THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

SOY.TO - Q2 2018 Sunopta Inc Earnings Call

EVENT DATE/TIME: AUGUST 08, 2018 / 1:00PM GMT

CORPORATE PARTICIPANTS

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

Robert McKeracher *SunOpta Inc. - VP & CFO*

CONFERENCE CALL PARTICIPANTS

Amit Sharma *BMO Capital Markets Equity Research - Analyst*

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

PRESENTATION

Operator

Good morning, and welcome to SunOpta's Second 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 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 the 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 to all 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 discussion 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'd 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 U.S. dollars and are occasionally rounded to the nearest million.

And now, I'd like to turn the conference call over to SunOpta's CEO, David Colo.

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

Good morning, and thank you for joining us. With me this morning is Rob McKeracher, our Chief Financial Officer.

During the second quarter, we continued to make progress with the Value Creation Plan, including additional conversions of our sales opportunity pipeline, strong performance in aseptic beverages and snacks and continued growth in organic ingredients. While challenges remain in frozen fruit, results improved sequentially, and we made good progress implementing our frozen food operational improvement plan.

On an adjusted basis, revenue was close to flat with the prior year and adjusted EBITDA was in line with our expectations. We continue to capture incremental EBITDA improvements through the Value Creation Plan, much of which we have reinvested into pricing actions in the fruit platform. We also remain confident with our expectation of returning to consolidated revenue growth in the second half of the year.

Let me review the second quarter highlights and then provide an update on the Value Creation Plan. Second quarter revenue was $319.3 million down 5.1% as reported or down 0.6%, excluding the impact of commodities, currencies and removing the impact of the bar and pouch lines of business. Second quarter adjusted EBITDA was $14.8 million, an improvement from the first quarter and consistent with our expectations.

In the Global Ingredients segment, we reported a 0.4% year-over-year revenue increase or 0.6% decline excluding the impact of commodities and currencies. We continue to see solid demand for internationally-sourced organic ingredients, including sales growth in the U.S. and European markets, although sales growth in Europe moderated from the first quarter level. Growth of internationally-sourced organic ingredients continue to offset the anticipated reduction of sales in our North American grains business, which is still lapping sales related to specialty soy products that we exited last year. Rob will provide some color on timing-related noncash, foreign exchange as well as commodity items that impacted gross margin inside Global Ingredients in the quarter, but the business is healthy, and we remain committed to our strategic focus that's designed to leverage structural advantages in Global Ingredients.

Turning to Consumer Products. We had another good quarter in Healthy Beverage, generating 1.6% year-over-year revenue growth. This growth was driven by strong performance in aseptic beverages, while premium juice sales were lower year-over-year as we rationalized unprofitable points of distribution. Aseptic sales were up 6% despite still lapping 1 month of sales to a large private-label account that ended at the end of April last year. Our go-to-market effectiveness strategies continue to build a robust sales opportunity pipeline in the Healthy Beverage platform, and we saw several conversions of this pipeline during the quarter, which I will discuss in a moment.

Margin performance continue to improve, reflecting increased capacity utilization and productivity improvements in our aseptic platform. Healthy Snacks also posted a good second quarter, excluding the resealable pouch and nutrition bar businesses that we excited last year, snack sales were up 7.6% and gross margins were higher year-over-year.

Turning to the Healthy Fruit platform. We continue to experience revenue declines in the second quarter. However, the decline narrowed to 3.3% during the quarter, after adjusting for commodity prices that's compared to a 17.1% decline in the first quarter. As expected, gross margin continues to trail the prior year, reflecting lower pricing and increased manufacturing costs driven by a reduced pack plan and excess costs associated with inventories, including transportation, storage and obsolescence. We are making steady progress on our plan to turn around frozen fruit and are 90% through our pack plan for next year, which will substantially wrap up in the third quarter. Recall that our plan is for a reduced pack plan this year in order to rebalance our inventory levels to our refined demand plan. This initiative is designed to improve matching up pricing to input costs, while ensuring optimal inventory levels.

