to answer yet, but there's no reason to assume a difference. Prices have performed well and prices in Turkey have been higher than anyone's expectations. So, when we do look at, let's say some of the statistical data, there's still a forecast that acreage in Turkey will be very similar to the last season.

CHRISTINE HEALY:
Okay, great. Thanks. That's it for me.

MURAD AL-KATIB:
Thanks.

OPERATOR:
The next question comes from Marc Robinson of Cormark Securities. Please go ahead.

MARC ROBINSON:
Good morning. In previous calls, you've provided some detail on the utilization, either on a system-wide basis in Turkey and the rest of the business. Can you provide some color on that now?

MURAD AL-KATIB:
I can tell you that, as we said, seasonal utilization in quarter two was at a low level and we've indicated to you that our quarter three utilization was 25% below that. So, you can take a guess

from all of those indications, Marc, that the utilization in Canada was significantly below our two thirds utilization that we've been running in normalized crop period.

So, while we saw a recovery of the Turkish utilization getting more up to that mid-30's to 40% utilization that we've been targeting in the pulses business, pasta is, of course, continuing to run at high utilizations. Rice sector in quarter three runs at nearly no utilization because you are transitioning from an old crop to new crop paddy rice and arrivals from the US haven't started to arrive into Turkey yet from the 2010 US rice harvest.

So, with that, generally utilizations were down to, this would be one of our lowest levels of utilization across the platform, even when we look at the historical utilizations of the companies we acquired. But, again, temporary timing affects will get back to utilization from now on.

MARC ROBINSON:
And with a delay, it sounds like in some of the shipping in Q4. Out of North America, would that mean that the utilization in Turkey would continue to be strong through Q4?

MURAD AL-KATIB:
Q4 — yes, Turkey and North America, in that regard, aren't necessarily so connected. Although, I guess Turkey is making up some of the shortfalls from Canada, they've had good shipping. But, the bottom line is, my comments about Q4, don't take them the wrong way. It's a timing affect. You cannot expect, when you had harvest only completed on the 14th of October that full utilization is going to be taking place in the first few weeks of the quarter. So, if you want to focus on three or four weeks of the quarter, deliveries were slower. Do we think that's fundamental to anything we're doing from today forward? Absolutely not.

MARC ROBINSON:
Okay. So, just to get back to that G&A line, which I don't want to harp on, but just it was a little bit higher than I thought and the reallocating issue, really, is more just moving the number around.

MURAD AL-KATIB:
Yes, that's a moving issue. You know what; more utilization means more expenses, right? Some of those expenses –- the reason we brought up the classification is it's not getting rid of expenses. There's no –- it's just moving them around from general administrative. As you acquire companies, you end up in a position where reporting by subsidiary and grouping of expense categories, at some point you have to standardize them across your platform.

What we're saying is, yes, some of the G&A expenses we'd like to actually allocate into selling and marketing expenses, some into cost of sales. So, we'll end up giving you a bit more guidance coming up in quarter one as to what we think a sustainable level is.

The G&A expenses are not above my expectations. We have a much bigger platform and we're ramping it up. On that perspective, going forward, those expenses will be reoccurring.

MARC ROBINSON:
So, really, where I was going with that was just around the realized synergies from the Arbel deal. Whether you, indeed, have seen some meaningful synergies and whether we could expect to see some further synergies there. Just some commentary on how that's played out.

MURAD AL-KATIB:
In general, there will be synergies from the growth of the global platform. This is one of Lori's comments, I think, was something along the lines of we continue to examine cost, areas whereby we can gain cost advantages from the scale and the overall platform.

So, part of tuning this business, Marc, is to ensure we deliver those. And that would be freight savings, option origin contracting, which will create margin opportunities, and global marketing prowess that we're acquiring through things like the Poortman's acquisition, give us a platform from which to drive utilization of our assets. All of those things will end up leading to a lower cost of general administrative expenses per metric ton handled.

And, that's the key measurable for me. You ramp up utilization; your cost per ton goes down. Your margins go up; you have a higher free cash flow. That's the game and that's what we'll look to achieve.

MARC ROBINSON:
Okay, thanks.

OPERATOR:
The next question comes from Keith Carpenter of Canaccord Genuity. Please go ahead.

KEITH CARPENTER:
Good morning. I've got a couple of follow-up questions to questions that were asked and, obviously, I don't want to belabor this point, but I have to for a minute. The G&A following Q2 being about $7.5 million, I had asked whether or not that should be a rough number we should look at going forward and then assuming, of course, M&A activity from that date on. And, I think, why everybody's asking that question is if we were, just as an example, if we were to throw $10.5 million, if people had assumed that number going forward plus M&A after that, if we just were to throw in this number as a go-forward, that's everybody's EBITDA is going to get hit by $10 million dollars.

And, I think, that's what everybody's trying to hammer down. Is that a $7.5 million on a normalized basis going forward plus M&A since Q2 or how should we think of that number in our models going forward?

LORI IRELAND:
You could probably think of it as the $7.5 million staying in the G&A or some sort of below the line category, maybe $3 million of it might be moved up to cost of sales. For M&A activity.

