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PRESENTATION

Operator

Good morning, and welcome to SunOpta's Third Quarter Fiscal 2018 Earnings Conference call. By now, everyone should have access to the earnings press release that was issued this morning and is available on the Investor Relations page on SunOpta's website at www.sunopta.com. This call is being webcast and its transcription will be -- will also be available on the company's website. As a reminder, please note that the prepared remarks, which will follow, contain forward-looking statements, and management may make additional forward-looking statements in response to your questions. These statements do not guarantee future performance, and therefore, undue reliance should not be placed upon them. We refer you all to risk factors contained in SunOpta's press release issued this morning, the company's annual report filed on Form 10-K and other filings with the Securities and Exchange Commission for more detailed discussions of the factors that could cause actual results to differ materially from those projections and any forward-looking statements. The company undertakes no obligation to publicly correct or update the forward-looking statements made during the presentation to reflect future events or circumstances, except as may be required under applicable securities laws. Finally, we would like to remind listeners that the company may refer to certain non-GAAP financial measures during this teleconference. A reconciliation of these non-GAAP financial measures was included with the company's press release issued earlier today. Also, please note that unless otherwise stated, all figures discussed today are in US dollars and are occasionally rounded to the nearest million. And now, I'd like to turn the teleconference over to SunOpta's CEO, David Colo.

David J. Colo *SunOpta Inc. - President, CEO & Non-Independent Director*

Good morning, and thank you all for joining us. With me this morning is Rob McKeracher, our Chief Financial Officer. I am pleased to report that as expected, we returned to adjusted revenue growth during the third quarter and we expect this trend to continue into the fourth quarter. We continue to make progress with the Value Creation Plan, which we believe is reflected by the solid sales growth and gross margin expansion within our beverages and snack platforms. Additionally, during the third quarter, we commercialized approximately 100 broth and frozen fruit SKUs. The results across the beverage, snack and organic ingredient platforms as well as a significant amount of sales opportunity in pipeline conversions gives us confidence in our ability to deliver long-term shareholder value.

Let me first review the third quarter highlights and then provide an update on the Value Creation Plan. Third quarter revenue was \$308.4 million, down 3.8% as reported, or up 2% excluding the impact of commodities, currencies and removing the bar and pouch lines of business. In the Global Ingredients segment, we reported a 0.9% year-over-year revenue increase excluding the impact of commodities and currencies. We continue to see solid demand for internationally sourced ingredients, particularly in the U.S. market. In Europe, the impact of drought as well as a slowdown in certain dry categories, including nuts and seeds, partially offset the strong U.S. growth. We had a very strong quarter in organic cocoa, reflecting the final commissioning of our recent capacity expansion. We remain very pleased with our strong positioning and the market opportunity in organic cocoa. Additionally, our sales contract book is robust and we remain confident with the growth outlook in Organic Ingredients. Growth of internationally sourced Organic Ingredients continues to offset the reduced sales of domestically sourced ingredients, which experienced lower sales of organic feed due primarily to timing of crop availability, continued soft market conditions for Sunflower and the previously announced exit from certain domestically sourced grain varieties in 2017. In addition, the delayed roasted snack and ingredients project at our Crookston Minnesota facility also weighed on revenue in the third quarter. We expect this to improve moving forward; however, we expect incremental operating costs in the fourth quarter as we finalize commissioning of the new roasting lines.

Turning to Consumer Products, we had another good quarter in healthy beverage, generating 6.8% year-over-year revenue growth. This was driven by 11.1% growth in aseptic beverages, despite some timing related impacts in nondairy due to revisions in our customers'



promotional activities and adjustments to inventory levels. Aseptic broth continues to be contributor to growth, especially following the commercialization of a significant number of new broth SKUs during the quarter. The successful commercialization of these products also demonstrates the Value Creation Plan is delivering on our objectives. As a result, we expect continued revenue growth in beverage through the fourth quarter. Importantly, this growth is also helping to diversify our aseptic platform by both category and customer. Premium juice sales were modestly lower year-over-year as we rationalized unprofitable distribution points earlier in 2018. Overall profitability in beverage improved year-over-year as a result of our continued focus on operational efficiencies and improved capacity utilization. Healthy Snacks also posted an exceptional third quarter. Excluding the resealable pouch and nutrition bar businesses that we exited last year, snack sales were up 53.9% and gross margins improved year-over-year. Much of the top line growth in the quarter was a result of the timing of a back-to-school program for a contract manufacturing customer. Volume is expected to moderate during the fourth quarter, given this seasonal boost.

Turning to the Healthy Fruit platform, we continue to experience revenue declines in the third quarter, with sales down 5.5% adjusted for commodity prices. The decline reflects our strategic decision to lower prices to regain lost distribution and stimulate category growth. On a volume basis, sales of frozen fruit were essentially flat in the third quarter of 2018 versus the prior year, and up 3.3% when looking specifically at sales to retail customers. Syndicated data for the 12 weeks ended October 6 indicated that overall IQF frozen fruit revenues increased 0.3% and volume increased 1.8%. The same data indicates that within the category, private-label revenue increased 6.4% and volume increased 13.2%.