We are leveraging our expanded procurement and processing capabilities at our Mexico facility and have utilized the more cost-effective combination of our California-based facilities to process this year's crop. We will continue to optimize our frozen fruit supply chain and production processes as we evaluate investments in automation and technology to enable improved product quality, productivity and costs.

We also continue to win new business that includes additional SKUs and broader distribution, some, of which we expect to shift during the fourth quarter. I'm pleased with our investments in quality, customer service and innovation, and encouraged by our progress within this important platform. We remain confident with the long-term outlook for this Healthy Food category and our competitive positioning.

Now let me turn to an update on the Value Creation Plan. As we've discussed over the last year, the first phase 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 the 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 in 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 higher capacity utilization and improved profitability. We are on track to deliver $20 million of productivity-driven EBITDA improvements this year. However, as we just discussed, these improvements are expected to be offset by pricing investments and increased operational costs in Healthy Fruit that we're addressing as part of the improvement plan.

We have largely cleaned up our portfolio and are now focused on strategically investing in key areas to drive growth in margin expansion. Our portfolio optimization efforts during the second quarter, included advancing the commercial production of the second roasting and processing line at our organic cocoa facility in Holland. We are currently at 80% of design throughput at targeted yields. Our plan is to reach design capacity by the end of the third quarter. We continued commissioning efforts on a new oil processing line at our Bulgarian sunflower facility, which is expected to drive incremental margins through growth and production efficiency.

We also began the commissioning efforts of our new roasting equipment in Crookston. As a reminder we added 2 new blanching and roasting lines in Crookston as a result of the closure of our Wahpeton facility. Due to delays in the timing of equipment deliveries as well as a longer than planned commissioning schedule, we now expect these lines to be fully operational in the fourth quarter, approximately 90 days later, than our original plan.

Finally, as we announced last quarter, we have now initiated our plans to expand aseptic processing and packaging capacity and capability to the Allentown, Pennsylvania beverage facility. This $22 million project will add capacity, additional capabilities and further cost advantages to our national footprint of aseptic plants. In addition to the $22 million project we have initiated, during the second quarter, we identified and approved another $13 million of capital spending to enhance the efficiency and increase capacity in our aseptic business over the next 24 months. In total, these investments will expand our aseptic capacity by approximately 25% once fully operational.

The focus of the operational excellence pilar 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 second quarter, we continue to generate strong operational performance, across the network of aseptic facilities. We are now targeting capacity utilization to be approximately 85% by the end of 2018. As I noted in our fruit discussion, we completed approximately 90% of the 2018 pack season at targeted food recovery rates and recently implemented sorting and handling enhancements that have resulted in improved food quality.

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. We also identified additional productivity improvement opportunities as the SunOpta 360 continuous improvement initiatives processes within our aseptic facilities.

The focus of the go-to-market effectiveness pilar 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. The pipeline of commercial opportunities and Consumer Products remain strong and the overall contract book for organic ingredients both in Europe and the U.S. exceeds prior year levels.

Recent commercial wins include additional private-label broth into the traditional and specialty retail channels, expanded distribution and additional SKUs of frozen food into the mass, grocery and limited assortment channels. Incremental frozen fruit offering, servicing the food service channel that are expected to ship in the fourth quarter and increased sales of comanufactured fruit snacks that are expected to ship in the third quarter.

We continue to convert our sales opportunity pipeline at a rate sufficient to meet our expectations of accelerating revenue growth in the back half of the year. We will be commercializing approximately 100 new SKUs in the second half of the year, resulting in 120,000 new points of distribution across multiple channels.

As you would expect, this is what drives our confidence and our expectation for consolidated revenue growth in the second half of the year. We are pleased with the level of commercial activity and feel confident that these wins will drive profitability over time.

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 second quarter, we went live with a new specification system for ingredients, which is designed to drive improved food safety and quality in addition to improved research and development efficiencies. We advanced our aseptic capacity planning capabilities to support the expanded volume increase I just mentioned over the next 12 to 18 months.

As part of our frozen fruit improvement plan, we have significantly improved our demand planning, fruit utilization planning and inventory management practices, which will lead to improvements in working capital and inventory turns in this business. We also made further enhancements to employee health and safety processes, which continue to result in a reduction in recordable incidents year-to-date in 2018 compared to 2017.

