THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

SOY.TO - Q4 2017 Sunopta Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 27, 2018 / 2:00PM GMT

CORPORATE PARTICIPANTS

David J. Colo *SunOpta Inc. - CEO, President and Director*

Robert McKeracher *SunOpta Inc. - CFO and VP*

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 Fourth Quarter Fiscal 2017 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 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 a detailed discussion of the factors that could cause actual results to differ materially from those projections or 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 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. - CEO, President and Director*

Good morning, and thank you all for attending our fourth quarter fiscal 2017 earnings call. With me this morning is Rob McKeracher, our Chief Financial Officer. It has been just over a year since I joined SunOpta as CEO and spoke with you on my first earnings call.

In that introductory call, I laid out the 3 phases of our turnaround, highlighted our plans supporting each pillar of our Value Creation Plan and told you we had significant work to do in the first phase of this turnaround and that the first phase is the bumpiest and is where we would build the foundation for long-term value creation. We said that we would invest in our people, assets and capabilities, all while finding ways to streamline our portfolio where it makes sense in order to increase our focus on the core business.

I am pleased to report that we have done what we said we would do. In 2017, we worked hard to strengthen the foundation of our business. While this has required difficult decisions and led to significant changes across the organization, we are entering 2018 with an improved business mix and a more efficient, reliable and higher-quality production network. Additionally, in 2017, we reinvested the savings generated from our Value Creation Plan into the talent and infrastructure necessary to drive the long-term growth and profitability at SunOpta.

As I had previously stated, our goal is to create sustainable long-term shareholder value. There is still work to be done, but we have begun to see the benefits of our efforts, even if they are not readily apparent in our financial results to date. We are still in the first phase of the turnaround, however, we have a good line of sight on the transition to the second phase, during which we will begin to realize the benefits of our productivity initiatives and drive revenue growth to our go-to-market effectiveness efforts.

A driver of our confidence is the growing sales opportunity pipeline reflecting early success under the go-to-market effectiveness pillar. We continue to add to the pipeline across the Healthy Beverage, Healthy Fruit and Healthy Snack categories and are entering the new year with a strong book of business in our international organic ingredients portfolio.

Adding to our confidence, we are beginning to see the pipeline convert, including new sales wins in private label non-dairy, conventional and organic orange juice and fruit wins into the food service and industrial channels. During the fourth quarter, we continued to make progress against all 4 pillars of our Value Creation Plan. We have substantially completed the exit of our pouch and bar operations and announced an investment in our roasted snacks operations, including the consolidation of facilities. We continued to implement additional food safety and productivity initiatives, we are increasingly realizing the benefits of our enhanced go-to-market efforts, and we added additional new talent across the organization.

I am pleased with the impact the Value Creation Plan has had on our business performance. With the exception of our frozen fruit platform, we saw increased gross margins across all of our businesses during the fourth quarter, reflecting our portfolio optimization and operational excellence efforts. We feel good about where the businesses are today. Unfortunately, these improvements are being masked by the underperformance of fruit, which I will discuss in a moment. However, across the remainder of our business, we are well positioned heading into 2018.

Let me recap the highlights of the fourth quarter. Total revenue declined 1.7% as reported, but was essentially flat, excluding the impact of changes in commodity prices, foreign exchange and sales related to our bar and pouch product lines. In the Global Ingredients segment, we reported a 1.8% year-over-year revenue decline. The decline was driven by lower sales in the domestic sourcing and supply operations, partially offset by growth internationally and across the organic sourcing platform. However, the declines in domestic sourcing and supply reflect our efforts to shift to more value-added roasted products. While domestic sales are down, both gross margin and gross profit dollars are up year-over-year.

Gross margin in the organic platform is also trending in line with where we expect the business to perform, while we are still in the commissioning phase of our portfolio enhancement projects related to organic cocoa and organic sunflower oil.

As we have repeatedly noted, maximizing revenue was not our goal in the first phase of the turnaround. The improved gross profit dollars on reduced sales domestically is evidence that our efforts are working.

Turning to Consumer Products, we generated improved results with the exception of frozen fruit. There was good growth in healthy beverage, driven by 2% growth in aseptic and 24% growth in premium juice. The efforts under our go-to-market effectiveness pillar are beginning to positively impact aseptic volumes, and we are optimistic about the pipeline of sales opportunities.