Gross margin in Healthy Fruit will take time to recover as we focus on building a consistent and reliable supply chain centered on product quality, innovation, customer service and productivity improvements. Our pack plan for this year is now complete with good fruit quality achieved during the season as a result of our improved food safety and quality programs. However, we experienced higher mango processing costs as a result of ensuring strict quality standards were maintained, which will temporarily weigh on margins until we get to next year's harvest. We are pleased that we have now won back more distribution than was lost in the middle of 2017 and we successfully commercialized a significant number of updated SKUs in the quarter for a large mass retailer. It will take time to regain historical margins in the frozen fruit business, but we are confident in our ability to optimize the margin in this business. I will elaborate further on our plans as I provide the Value Creation Plan update. As we've discussed over the last year, the first stage of the Value Creation Plan is targeting implementation of \$30 million of productivity driven annualized EBITDA enhancements over 2017 and 2018. Recall that for 2017, these EBITDA benefits were offset by structural investments made in areas of quality, sales, marketing, operations, engineering and other functional resources as well as nonstructural third-party consulting support, severance and recruiting costs. The plan also calls for increased investment in capital upgrades to several manufacturing facilities to enhance food safety and manufacturing efficiencies. Over time, these investments are expected to yield EBITDA improvements that go beyond the \$30 million that is being targeted in the first phase.

We expect to deliver ongoing productivity improvements as our go-to market strategies drive revenue growth, which drives further higher utilization and improved profitability in our plans. We are on track to deliver \$20 million of productivity driven EBITDA improvements this year. However, we continue to expect these improvements will be offset by the price and quality investments we have made in the Frozen Fruit platform as well as increased operational costs that we are addressing as part of the improvement plan.

Turning to portfolio optimization. Recall that the aim of this pillar is to simplify the business, invest where structural advantages exist and exit businesses or product lines where the company is not effectively positioned. The company has exited 3 lines of business and closed or consolidated 5 facilities since the launch of the Value Creation Plan. We continuously evaluate our portfolio to ensure all businesses are strategically aligned with our goal to drive long-term shareholder value. Our portfolio optimization efforts during the third quarter included completing the commissioning of a second roasting and processing line at our organic cocoa facility in Holland. As I noted, we delivered strong sales growth as well as gross margin improvement this quarter in organic cocoa. We continue to make progress with our aseptic expansion project to add processing and packaging capacity and capabilities to our Allentown facility. This \$22 million project is expected to come online in mid 2019 and adds mixing and processing capabilities to support further renovation to serve a variety of aseptic packaged solutions. We also continued commissioning efforts of our new roasting equipment in Crookston. This new equipment is designed to increase production efficiencies and add incremental capacity and roasting capabilities in support of the growing market for healthy roasted snacks. We expect these lines to be fully operational by the end of the fourth quarter. The focus of our operational excellence pillar is to ensure food safety and quality, coupled with improved operational performance and efficiency. These



efforts are expected to generate productivity improvements and cost savings in manufacturing, procurement and logistics.

During the third quarter, we continued to deliver strong operational performance across the network of aseptic facilities, and we are on track to reach our target of approximately 85% capacity utilization by the end of 2018. We expect our aseptic plant utilization to moderate in the first half of 2019 from Q4 levels and increase in the back half of fiscal 2019 due to the seasonality of the new broth business. As I noted, we completed the 2018 fruit pack season with high scores for fruit quality as a result of enhanced sorting and handling processes, in both the U.S. and Mexico. During the quarter we approved a significant capital investment project that will be implemented over the next 2 crop years to bring new automation and technology to our California facilities. As part of this, we also negotiated a long-term lease at the Santa Maria location in exchange for landlord commitment to construct a new cold storage facility adjacent to our current plant. These enhancements are an important step in our fruit margin optimization plan, which is a multi-faceted program designed to drive profitability in the Frozen Fruit platform back to historical levels. At a high level, the plan is focused on 4 key areas to drive improved margins over time. First and foremost, we will continue to make food safety, quality and customer service our top priorities. Second, we are focusing on volume growth. Our strategic decision to lower prices to win back distribution is evidence of this in action. Third, we are committed to driving costs out of the business. The capital enhancement project I just mentioned is the first step of many in this direction. Increasing automation with proven technology in our facilities, combined with the streamlined facility in Santa Maria is expected to lower conversion expenses, improve yield and increase productivity. When coupled with an efficient supply chain, all aspects of the plan work to lower costs and help insulate this business from inflationary pressures on the horizon.

Finally, we will bring innovation to the platform to increase the number of value-added products we offer to our customers. We also continue to advance food safety and quality efforts across the entire manufacturing footprint, leading to significant improvements in third-party food safety and quality audit scores and significant reductions in customer and consumer quality complaints.

Looking ahead in Q4 and into 2019, our SunOpta 360 continuous improvement initiative will continue to identify additional productivity improvement opportunities in areas of manufacturing, purchasing and supply chain management. The focus of the go-to-market effectiveness pillar is to optimize customer and product mix in existing sales channels and to identify and penetrate new high potential sales channels. Efforts under this pillar are expected to improve revenue growth and profitability over time.

As I previously mentioned during the third quarter, we commercialized approximately 100 new SKUs. Prior to the Value Creation Plan, the organization did not have the capability to effectively bring so many new products to market in such a short window. I would like to thank our SunOpta team members for the effort and dedication that was required to achieve this significant accomplishment. The pipeline of commercial opportunities in Consumer Products remains strong and the overall contract book for Organic Ingredients, both in Europe and the U.S. remains above last year's level.