As we discussed last quarter, we have began to see the positive impacts of the Value Creation Plan on several of our business platforms. Our success in the transformations of both our aseptic beverage and snacks platforms is the road map to improve growth in margin across the consolidated business. We have a strong portfolio that is on trend with competitive advantages, and we will continue to focus on our plan to deliver improved growth and profitability.

We look forward to updating you on our continued progress. I will now turn the call over to Rob to go through the second quarter financial results. Rob?

Robert McKeracher - *SunOpta Inc. - VP & CFO*

Thanks, Dave. I'll take you to the rest of the financial results as well as balance sheet and cash flow metrics for the second quarter.

As Dave mentioned, second quarter revenue was $319.3 million, a 5.1% year-over-year decline as reported. Excluding the impact on revenue from changes in commodity-related pricing and foreign exchange rates, and removing the impact of the bar and pouch lines of business, revenue declined 0.6%.

The Global Ingredients segment generated revenue from external customers of $146.7 million, an increase of 0.4%. Excluding the impact of changes in commodity-related pricing and foreign exchange, revenue in Global Ingredients was relatively flat, decreasing by 0.6%.

The second quarter revenue reflects 6.8% growth in internationally-sourced organic ingredients, excluding the impact of commodity prices in foreign exchange, as we continue to experience increased demand for organic ingredients, including cocoa, oils, coffee, fruits and vegetables, which more than offset declines in organic feed. This growth is offset by lower volumes of North American sourced grains and seed projects, which declined 14.2% during the quarter, excluding the effect of commodity prices mainly as a result of our exit from certain specialty soy products in 2017 as well as softer market conditions for sunflower.

The Consumer Products segment generated revenue of $172.6 million during the second quarter of 2018, a decrease of 9.3% compared to the second quarter of 2017. Excluding the impact of commodity prices and removing the impact of the bar and pouch lines of business, revenue in the second quarter decreased by 0.6%. The decline in revenue primarily reflects 3.3% lower sales in frozen fruit, which excludes the effect of changes in commodity pricing due to reduced distribution to certain retail customers. This decline was largely offset by 1.6% growth in our beverage platform driven by continued growth of aseptic nondairy and broth products, partially offset by lower sales of premium juice compared to the prior year, mainly due to a reduced private-label juice program as we exited certain unprofitable regions. Excluding sales related to a large private-label account that we stopped servicing at the end of April 2017, aseptic beverage volume would have been up approximately 12.5% during the second quarter.

In our snack platform, excluding sales of nutrition bar and pouch products, revenue grew 7.6% in the second quarter, driven by increased contract manufacturing volume in fruit snacks. Consolidated gross profit was $34.3 million for the second quarter of 2018 compared to $41.7 million for the second quarter of 2017. Global Ingredients accorded for $6.8 million of decrease in gross profits, which was largely due to the impact of foreign exchange and commodity price movements had on certain contracts within our European operations.

During the second quarter of 2018, we recognized a noncash $4.3 million foreign exchange loss on U.S. dollar-denominated raw material purchase contracts compared with a noncash foreign exchange gain of $3.7 million in the second quarter of 2017. This reflects the significant strengthening of the U.S. dollar versus the euro in the second quarter of this year, compared with a significant weakening of the U.S. dollar versus the euro in the second quarter of last year.

This was partially offset by a gain of $1.8 million on commodity futures contract used to hedge our organic cocoa position, compared to a gain of $0.2 million last year. These foreign exchange and commodity-driven items account for $6.4 million of the $6.8 million decline in gross profit. It's important to note that inside Global Ingredients, we employ a variety of financial instruments to proactively manage exposures related to foreign currency and commodity price, with the objective of protecting margins and ultimately cash flow. These efforts are designed to derisk our business over the inside length of a transaction cycle, which occasionally can lead to temporary P&L effects when report our financials as many of the contracts in Global Ingredients span multiple quarters.