KEITH CARPENTER:
Okay, but, if we look at the past –- then G&A increased by $3 million over the previous quarter and that, actually, regardless of where it goes, that's actually an increase run rate of $3 million. Is that the way we should look at that.

MURAD AL-KATIB:
It is an increased run rate of $3 million but, of course, when you ramp up your utilization and your tonnes, then the effect of that isn't necessarily going to be the whole amount coming off of your earnings. If there's a fixed cost component of that –.

KEITH CARPENTER:
No, understood. And, then, just following on comments of the opportunities that you guys have on margin expansion given to you here with the crop. You say in your press release that: "Lower utilizations may be partially offset by margin improvements in certain market segments." But, the comment seemed a little more, obviously at the end of the day, you're guesstimating where it could be, but that seems a little more conservative than what you've said the potential could be in your stated comments. If you could just reconcile those two.

MURAD AL-KATIB:
That's because my press releases are probably vetted a lot more by my legal than my comments are. No, joking aside –- listen, I cannot reiterate enough, processing expertise and management expertise is necessary to navigate through an incident as significant as the weather event in Canada in 2010.

Our ability to take technicians with two decades of experience in splitting products in our splitting factories will allow us to do things that other millers in the world have trouble with. It will allow us to deliver products to other millers in the world because, don't forget, we don't just mill ourselves, we are a supplier to millers of the world. So, we'll supply products that are suitable for their milling processes and that will allow us to create margin opportunities.

If you can take a lower grade product and you can slow down your process, increase the magnitude of certain processes that you're using and create a higher grade product, then you, ultimately, have the ability, if you have depth of distribution channels, to create a margin out of that. And, that is the entire goal of what we are looking at today.

KEITH CARPENTER:
Perfect. And, then, just last question. Just on the Q3 and, again, obviously, I understand the timing issues. Just on the Q3, what was the majority of product you were moving through your facilities? Were you doing a lot of whole peas again?

MURAD AL-KATIB:
No, we weren't and that's why, as I said, you had a gross margin improvement from quarter to quarter. It was a throughput issue, but the peas that we would have done, we would have still done some peas, but we would have had a return to split peas, lentils, very limited stocks of chickpeas, some beans, pasta. The pasta business performed as per our expectations this quarter, so, things have continued. The pulses platform was affected. That's the bottom line of where our results fell short and that's been, of course, our biggest platform and timing issues there have affected us.

KEITH CARPENTER:
Okay, thanks Murad.

OPERATOR:
The next question comes from Rod Nickel of Reuters. Please go ahead.

ROD NICHOL:
Yes, just a question about how you go from, in your consolidated financial statements, quarterly net gain of $6.2 million, or $0.31 a share to the adjusted net income of $730,000, or $.04 a share.

LORI IRELAND:
We back out the non-cash foreign exchange adjustment. So, each quarter we take a snapshot of our open FX contracts AR, AP, loans and we mark them to market. So, that forms part of our EBITDA, but we feel that it's a better picture to back that out and reporting an adjusted EBITDA number. So, that's the difference.

ROD NICHOL:
So, the one-time items are currency, not the weather problems?

MURAD AL-KATIB:
Just hold on though, just remember, they're non-cash currency adjustments. So, we report the earnings as stated and then we report an adjusted earnings. The analysts and our institutional investors have told us they want to see the actual earnings of the company from operations not affected by non-cash FX issues. And, non-cash FX are under GAAP and IFRS, we have to take the currency effects on our assets and liabilities and report them on a translated basis.

So, this is why we moved a quarter ago to an FX adjusted basis. We have adjusted EBITDA, adjusted net income to be able to give a more accurate picture.

ROD NICHOL:
So, the best comparison, then, is likely the $4.5 million quarterly gain a year ago to the $6.2 million this time around.

LORI IRELAND:
Yes, you should be looking at adjusted net income to adjusted net income. Or adjusted EBITDA to adjusted EBITDA.

OPERATOR:
The next question comes from Anoop Prihar of GMP Securities. Please go ahead.

ANOOP PRIHAR:
I'm just trying to understand the current situation in the market right now. So, for the lowest grade lentils that are out there right now, how eager are the farmers to sell at the prevailing prices, on the very lower grade product?

Murad Al-Katib:
You know what, the reality is, Anoop, what they have is what they have to market and we've been out very actively stating that the window and the market exists today to realize the quality they have, to get a competitive price for that quality and to get it moving before the Indian crop harvest in March and before Australia comes in to affect.

So, from that perspective, we end up in a position where we do have farmers marketing and — listen, as in anything, when you're expecting one grade and you end up with a weather event that gives you a grade that's two grades below where you expected to get, there's a bit of shock, there's a bit of anguish, there's a bit of disbelief.

There's a shopping around period whereby they'll take their samples to a number of processors to try and gauge what the value of that product is. We're starting to get over those timing issues and people are marketing and that's what we want. We need regular marketing for regular processing for a regular sales program to drive our utilization and we're seeing that over the past few days and weeks.