Recent commercial wins include innovative oat-based non-dairy beverages into retail and industrial channels, traditional non-dairy SKUs into retail and broad line food service channels, expanded distribution of everyday broth with a large mass retailer, private-label frozen fruit for a specialty retailer and increased orders for private-label frozen fruit items, following a category reset by a large customer. The focus of the process sustainability pillar is to ensure the company has the infrastructure, systems and skills to achieve and sustain the business improvements captured from the Value Creation Plan.

During the third quarter, we made significant advancements with a new demand planning system that is expected to enhance our sales and operations planning processes. The new tool is expected to go live during the fourth quarter of 2018. We also improved capacity planning capabilities across the frozen fruit network and new product commercialization capabilities were further refined and certainly put to the test during the third quarter. Combined with our R&D capabilities, our new product commercialization act demand is expected to pay increasing dividends looking forward as we bring new innovation to market.

Finally, our enhancements to employ health and safety processes continued to result in a reduction in reportable incidents year-to-date in 2018 compared to 2017. To wrap it up, the positive impacts of the Value Creation Plan are evident in the transformations of both our beverage and snacks platforms and continued strength in our Organic Ingredients business. However, we recognize there is much work ahead of us as we focus on improving profitability in our Healthy Fruit platform. We have a strong portfolio that is on trend with consumers and has competitive advantages. We will continue to focus on our plan to deliver improved growth, profitability and



shareholder value and we look forward to updating you on our continued progress. I will now turn the call over to Rob to provide additional details on the third quarter financial results. Rob?

Robert McKeracher SunOpta Inc. - VP & CFO

Thanks, Dave. Let me walk you through the rest of the third quarter financial results in greater detail. Unless otherwise noted, all growth percentages reflect the year-over-year change, as compared to the third quarter of 2017.

As Dave mentioned, third quarter revenue was \$308.4 million, a 3.8% decline as reported. However, excluding the impact on revenues from changes in commodity related pricing and foreign exchange rates, and removing the impact of the bar and pouch lines of business, that were exited last year, revenue increased 2% with both of our reportable segments posting year-over-year adjusted growth. The Global Ingredients segment generated revenues from external customers of \$136.8 million, a decrease of 0.4% as reported, but an increase of 0.9% after excluding the impact of changes in commodity related pricing and foreign exchange. The revenue reflects 5.4% growth of internationally resourced organic ingredients, excluding the effect of commodity prices and foreign exchange, which was driven by strong demand in the U.S. market, while sales in Europe were under pressure. We expect a similar pattern in the fourth quarter with continued growth in the U.S. market, partially offset by competitive pressure on organic feed and a decline in prices of certain organic nuts and other dry commodities, which is leading to delayed purchasing on the part of buyers. Domestically-sourced ingredients decreased 9.6% excluding the impact of commodity prices. The decline was driven by lower sales of organic feed, continued soft conditions in the sunflower market and the exit from certain specialty soy products in 2017. The consumer product segment generated revenues of \$171.6 million during the third quarter of 2018, a decrease of 6.5% as reported. Excluding the impact of commodity prices and removing the impact of the bar and pouch lines of business, revenues in the third quarter increased by 3%. The increased revenue primarily reflects 53.9% growth in Healthy Snacks, 6.8% growth in Healthy Beverage and a 5.5% adjusted decline in Healthy Fruit, all of which Dave discussed in detail. However, let me note that the seasonal benefit in Healthy Snacks was significant in the third quarter and supported back to school promotional activity and while the business is healthy and growing, the rates of growth are choppy. We expect a meaningful sequential decline in Healthy Snacks in the fourth quarter in terms of revenue and gross profit given the seasonality I just mentioned. Consolidated gross profit was \$34.1 million for the third quarter of 2018, a \$2.3 million decline from \$36.5 million in the third quarter of last year.

Global Ingredients accounted for roughly half of the decrease in gross profit, which is largely due to startup costs on the new roasting equipment in Crookston and lower volumes and pricing for domestically sourced grains and seeds as well as the impact of foreign exchange movements on certain contracts within the Netherlands-based operations of our international Organic Ingredients platform. During the third quarter of 2018, we recognized a \$0.7 million foreign exchange loss on US Dollar denominated raw material purchase contracts, compared with a foreign exchange gain of \$0.7 million in the third quarter of 2017, which reflected a strengthening of the U.S. dollar versus the euro in the third quarter of 2018 compared with the weakening of the U.S. dollar versus the euro in the third quarter 2017.

These factors were partially offset by higher volumes and pricing spreads for certain internationally sourced organic ingredients as well as a gain on commodity futures contracts used to hedge our organic cocoa position of \$2.6 million in the third quarter of 2018, compared with a loss of \$0.1 million in the third quarter of 2017.

We enter into futures contracts to manage exposure to changes in cocoa prices on our physical organic cocoa position, which has increased due to the expansion of our cocoa processing operations. During the fourth quarter, we expect to realize additional startup costs and inefficiencies as we commence production in roasted snacks that will impact ingredient gross margins.

Consumer Products accounted for the other half of the decrease in gross profit, reflecting our investment into sales prices to gain back volume, combined with unfavorable product mix for frozen fruit as well as costs related to the introduction of new beverage and frozen fruit products.

These factors were partially offset by the favorable impact within the Healthy Beverage and snack platforms of improved plant utilization due to higher production volumes to meet sales demand and productivity driven cost savings.