Consumer Products accounted for $0.5 million of the decrease in gross profit as increased volumes and margins in our beverage and snacks platforms largely offset the lower sales volumes and pricing of frozen fruit, along with higher processing and handling cost reflecting our fruit inventory position. As a percentage of revenue, gross profit in the second quarter of 2018 was 10.8% compared to 12.4% in the prior year. The gross margin would have been approximately 10.6% in the second quarter of 2018, excluding the recovery of $1.2 million of previously-incurred product withdrawal costs from a third-party supplier, partially offset by start-up because of $0.7 million related to new roasting equipment in our Crookston facility. This compares to an adjusted gross margin of 12.5% in the prior year with the impact of the previously mentioned foreign exchange and commodity related items during the majority of the rate decline.

Operating income was $4.6 million or 1.5% of revenues compared to $2.6 million or 0.8% of revenue in the second quarter of 2017. The increase in operating income primarily reflects lower, nonstructural SG&A cost when compared to the prior year. For the second quarter of 2018, operating income would have been $4.5 million or 1.4% of revenue, excluding the $1.2 million recovery of product withdrawal costs, offset by $0.3 million of nonstructural costs and SG&A related to the Value Creation Plan and $0.7 million of cost related to equipment start-up as compared to a normalized operating income of $9.9 million or 2.9% of revenue in the second quarter of 2017.

On a GAAP basis for the second quarter, we reported a loss attributable to common shareholders of $5.1 million or $0.06 per common share compared to a loss of $2.4 million of $0.03 per common share during the second quarter of 2017. On an adjusted basis, we reported a loss of $5 million or $0.06 per common share compared to an adjusted loss of $0.7 million or $0.01 per common share in the second quarter of 2017.

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.

For the second quarter of 2018, we realized adjusted EBITDA of $14.8 million compared to $19.4 million during the second quarter of 2017. As Dave has already touched on, our investments in fruit pricing and the ongoing costs in the fruit platform are expected to offset productivity gains driven by the Value Creation Plan. We also expect some inefficiencies during our Crookston facility commissioning in addition to start-up costs associated with the commercialization of new SKUs in the coming 2 quarters. Taking these items into account and looking towards the back half of 2018, we anticipate consolidated revenue growth and sequential quarterly improvements in adjusted EBITDA.

For from a cash flow perspective, during the second quarter, cash used in operating activities was $34.2 million compared to $25.8 million in the second quarter of 2017. The increase in cash used reflects purchases of inventory, to support growth in Global Ingredients and the timing of this year's fruit harvest.

During the quarter, we spent $10.4 million on capital expenditures compared to $7.1 million a year ago. Spending in the second quarter focused on growth capital inside our aseptic network, completion of the build-out and system operator of Mexican frozen fruit facility and spending related to the roasting enhancements in Global Ingredients in addition to ongoing maintenance capital. We continue to anticipate CapEx of $25 million to $30 million for the full year of 2018.

Seasonally, our debt peeks over the summer months as this is when the majority of the fruit is harvested. At the end of the second quarter our total debt was $509.1 million reflecting $216.4 million net of issuance costs of 9.5% senior secured second lien notes, due in 2022, $277.3 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 $365 million.

With that, let me turn the call over to the operator to facilitate Q&A. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Amit Sharma with BMO Capital Markets.

Amit Sharma - *BMO Capital Markets Equity Research - Analyst*

Dave, let me start with the frozen fruit segment. Can you talk about the crop in California. How is it turning out to be? You said you're 85% through your price pack. Can you provide a little bit more color on what the pricing has been for you and inventory levels?

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

Sure. Yes, I think, we might have mentioned this on the previous call that the pack season had a little bit of a delayed start due to the extended fresh crop season. So the crop came delayed but then came hard, and we've been able to handle the crop. We're about 90% of the way through our anticipated receipts for the year. We expect to substantially wrap up the harvest season by the end of the third quarter. The quality of the fruits have been pretty good this year and pricing levels are fairly similar to where they were last year. So overall, we're pretty much in line with our expectations.

Amit Sharma - *BMO Capital Markets Equity Research - Analyst*

Can you also talk about the pipeline for perhaps new wins there, this is a good crop, your inventory levels are reset where you don't have to discount the product to move the inventory?