ANOOP PRIHAR:
With respect to your blending technology, I appreciate the fact that you have to run the product through the plant for an extended period of time to get the higher grade you're looking for. From your selling perspective, are your buyers stepping up to the prices your asking for?

I guess what I'm really trying to understand is what is the evidence to date in this quarter that your blending technology actually does have the ability to make a significant difference. I'm not talking about historical, so understand my question. I'm talking about right here, right now.

MURAD AL-KATIB:
For those of you who know the company, you know that we actually project profit and loss by sale and we do have already results from October that are giving us the basis for our comments. Frankly, it's a conversion analysis, Anoop. You buy it at one price, you convert it to

a product either sorted or split or processed and we know our cost of freight and we know our selling price and hedge our FX and we have EDC behind us, so, we have a very good idea of estimated profit versus actual profit. Our variances in a normal operational standpoint are not significant. So, we're quite confident in our current business model.

ANOOP PRIHAR:
Okay, and just one last question. On the higher G&A, you gave the breakdown in the MD&A and you said there's commission in there for $1.6 million. Can you just tell me, what does that commission relate to?

MURAD AL-KATIB:
It's actually sales related commission. So, it would be for marketing and sales expenses around the globe. We have a number of commissioned sales agents that are located throughout the world and, so, as a result of that, those are the type of people that would be included in those. And, that's the classification project. You can't change mid-year, Anoop, and have reference from past quarters.

So, the decision was made in quarter two, actually, that we would do a project to identify all the costs across all subsidiaries and all acquisitions and come up with a standardized grouping of what's a general admin, what's selling cost, and what's cost of sales. So, you'll see what unveiled in the IFRS unveiling in quarter one of 2011.

ANOOP PRIHAR:
Thank you.

OPERATOR:
The next question comes from David Pupo of Macquarie. Please go ahead.

MURAD AL-KATIB:
We have time, I think, for one more question. So, this will be the last one.

DAVID PUPO:
So, I'm a little confused on the timing issue. And, the reason I'm confused is because if we look at supply year-over-year, but this year you consider a number of things. So, the low percentage that are number one.

Number two, the percentage that is expected to go to feed by, call it the people out there that are making the estimates, the percentage that you would expect that you need for seed for next year is plantings, and, the fact that your processing yield dropped significantly, the throughput drops.

In the end, would the supply of lentils not be significantly lower than last year? Therefore, there is a potential for an issue going into the beginning of the second quarter of 2011.

MURAD AL-KATIB:
You have a couple of answers to that. If you're talking about output of product versus input, it's a different discussion --.

DAVID PUPO:
Output of product.

MURAD AL-KATIB:
We're talking about input into our factories is not necessarily affected by the conversion ratio of input product to output product. So, we're saying that the product that exists in the market is largely in the class of extra three, number three, and there is a portion of feed. Now, don't get confused by one thing. Feed lentils, depending on why they are feed, many do not go to animal feed, they go for further processing. The category of feed is only a definition of product that has more than 10% damage.

So, that can be sprouted kernels, so, kernels that were left in the field and that, actually, through water and sunshine started to grow again versus frost damage which those kernels would likely be lost entirely. So, feed does not necessarily mean it's destined for animal feed.

DAVID PUPO:
No, that's understood. You're able to process it, but there was very little feed last year. So, the year-over-year comp is bad on that percentage that was expected to be called feed.

MURAD AL-KATIB:
Yes, last year, the feed was actually feed. But, there was a very small percentage. This year, we think that many of the category of extra three, three, and feed will be marketable in some form. I think, David, the answer to your question is with the significant increase in US stocks, with the marketable nature of the Canadian crop and with our view that there is the potential that the statistical reporting may be revised upwards, we think there will be ample stops to process this year.

DAVID PUPO:
But what about the throughput or the end product? That's the answer to the question. The answer to the earnings question is, what comes out of the facility.

MURAD AL-KATIB:
It's what comes out of the facility and at what margin. So, you can't just look at a fixed margin per ton, David, that's not the proper way to look at it. When you look at that, we're talking about as you quoted in your note this morning, the fluidity and the velocity of our facility is being affected, but then "Our margins can be enhanced as a result of our technologies." It's the interaction of those two factors that answer earnings, not just the output.

DAVID PUPO:
Is that enhanced year over year or is that enhanced versus something else? I mean, what I'm getting at is –

MURAD AL-KATIB:
I don't understand your question David, that didn't make sense to me.

DAVID PUPO:
Yes. Last year in the fourth quarter, you did 14% EBITDA margin. Is that attainable this year?

MURAD AL-KATIB:
I think 14% EBITDA margin is attainable and depending on the combination of products, you could see, actually, lower sales and even higher margins than 14%.

DAVID PUPO:
Okay. Thanks.

OPERATOR:
This concludes the time for question and answer. I will turn the conference back over to Mr. Al-Katib.

OMER AL-KATIB:
Thanks a lot. That brings us to the end of our questions today. I'd like to thank you all for joining us and I'd like to remind you that if you do have any follow-up questions, you can feel free to contact us at our Regina head office. We'd be more than happy to follow up with you. Again, I'd like to thank you for attending our conference call and wish you all a good day. Thanks.

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