In addition, we gained operational savings following the discontinuance of flexible resealable pouch and nutrition bar for production in the fourth quarter of '17. We expect to continue to see soft gross margin in the frozen fruit platform as we have strategically invested in price, while adding the quality and customer service. Additionally, we will see increased costs on certain fruit varieties following the completion of the 2018 Mexican mango season as we took additional steps to ensure fruit quality.

As a percentage of revenues, gross profit for the third quarter 2018 was 11.1%, compared to 11.4% in the prior year. The gross margin would've been approximately 11.7% in the third quarter of 2018, excluding startup costs of \$1.5 million related to new roasting equipment and \$0.4 million of costs associated with the commercialization of new beverage and frozen fruit SKUs. This compares to an adjusted gross margin of 11.8% in the prior year, excluding the impact of write-downs in the flexible resealable pouch and nutrition bar businesses. Operating income was \$4.5 million or 1.5% of revenue, compared to \$5 million or 1.5% of revenue in the prior-year period. Excluding SG&A costs related to the Value Creation Plan as well as those items I previously mentioned that affected gross profit, segment earning income as a percentage of revenues on an adjusted basis would have been 2.1% for the third quarter of 2018, compared with 2.7% for the third quarter of 2017.

On a GAAP basis for the third quarter, we reported a loss attributable to common shareholders of \$6.6 million or \$0.08 per common share, compared to a loss of \$8 million or \$0.09 per common share during the third quarter of 2017.

On an adjusted basis, we reported a loss of \$3.8 million or \$0.04 per common share, compared to an adjusted loss of \$1.9 million or \$0.02 per common share in the third quarter of 2017. Adjusted EBITDA for the third quarter 2018 was \$16.7 million or 5.4% of revenue, compared to \$19.1 million or 6% of revenue in the prior-year period. I'd like to remind listeners that adjusted EBITDA and adjusted earnings are non-GAAP measures and a reconciliation of these measures to GAAP can be found towards the back of the press release issued earlier this morning. From a cash flow perspective, during the third quarter, cash generated by operating activities was \$10.5 million, compared to cash used in operating activities of \$11.1 million in the third quarter of 2017.

We invested \$7.8 million in capital expenditures during the third quarter and continue to anticipate CapEx of approximately \$30 million for the full year of 2018. At the end of the third quarter, total debt was \$505.7 million, reflecting \$216.7 million net of issuance costs of 9.5% senior secured second lien notes due in 2022, \$274.3 million drawn on our first lien global asset-based credit facility, with the balance representing smaller credit facilities, lease and other financing arrangements. The global asset-based credit facility is a syndicated credit agreement maturing in February of 2021 with an aggregate commitment of up to \$370 million. With that, let me turn the call over to the operator to facilitate Q&A. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Amit Sharma with BMO Capital.

Amit Sharma *BMO Capital Markets Equity Research - Analyst*

Dave, you listed a number of new wins for -- or revenues coming through in fourth quarter and next year. Can you just provide us a little bit more clarity on the size and the timing of these new wins?

David J. Colo *SunOpta Inc. - President, CEO & Non-Independent Director*

Yes, the timing, some of those are shifting now and into the fourth quarter. Others will start shifting next year in fiscal '19. From an overall quantification of the dollar sales, on the new items that we've win I put it approximately in the \$10 million category on a revenue basis.

Amit Sharma *BMO Capital Markets Equity Research - Analyst*

Got it. And then, Rob, as we think about 4Q, looking at the estimates, it's still a pretty large ramp up in expectations for the fourth quarter, and Dave talked about maybe some incremental expense related to the Crookston facility. You talk about some puts and takes for what's coming up in the 4Q from a sequential perspective?

Robert McKeracher SunOpta Inc. - VP & CFO

Yes, obviously, we've got a policy of not providing guidance but I think if you listened to our prepared remarks, there is a number of things that we spoke to, to kind of give a sense of what we see coming down the pipe, both favorable and potentially unfavorable. So as I think about some of the favorable things, as Dave just mentioned, we are commercializing quite a bit of the new products, especially broth, which got going later in the third quarter and we should see a ramp up of that in the fourth quarter and then into next year. So that is one area of, certainly, growth that I think is fair to have an expectation for. As I think about some of the other cost pressures that we called out there, we are focusing quite heavily on quality when it comes to fruit. As a result, the cost of the mango that we made this year and are coming out of Mexico is a little higher than we expected, so that's not going to get passed on to customers. So you'll see that weigh on margin a little bit in the fourth and really into next year until we get to the new mango season in 2019. And certainly, Amit, you call it out the roasting assets inside of the Crookston facility, we continue to make progress commercializing those, but we should expect to see some continued spend and costs there in the fourth quarter. I would say not bigger than what we experienced in the third quarter, but it could be in a similar range would be kind of how I'd position that.

Amit Sharma BMO Capital Markets Equity Research - Analyst

So if you put it all together, would you expect a sizable jump in EBITDA, margins this quarter? Or that should be -- think about that as 2019 at this point?

Robert McKeracher SunOpta Inc. - VP & CFO

Yes, I mean we expect to see EBITDA grow certainly over time as we execute against the Value Creation Plan. Obviously I'm not in a position to provide specific guidance on fourth quarter of '19, but the plan is designed to see growth and EBITDA enhancement over time.