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

Yes, I think, a big part of what we're trying to do this year is rebalance our inventory and what we mean by that is basically put ourselves in a position where our supply and demand match on a crop year basis. So that's -- we're making pretty good progress against that (inaudible) for the year. Just to put that in perspective and what's kind of -- put us in somewhat of a position that we're overcoming going forward is in the prior 2 years, we actually produced just north of 50 million more pounds than we actually sold. So you can see how that obviously puts you in a position where your inventories are not balanced from a supply and demand perspective. So that's been a big focus this year. And the team has done a very good job of putting all the tools and capabilities and then the plans have executed to help us make that happen. So that's the -- put us in a good position as we go forward to have balanced inventories. On the pipeline, we've had some good success in converting sales wins, both with increases in distribution with some key accounts as well as gaining distribution with new customers. Some of that business will start shipping in Q4, other parts of that will start shipping as we go into next year. So overall, we're not where we want to be yet on this business, but we made a pretty good progress over the last quarter.

Amit Sharma - *BMO Capital Markets Equity Research - Analyst*

With that in mind, Rob, your comment about sequential improvement in EBITDA next year or next quarter in Q3. From a year-over-year basis, we still expect it to be below year-ago levels?

Robert McKeracher - *SunOpta Inc. - VP & CFO*

Yes. Obviously, we have a policy, and we're not providing exclusive guidance. But I think, what you see this quarter is our improvements in beverage and snacks went a long way to cover some of the decrease in fruit. I would expect a similar sort of thing next quarter, but perhaps not to the same extent. Last year the third quarter for fruit was a sizable third quarter by way of revenue and production pounds. So you get the efficiency inside the plants at the same time as you're getting the contribution from higher volumes. So I would expect that the trend in fruit does continue in the third quarter, and it's not really till the fourth quarter that we start to see some noticeable improvements because of the efforts both top line and bottom line. So that, in that regard help you understand some of the trendline there in CPG that's what you would expect going forward. And then inside Global Ingredients, my comments were largely focused on the delays, the 90-day delay that is inside of the other roasting equipment so that obviously would weigh a little bit on our expectation in terms of the gross margin in that segment.

Amit Sharma - *BMO Capital Markets Equity Research - Analyst*

And last one. In the GI segment, the affect penalty of $8 million and maybe $6.4 million net, would you recover that in the back half or that may extend into 2019 as well?

Robert McKeracher - *SunOpta Inc. - VP & CFO*

Yes, no. It's obviously a noticeable swing quarter-over-quarter. You should associate most of the loss this quarter as the comeback from last year's gain, rather than something that reverses into the future.

Operator

(Operator Instructions) Our next question comes from the line of Jon Andersen with William Blair.

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

On the Global Ingredients business, can you talk a little bit more about the domestic side? The status of that business and your rationalization efforts in certain grain areas. I mean, how big is that business today as a percentage of your total Global Ingredient business. Where are you in terms of rationalization of certain grains and when do you lap some of that, such that you think you could see some stabilization overall or is that just a business that continues to kind of decline over time as you refocus resources on international organic?

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

Let me kick it off Jon. I think it's fair to expect that it largely now laps the declines from the rationalization of certain varieties of soy. So I think, this will be the last quarter that really stands out and that starts to taper off in the third and going forward. Inside of that, North American piece, which is now obviously the smaller component of the overall Global Ingredients, the bigger piece being internationally-sourced organic, which is now north of 75% of what we handle is the certified organic in that segment. The go-forward focus really is on the parts of that North American business where we do our structural right to win and the investment we're making into some off the roasted snacking capabilities. So we're expecting is to gradually see over time growth as a build out that side of the platform. And really the other factor I guess in play inside of North American ingredients is we're seeing somewhat of a soft sunflower market right now. So our traditional business it's co-located with the roasting operations also processes sunflower, lot of kernel and the ingredient kind of based on sunflower products, so we're seeing that soften up as demand isn't where it once was.

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

Okay. On the commentary around the EBITDA productivity improvements of $20 million with an offset this year resulting from increased pricing investments and higher costs in frozen fruit. I guess, I'm trying to understand how to read that, is that a -- are you calling out an incremental -- like incremental investments, incremental costs, is it different than how you thought about it and communicated in the past. What should we make of that when we think about the earnings of the company, I guess, in '18 and is there any implication here for '19 as well?