Amit Sharma BMO Capital Markets Equity Research - Analyst

All right. And the Dave, just going back to the frozen fruit, certainly, it continues to be the one, which is lagging from an improvement perspective. Is it -- do you feel like with the improvements that you made operationally and from your ability to win back some of these contracts as well, do you feel like this is now a matter of getting through the inventory that you're carrying? And as you go to next crop, the volume and the margin expansion improves dramatically or this is a longer improvement here?

David J. Colo SunOpta Inc. - President, CEO & Non-Independent Director

Yes, it's a longer improvement process, Amit, and there's really -- we think of it in 4 key steps. So the first step that we've been executing against, let's call it, this past year was really to improve food safety and quality and our customer service to regain our customers' confidence. Because as you'd recall, we had some pretty significant issues in those key areas. We feel like we've got that work done at this point and we've put it in place in a sustainable way. The second step was, we have to win back volume. We'd lost volume over the last 2 years. We knew that we had to take pricing actions, which we did, so we invested in pricing, also known as lowering pricing to win back volume. We were successful there as well. We think that, as we commented in the prepared remarks, we think we've regained all of the lost volume from the last couple of years and expect to see some pretty good volume growth ahead of us. So those 2 are the first steps and we feel like we pretty much accomplished those. The next step is rebuilding the gross margins. So we've brought back this volume but we did it at much lower pricing, which has compressed margins. So the rebuilding of the gross margin is key, and there's a couple of things we're doing there, but there's -- it's a multifaceted approach, there's not a 1 silver bullet. So we announced in this earnings call that we were now proceeding with investing in automation in our California-based plants. That will happen over the new -- the next 2 crop years, so we'll start some of that work in preparation to have it in place for the 2019 crop year. Then we'll do the second phase to have that automation in place for the 2020 crop year. The other component of that is our Santa Maria facility, which is our -- one of our largest frozen fruit facilities. It's a leased facility, we signed a long-term lease to stay in that facility. As a result of signing that lease, the landlord is building a new frozen storage facility adjacent to the plant, which will improve our logistics efficiencies, if you will. So that's going to be a key part of it. And then we're also focusing on the traditional things improving overall effectiveness inside the plants, yield improvement, et cetera, but we do see the margin recovery occurring over the -- for the most part the next 2 crop years. And then of course the last thing is bringing margin accretive innovation to the market, which, as we lost business over the last couple of years, the majority of what we lost was some of the more margin-accretive SKUs, so we're working on bringing innovation types back into the market as -- also is a part of the margin recovery effort.



Amit Sharma BMO Capital Markets Equity Research - Analyst

That's really helpful. Just one last one for me. As you look at this full year from a 2018, from a frozen fruit perspective, can you help us understand like what's the level of headwind you faced this year from a gross profit perspective or EBITDA, whichever way want to do? And how much of that goes away next year so that the \$28 million VCP related savings start to show up on the EBITDA line?

Robert McKeracher SunOpta Inc. - VP & CFO

Yes, I can take that one, Amit, and when the Q comes out, of course you get the greater insight into that. But if you're looking at the MD&A, you'll see a \$26 million year-to-date decrease in gross margin dollars from the fruit segment. So obviously that puts -- it puts it into perspective just how meaningful decline in that business is in the sense of profitability. The biggest chunk of that reflecting really the investment in price that Dave mentioned, that obviously we're doing with a -- for a specific reason to return that business to margin health over time, if you go back to historical levels. So that's the year-over-year delta through 9 months. As I think about costs, if you will, that exist in the business in '18, that mainly due to passage of time, or just not having as much inventory et cetera, that should go away next year. There's probably around \$5 million phased in that doesn't really require a lot of action other than having less fruit and have less movements in terms of freight and things of that nature. But the bigger part of the lifting here is really the automation improvements and all the things that Dave has mentioned in terms of our 4-phase plan to drive costs out of that business and get margins back to more of a historical state.

Amit Sharma BMO Capital Markets Equity Research - Analyst

So just to be clear, that \$5 million is the headwind that goes away? Or that's the headwind that remains for next year?

Robert McKeracher SunOpta Inc. - VP & CFO

That will be the headwind that goes away.

Amit Sharma BMO Capital Markets Equity Research - Analyst

So you still face pretty large headwind, like to the magnitude of, let's just say, a 9-year -- 9-month basis, almost \$20 million of headwind next year too?

Robert McKeracher SunOpta Inc. - VP & CFO

That would be the -- I mean if you think about it in terms of what we need to overcome, that then is what we're tackling in terms of driving costs out of the business through actual action. So the \$5 million is, it's an approximation, but I think that's a pretty fair estimate of what would happen just via passage of time. The \$20 million is what we're taking action on now to eat further into that headwind, as you called out.

Operator

Your next question comes from Jon Andersen with William Blair.

Jon Robert Andersen William Blair & Company L.L.C., Research Division - Partner

I wanted to start on the Global Ingredients side of the business. And if you could talk a little bit about the international side, I think it grew mid-single digits in the quarter on an adjusted basis. I think in the past that business has grown high single, closer to double digits, given kind of the demand you've seen for organic ingredients in developed markets around the world. Can you talk a little bit about, I think you mentioned pressure in Europe, maybe some more specificity around that pressure in Europe and how long you expect that to persist? And then shifting over to the domestically sourced ingredients, that was down about 10% in the quarter. I know there have been some planned exits there, but when do we lap those planned exits of some of the specialty soy, and also, if you could talk a little bit about what's just going on in the sunflower market and the feed market that are kind of contributing to weakness there? Let's start with that.

David J. Colo SunOpta Inc. - President, CEO & Non-Independent Director

Jon, this is Dave. So in the international Organic Ingredients, couple of primary factors that have kind of dampened the growth rates. One is, in the organic feed markets, there's been some pretty good competitive pressure in those markets, that's driven some compression in sales prices and margins. So that's one of the primary factors in the international market. The second is, we're a fairly large seller of

organic nuts and cashews and almonds in particular, the pricing in those markets has come down very significantly over the last several months, and what happens in that kind of environment is the buyers of those particular items go into a spot buying mentality, waiting for the pricing to bottom out. So that's been impacting our, what we call our nut and seed basket, if you will, pretty significantly this year. The good news there is we are seeing signs now that those markets might be at the bottom and seeing some strength in pricing starting to return. So hopefully, over the next quarter or 2, we'll see strength come back into the organic nut segment. Those are the 2 primary factors on the international market. On domestic, basically the -- as you well know, we are a large, one of the largest sunflower producers in the U.S. and we continue to see softness in the sunflower market. There's a situation, really on a global basis, where prices are quite low, a lot of competitors have too much capacity and it hasn't been rationalized out of the market, so that factors into it, and then demand for the product itself isn't as robust as we like as people are looking for alternatives to sunflower, and that's what led us, by the way, to make the investment in the roasted snacks platform in Crookston. So the sunflower business remains soft and then on the timing in the quarter, we had organic feed in our RMSS business that -- we still have the business, but due to the availability of new crop timing, we were not able to ship as much as we thought we were going to be able to ship in Q3 versus prior years. So the good news on that is that the harvest is underway, and we're we are now shipping that organic feed. So that should correct itself as we go into the fourth quarter.

Robert McKeracher SunOpta Inc. - VP & CFO

And Jon, just to answer I think the last element to your question there, there's probably been \$1 million delta between the exited lines of business, so because we got out of that and that we're now in the new crop, that would be the last quarter you'd see the -- it was really the bin cleanout, the bottom of the bin that we would've sold and reported revenue on last year, at the Moorhead facility that you're no longer seeing this year. So it was about \$1 million of that 9% in that -- in that domestic side of the business.

Jon Robert Andersen William Blair & Company L.L.C., Research Division - Partner

Okay. Shifting gears to the beverage business, which continues to perform well. Where -- the 11% growth in aseptic, high single digit overall, is that -- I know you've got new capacity coming online next year, I think maybe some capacity coming on late this year, or new capability. But what is your visibility into the continued growth of that business at kind of these rates that we've seen over the past few quarters? The reason I ask is, we have fruit, which is lagging and it sounds like frankly it's going to continue to be a headwind for some period of time now, so we really need businesses, right, like beverages, which seem to have a little bit more momentum behind them to continue to exhibit that momentum. So again, if you could talk about the pipeline, your visibility in -- as you bring on more capability and capacity to continue to drive strong growth out of that beverage business?

Robert McKeracher SunOpta Inc. - VP & CFO

Yes, sure, I'll try and take one, Jon. I think as I think about beverages, if you even contrast it with a year ago, we weren't really in the broth side of -- the broth category really at all. So here we sit today now, firmly implanted in that category. Revenue started to ramp towards the end of the third quarter. We expect more to come and are shipping more in this fourth quarter. So if I think about maybe what does that mean to that overall beverage portfolio, I think the broth business we brought could kind of support a 10% growth rate on the beverage portfolio on its own. And then what we do, of course, with nondairy and other things would be above and beyond that. So to give you a sense, it is a very sizable piece of business for us and that's why we're adding the capacity because we see such growth potential, both now with won awards and other awards that we think could drive more growth, and not to mention the category itself, in broth and private label in particular, we continue to see upwards trends there. So think of it as a 10% -- or plus 10% over the course of the next year.

David J. Colo SunOpta Inc. - President, CEO & Non-Independent Director

Jon, from a pipeline perspective in beverage, we continue to have a pretty strong pipeline and also from an innovation and new product point of view, we'd mentioned it in our prepared remarks that we are now getting interest in selling oat milk. So oat milk, we think and has a pretty bright future in the aseptic format and we also have a pretty robust pipeline of opportunities with customers as well. So we continue to feel pretty confident in the ability to grow the beverage platform.

Jon Robert Andersen William Blair & Company L.L.C., Research Division - Partner

And is the beverage platform -- are there other areas that you're exploring beyond, let's say, the aseptic and nut-based beverages, there's been a migration, right, to the refrigerated case. Is that something that you would even consider or is that just non-core? And then

are there other categories around the store where your aseptic capability might apply beyond nut-based beverages, beyond broth that we could get kind of excited about as another kind of whitespace for that business?

David J. Colo *SunOpta Inc. - President, CEO & Non-Independent Director*

Yes, Jon, our -- as you know, our core is plant based beverages. So almond milk, coconut milk, soy milk, et cetera. However, having said that, we do see additional category potential within the aseptic format. There is the protein category, the protein drink category, nutritional drinks. We see those as a potential area to pursue with our -- some of the new capabilities we're adding as part of the \$22 million expansion that we spoke of allows us to have the process capability now to start producing those types of items. It would require potentially additional investment in fillers to accommodate the actual package types that those product types are typically sold in, but we have interest in that area, we think it's a high growth sustainable area. So yes, there's other areas that we're looking at, but our core in this business is plant based, but we do see some adjacent categories that make sense for us.