Robert McKeracher - *SunOpta Inc. - VP & CFO*

Yes, I mean, in real simple terms, we remain confident in getting the $20 million of productivity, but that will be offset and potentially slightly higher than offset by the declines in fruit. So what you'll see in fruit is gross margins have deteriorated compared to the prior year and a big factor in that deterioration is the pricing that we had to concede to our customers as well as the increased costs inside the platform. So those 2 things taken as a whole, I mean that in essence is our investment in pricing. We lost distribution as we are maintaining price last year, and this year we're extending price reductions as a result and that's what is hitting the margin. So I look at the implication is certainly on fiscal '18, the productivity there, fruit and year-over-year decrease in margin there will offset it but the that doesn't mean that the structure of investment and improvement we've made in the business as a result of those productivity efforts isn't there, right? So it remains and then our focus is on improving and restoring our fruit business back to kind of first acceptable, and then after that the targeted gross margin levels. So I don't see us having long-term implication, but it certainly stands out as far as our ability to all things equal at $20 million to the P&L in 2018 fruit eat it up.

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

Okay. But you earned, let's call it $67 million in EBITDA in 2017. Are you suggesting that the $20 million in productivity improvement will completely be not, I guess, by customer investments in frozen fruit, such that, we should expect little or no EBITDA growth in '18 or '17 or are there other parts of the business that is growth in international organic, growth in beverages, growth in snacks that are accretive to earnings in 2018?

Robert McKeracher - *SunOpta Inc. - VP & CFO*

Yes, no. The fruit certainly does consume the $20 million of productivity. We are seeing benefits inside of beverage and snacks, not to a magnitude that can offset fruit, but sizable step ups there. As I look towards the time we got left, I think, that it's reasonable that we can perhaps come out ahead of last year on a net basis, but there is only half a year left in 2018. So what we are focused on is existing this year to trajectory we intended to exit out and then have a step up inside of 2019 and then 2020. So hopefully that helps to answer your question, Jon given that I don't have a policy of providing guidance.

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

Yes, it does and that helps. And then in the quarter you talked about -- at some Investor events, talked about a longer-term earnings algorithm that I think gets you to closer to $150 million of EBITDA by 2020. Is that still applicable or does that -- do we need to think about that getting pushed out a bit, given some of the issues here in the near term that you're discussing?

Robert McKeracher - *SunOpta Inc. - VP & CFO*

Yes, no. I mean, the ultimate target that I think about and that we've been public about it focusing on the 10% to 11% EBITDA as a percentage of revenue, and we still are firmly committed to, and have line of sight to achieving that, a very important job that we got in our hands in order to get there is, of course, correcting fruit. So that's the focus of the company, and we expect to see meaningful step improvements as we exit this year with the inventory position that's same or in equilibrium with the need of the business. And then new go-to-market focus that is going to help to return that business to growth, in addition to the investments that we are putting in when it comes to things like automation and investing in Mexico. So a big, big factor getting back there is definitely getting fruit back to the healthy margins that we expect from it. And then a lot of the new business wins, I guess, that I -- you heard Dave speak about in his prepared remarks, where a lot of that coming through our innovation efforts. And those innovation efforts are intended to drive revenue that is margin accretive.

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

Okay. And in the beverage business, can you talk a little bit more about the incremental capital? You talked about $22 million previously, what the incremental 12% or 13% you talked about is going to, and is this just a pure kind of capacity expansion of you're existing product lines or is there a capability element to it as well that might allow you to participate in more categories on the beverage side?

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

Yes, Jon, the incremental capital is designed to do a couple of things. First, kind of de-bottleneck our existing plants in the areas primarily in processing related issues, which will free up additional capacity and give us more flexibility to utilize our existing fillers, that's the first component. The second piece is actually adding another filler line to support both business we've already won as part of our go-to-market plans as well as give us some headroom for additional growth in the next 24 months. From a capability point of view, the project that we approved for $22 million, that project gives us some enhanced capability to make products that we currently can't produce today that are higher solid content products. We call them hard-to-batch products, which basically allows us capabilities to enter some new product categories that we don't have the capability today. And then of course, the balance of that project is adding new processing and filling capacity in the Allentown plant to support growth.

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

Okay, that's helpful. Last one from me, I guess, is on the -- well, 2 quickies. So when you talk about Crookston and putting more capability into that facility to assist with roasted snacks, where does that benefit ultimately from that show up, is that revenue accounted for within your Global Ingredients business, is that accounted for within the snack business, is it a Consumer Products sale? And then the last question I have is just on fruit and whether you are seeing any kind of trend improvement in a category. I know you have done some things with I think a natural retailer that where you kind of took more control of the offering and the merchandising of the shelf, and I think saw some decent results from that, so if you can just talk about what you are seeing some from a market perspective in frozen fruit on the retail side?

Robert McKeracher - *SunOpta Inc. - VP & CFO*

Hey Jon, this is Rob, I'll take the first question and hand it over to Dave. So you're correct, the roasting investments, the capital what we expect to come by way of revenue enhance margin, that will also show up in the Global Ingredients segment. A portion of the sale there and the effort is certainly consumer in nature, and to that extent, we leverage the consumer sales group and marketing group to help grow the business. But the facility itself resides in the Global Ingredients footprint. So its -- we reported there because of shared assets.

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

On the category trends Jon, the category as a whole for frozen fruit, it's showing some small growth overall as a category based on the last syndicated data read. But inside of that, private-label is actually starting to show some decent strength. I think, the last quarter we created, which was mid-July, I think private-label was up between 4% to 5% on a dollar basis, and I think close to 10% on a volume basis. So it looks like 1 data point doesn't make a trend, but it looks like the category has stabilized and it's starting to return to growth. We also see that private-label is growing at a greater rate than branded within the category, which is historically kind of in the norm. So I think we're getting back to some of the historical tendencies of the categories, which is a good thing. As far as -- with our retail accounts, the accounts that we've worked with that we've done some category management type work, we continue to see growth with those retail accounts. And again, it's just taking advantage of some of the insights that we gained starting this category in the consumer trends and positioning ourselves to take advantage of some of those -- the growth that comes with those trends. So overall, again, as Rob said, our plan remains the same on fruit. We know that we've got to bring accretive margin, accretive innovation to the retail customer base. We got to continue to take costs out of our supply chain and manufacturing network and we think the combination of those 2 factors will get us back to the margin structure the we planned for this business.

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

Hey, David, if I could just squeeze in one more, when you think about frozen fruit today, where it sits today and you are looking out over the next 6 to 12 to 18 months, I mean, I know when I talked to you early in the year, I sense some, obviously the disappointment with where that business was. 6 to 8 months later, now in the year, you've done a lot of work, right, I mean you've put a lot of investment at the facilities kind of taking the medicine in terms of balancing the pack plan, built -- it sounds like a more robust new product pipeline. But there are still challenges. So are you more optimistic, less optimistic, kind of stay the same in terms of your kind of your outlook, your attitude, your expectations for that business today relative to where we were kind of 6 months ago?

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

Yes, definitely more optimistic versus 6 months ago. I think 6 months ago, the kind of way I categorize it is, we feel like we found the bottom of this business and are rebuilding it from the base. And doing all the foundational things that you need to do in a business to support long-term, profitable, sustainable growth. And we've said all along in this business as a whole that this is a turnaround, it's not linear, we're going to experience bumps in the road as we go and I classify fruit as one of those bumps. But we definitely made significant improvements over the last 6 months, primarily, again, in just taking the medicine to use your term Jon, on correcting a lot of the fundamental gaps that we have in this business that we now have very good plans in place. So going forward, I think we're in a much stronger position than we've been, since I've been here to really position this particular business for growth going forward.

Operator

(Operator Instructions) We have a follow-up question from line of Amit Sharma with BMO Capital Markets.

Amit Sharma - *BMO Capital Markets Equity Research - Analyst*

A couple from me. In the aseptic beverages, 12.5% ex Costco growth, is that a good run rate for the back half and in 2019 as well, especially as you add up more capacity?