Jon Robert Andersen *William Blair & Company L.L.C., Research Division - Partner*

And in the gross -- I don't think you mentioned in the prepared comments, were gross margins higher in aseptic in the quarter? I think you mentioned that snack gross margins were up year-over-year. How about the beverage business?

Robert McKeracher *SunOpta Inc. - VP & CFO*

Yes, no, the beverage business and the snack business were up, but certainly on a combined basis, they weren't up enough to offset the headwind in fruit.

Jon Robert Andersen *William Blair & Company L.L.C., Research Division - Partner*

Okay. Are both -- are the beverage and snack business operating at levels, gross margin levels, that are consistent with your 3-year plan to get to 10% EBITDA margin?

Robert McKeracher *SunOpta Inc. - VP & CFO*

They're certainly making strides in that direction and I'd say they're closer to that profile that we're targeting. It is really fruit that is, obviously, the furthest from it, so we have sight lines for beverage and snacks to certainly get to the range we set out.

Jon Robert Andersen *William Blair & Company L.L.C., Research Division - Partner*

And how far is fruit off? Like order of magnitude, if you can talk about it. I don't know where you sit today relative to where you want that business to be or need it to be to hit your kind of longer-term objectives?

Robert McKeracher *SunOpta Inc. - VP & CFO*

Yes, we don't -- I steer clear of giving specific margin ranges by the sub platforms, Jon, but I did mention, and Amit asked the question, about the overall decrease. And that's a \$26 million drop in dollars this year versus last year so I think that should probably help to give you perspective on the quantum.

Jon Robert Andersen *William Blair & Company L.L.C., Research Division - Partner*

Okay. Okay. And am I right to -- I kind of feel like the discussion today suggests that you're thinking about the recovery in fruit as a longer-term process, perhaps than you -- were thinking even a quarter or 2 ago. Is that a fair statement or not a fair statement, at this point? And nuts -- because I of fruit, if it's a longer-term proposition to kind of get the margin recovery. I think, maybe David, you mentioned 2 seasons now that might push out some of the financial objectives that you've talked about previously in terms of where you'd like to be from an EBITDA standpoint by 2020? How should we be thinking about that? Is it fair to say that we should be thinking longer-term now towards objectives or still on track?

Robert McKeracher *SunOpta Inc. - VP & CFO*

Let me try and start there. Jon, I think from my perspective, the objectives are unchanged, the 10% to 11%. And I think on last quarter's call we gave a bit of a breakdown on how the Value Creation Plan drives sustained improvements to get the profiles of our businesses to that level. When it comes to fruits, specifically, as we step back and look at the work that's got to get done there, and if you look at the nature of the business where it's very seasonal, right, you're really talking May 1, give or take, is the start, if you will, to each primary crop season, running through to August. In order to make and give effect to the change that we're going to do to drive costs out of there, it's

going to take 2 crop seasons. So I don't think that's -- that's not necessarily unchanged from where we were at or our heads were at last call. That just is the reality of that business. So we'll get to work ahead of the '19 crop, bringing automation in and streamlining parts of the businesses. We'll go through that crop. We should have the new facility up and running for -- in time for the 2020 season up in Santa Maria, along with another wave, if you will, of cost reduction and efficiency enhancements, and, I mean at that point in 2020, we'll certainly know where we're sitting in terms of what we've accomplished to drive costs out of the business.

David J. Colo SunOpta Inc. - President, CEO & Non-Independent Director

Jon there is 2 -- the CapEx that we just outlined. That does require implementation over the next 2 crop years. If you think about that, we do have to do that in a way that we don't risk the season. In other words, these plants are heavily manual today. As we put automation into the facilities, it kind of needs to be staged so that we don't disrupt production during the season, so that's the CapEx is what will be installed over the next 2 crop cycles, if you will. However, on the -- there's other parts of marginal recovery that we're working on that aren't necessarily CapEx dependent, so those are the things that we can do to try to increase margin while we are implementing the CapEx and the automation over the next 2 crop cycles.

Jon Robert Andersen William Blair & Company L.L.C., Research Division - Partner

Okay. Since it's just 2 of us, sell-siders I -- can I ask a couple more questions, I hope. Rob, coming back to, I think Amit tried to ask this earlier. How would you like us to think about the sequential improvement in the business from Q3 to Q4? You haven't really given -- I think the last quarter you give some bounds on how to think about Q3, like what I'm digging for here is how you'd like us to think about sequential improvement or lack thereof in Q4 this year and then I have a follow-up on 2019.

Robert McKeracher SunOpta Inc. - VP & CFO

Yes, sure. And as I mentioned, I think, when I was answering Amit's questions, we're not in a position to give guidance, that's our policy. So in the prepared remarks, I've given some -- and part of Dave's section as well we gave a bunch of indications on what we see coming essentially within each of the platforms. So we do expect to see more growth. We're expecting growth in beverage really driven by broth, we're expecting volume growth in fruit, but as we described there is -- we've taken price out, so that the revenue growth would be muted. In terms of the snacks platform, seasonally, we had quite a big promotion back at school for one of our contract manufacturing customers, so you're going to see that sequentially change, and that was in the remarks we made. We talked about the roasted snack platform and that we expect to be finalizing commissioning of those new assets here in the fourth quarter, but that, along with the commissioning activities and then beginning to commercialize new business off of it, there will be costs there. I'm missing one here -- and then we talked about the costs inside of fruit, mainly focused on mango. And so what does that really mean? It means we took extra care this season to ensure the highest of really fruit quality coming out of Mexico and as a result of that, we did incur slightly higher yield loss, which drives the cost of the fruit up a bit. So those, I think, are the indicators, Jon, that I think you can go on it if you're thinking about what fourth quarter looks like and in some cases into next year.