Robert McKeracher - *SunOpta Inc. - VP & CFO*

Yes, obviously, we did lose that large club accounts. So I think, it's probably not a bad run rate, I mean, in the sense that a lot of the new business we're commercializing, and it's going to ramp here and starting in the third quarter, and then into the fourth. It'd be reasonable to expect that as a magnitude that it can offset that large account that we lost.

Amit Sharma - *BMO Capital Markets Equity Research - Analyst*

Okay. And then just thinking about the margin structure, I mean, obviously 2018 EBITDA and gross margins probably need to come down vis-a-vis consensus yesterday. But as we look to '19 Dave and Rob, both, I mean, you talk about taking some of the lumps this year. If you look to '19 and perhaps '20 as well, structurally, are there any other large items on your to-do-list or are we in a position where the heavy lifting is done, and obviously, you have quarter-to-quarter volatility, but from a structural perspective anything else that's on your plate Dave, that needs to be tackled later this year or in 2019?

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

Yes, I think, from a structural perspective and as we kind of laid out this turnaround process that Phase I has cleaned it up, Phase II has tuned it up, Phase III has turned it up. I think for the most part, we're through that clean it up phase, right, in all of these businesses. And now we're definitely focused on tuning it up with the most tune up work obviously in the frozen fruit business. But that's work that we have well underway, we have good line of sight to the actions that we need to take, a lot of them we've already taken and we'll continue to build on. So I think, overall from a structural foundational point of view, I think we've done a lot of the heavy lifting. And now, it's focusing on how do we continue to refine and improve our opportunities to grow these businesses profitably across all of the business categories that we participate in. On fruit in particular, that's going to be -- it's not a 1-year fix, I mean as we look to improve the margin structure, a big piece of that improvement is going to come from automation in our facilities, improving overall supply chain optimization. And I think to be prudent in that, we're not going to take a big bang approach and try to do that all in 1 bite, we're going to face it over time. I'd say that's the business where there is still probably the most infrastructure rebuilding within our physical asset base. The rest of the businesses I think foundational are set, and capital that we're investing there will be similar to what you see as doing in both our Organic Ingredients platform as well as aseptic, we're investing capital more for a growth to support the growth of the business, and we'll continue obviously to spent maintenance capital.

Amit Sharma - *BMO Capital Markets Equity Research - Analyst*

And then just to put some qualitative framework around the discussion Dave, if we look at the gross margin, either a consolidated level or at segment level, can you provide us some visibility or a pathway to where those margins are and how far are they, within a reasonable time frame, let's say 18-month, where they could be?

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

Yes, I guess, if you want to think about maybe the destination...

Robert McKeracher - *SunOpta Inc. - VP & CFO*

I am going to guess if I start there, we're targeting a gross margin in the range of 16% to 17% as a consolidated business with consumer, of course, contributing proportionally more than Global Ingredients. If I look at where Global Ingredients is today and then obviously if you remove some of the noncash noise and other things, it's sitting around 11.4%. And so it's got kind of 100 to 150 basis points really to step up to get to where it needs to go and I do think that before the success on executing that roasting project as well as doing what we have been doing all along in Tradin, our organic ingredients business, and investing there that will certainly be there in the time frame we set out. If I move on to consumer, consumer put up I guess 12.5% if you remove some of the noise this quarter. And so it's obviously got a larger step up to get to the high-teens. And so I think what you'll see is that we're basically there when it comes to beverage and snacks with line of sight, if the fruit step up. And so I guess, I'm almost using numbers backing the same thing that Dave just said, where we don't see it as 1-year, but it's reasonable that doing the investments in fruit both this season and in a phased approach into the following season could get to that destined margin target, I think that's reasonable.

Amit Sharma - *BMO Capital Markets Equity Research - Analyst*

Got it. So fruit is further away from where you launch your target margins should be, right? And the beverages are far closer, and you see a line of sight for them to get better next year?

Robert McKeracher - *SunOpta Inc. - VP & CFO*

Correct.

Operator

I'm showing no further questions in queue at this time. I'd like to turn the call back to Mr. Colo for closing remarks.

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

Thank you, operator, and thank you all for participating on our second quarter conference call. We 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. Thank you.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program, and you may now disconnect. Everyone, have a great day.