Jon Robert Andersen William Blair & Company L.L.C., Research Division - Partner

And mango is how big of -- how much of the fruit that you sell is mango?

Robert McKeracher SunOpta Inc. - VP & CFO

This year it's going to be about 5%, on a volume basis.

Jon Robert Andersen William Blair & Company L.L.C., Research Division - Partner

All right, and I guess I'll give it a stab and just -- this we'll be the last one. In 2019, looks like you'll come in this year around \$60 million, \$65 million of EBITDA. Do we, on a path to something like \$120 million to \$150 million, do we see material progress towards that goal, which I think was a 2020 goal in 2019 or I could read all of the comments here and say we have another kind of investment year in 2019 to kind of work through. Any thoughts on how we can try and put that picture together for '19?

Robert McKeracher SunOpta Inc. - VP & CFO

Yes, I think -- I've made this comment, we are focused on executing the Value Creation Plan. What really is the biggest amount of heavy lifting we have and I think it comes through on most of the calls we take and certainly on this call, it's inside of fruit. We think we're right where we want to be when it comes to beverage and snacks. Certainly, our Tradin or our organic ingredient business, we're seeing the

growth rate there hold, the contract book remains strong. So as you describe a year of investments, I mean, the entire plan itself is an investment but I think it's really fruit that, as we've been talking about, here is the 4 steps we're going to go through to drive more margin back into that business and we're certainly confident in our ability to do that, and we're seeing the proof of some of the early activities now in terms of driving higher quality, higher customer service, now volume growth back to that business, it's playing out. So it would I'd say...

Jon Robert Andersen William Blair & Company L.L.C., Research Division - Partner

But those are all -- those are all important things, quality of product -- I mean, they're paramount, right? Quality of product, and the variety that you can offer your customer, the efficiency with which you can process and produce it, it sounds like it's winning new volume. But it doesn't necessarily get you margin, right? I mean the customer will take all of that and they'll take it at the lowest price possible. How do you have conviction that all of these investments are actually, not just deliver the volume, but the overall value, I guess, in terms of margin rates that you're kind of targeting?

David J. Colo SunOpta Inc. - President, CEO & Non-Independent Director

Yes, I think, the 4-step process we outlined earlier, Jon. Steps 1 and 2, which was improving food safety and quality getting our credibility back with the customers and then the investment in pricing. That -- those have paid off, to your point. We've gotten the volume back. Rebuilding the margin structure, that takes more time because it's -- there's not just 1 lever you can pull and increase margins overnight. So it's, again, it's why we're working on it from multiple angles and making sure that as we progress here over the next year or 2, if you will, that we take advantage of the fact that we now have good volumes back in these businesses and we drive margin improvement basically through a reduction in cost. The other thing that we haven't spoken of is, these businesses can change very quickly from a market dynamics point of view, right? Crop year to crop year, there could be changes. That could lead to the opportunity on pricing and the kind of the approach we're taking is, pricing is certainly 1 option that we have over time, but our initial process is trying to rebuild margin through all these enhancement projects, both from a CapEx investment point of view as well as just taking the actions that are necessary to improve overall plant efficiencies as well as our total supply chain efficiencies. So there is, it's -- again, there's not 1 single item, it's multifaceted. But this is not new work. This is what it takes to get margin back into businesses of this nature, and that's the exact approach we're going to take and I'm very confident that we can rebuild the margin structure.

Jon Robert Andersen William Blair & Company L.L.C., Research Division - Partner

Okay. And would you still characterize Q3 as kind of the bottom in the margin performance for fruit? You have -- the inventory, I think is worked down by year-end or better aligned, the bagging operation is up and running. You've got new volume that you're shipping. Is Q3 kind of the trough, if you will, and we make study sequential improvement from year?

Robert McKeracher SunOpta Inc. - VP & CFO

Yes, no, we're certainly the trough now, Q3, Q4. Would I suggest you're going to see a massive step up in the fourth quarter? No, but we're not -- certainly not seeing any further deterioration from an overall margin profile perspective from where we sit right now.

Operator

Your next question comes from Amit Sharma with BMO Capital.

Amit Sharma BMO Capital Markets Equity Research - Analyst

Just a very quick 1 for me. Dave, when you said \$10 million incremental sales from new wins, were you talking about a quarterly run rate or for the full year 2019?

David J. Colo SunOpta Inc. - President, CEO & Non-Independent Director

Yes, so those particular items, that was an annualized number.

Operator

There are no further questions at this time. I will now turn the call back over to David Colo for closing remarks.

David J. Colo SunOpta Inc. - President, CEO & Non-Independent Director

Thank you, Operator, and thank you all for participating in our third quarter conference call. I look forward to speaking with you in the future and updating you each quarter on our progress as we unlock the opportunity and value in SunOpta. Have a great day.

Operator

This concludes today's conference call. You may now disconnect.

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