Aseptic utilization is up in Q4, and we are now evaluating alternative work schedules and other changes to support the growth we are anticipating if we are successful in converting a portion of our sales pipeline. Despite the loss of a significant private label non-dairy contract that stopped shipping in April of 2017, that we have discussed on previous earnings calls, we were able to increase aseptic volumes during the quarter, which adds to our confidence in delivering growth in 2018.

We believe our Q4 performance is evidence of a turnaround taking shape in beverages. Our Healthy Snack sales were down as expected given our exits of both resealable pouches and nutrition bars. However, our fruit snacks revenue was up 10% during the quarter and was up 7% for the year.

Before I provide an update on the Value Creation Plan, let me address frozen fruit. In the fourth quarter, sales declined 4% in the Healthy Fruit platform and were virtually flat, if we exclude price variances. IQF fruit shipments were down, while industrial ingredient sales increased. However, the results came in below our forecast, and gross margins were significantly below our expectations.

As we have noted, the category has been in a state of modest decline as evidenced by the latest syndicated data as of January 27 for the most recent 12- and 4-week periods with declines of 2.2% and 0.8%, respectively. Earlier in the year, we held pricing to protect margin as we worked through higher cost inventory. This impacted our competitive position in volumes. During the fourth quarter, we reduced pricing, resulting in increased pressure on gross profit, which, as I noted, is masking the improvement across the rest of the business. Going forward, we are taking action to rightsize our pack plan for 2018 relative to our forecasted demand. This will include lower purchases of fruit in 2018, allowing us to work through the unfavorable inventory position we have held during the past year. We will also leverage our procurement and processing capabilities at our Mexican facility, where we are nearing completion of a project to add retail bagging capabilities that will allow us to ship directly to customers. We are also planning to utilize the most cost-effective combination of our California-based facilities as we process a reduced strawberry crop versus last year.

As we enter 2018, we have been focused on building a pipeline of sales opportunities, rebuilding relationships with key customers, developing opportunities with new customers and working on the most effective assortment, merchandising, pricing and innovation strategies. We believe the combination of these efforts will allow us to stabilize and return this business to growth over time.

Now let me turn to an update on the Value Creation Plan. As we have discussed over the last few quarterly calls, 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 at 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 plant utilization and improved profitability.

Our portfolio optimization efforts included the progress we made exiting both our flexible resealable pouch and nutrition bar operations. We have substantially completed each business exit. As I mentioned, we have shifted our domestic sourcing and supply operations toward an enhanced focus on roasted snacks. During the fourth quarter, we announced a significant investment to expand our roasted capabilities in our Crookston, Minnesota facility, which also involves a facility closure. The new equipment and enhanced capability is expected to come online in the third quarter of 2018 and will support further growth of a variety of roasted grain, seeds and plant-based snacks.

We are also nearing completion of the expansion project to add incremental freezing capacity, storage and retail bagging capabilities to our Mexican frozen fruit facility. As discussed, this project is expected to drive incremental cost savings in addition to enhanced profitability from retail bagging capabilities and will support diversification of fruit varieties sourced from Mexico.

We have also begun commissioning the expansion project to add a second roasting and processing line at our organic cocoa processing facility in Holland, doubling processing capacity in addition to adding new capabilities. We also began commissioning the new organic sunflower oil processing line at our Bulgarian sunflower facility.

Since the initiation of the Value Creation Plan, we have now implemented portfolio changes expected to yield $7.9 million of annualized EBITDA benefits. The focus of the 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. I remain pleased with our progress to date. We will continue to focus on and increase our diligence in becoming the leader in food safety and quality across the healthy food industry.

At the same time, we continue to identify and implement cost-savings initiatives to increase productivity in our manufacturing operations and lower procurement and logistics costs. During the fourth quarter, we continued to advance food safety and quality efforts across the entire manufacturing footprint, including a new partnership with a third-party sanitation firm. Additionally, the SunOpta 360 continuous improvement program has been deployed across the company's aseptic platform, targeting a 20% improvement in output from existing aseptic lines in 2018.

As I discussed when addressing frozen fruit, we have taken steps to rightsize the incoming 2018 crop, which is expected to reduce storage costs and lower working capital and operationally better prepare the business for the start of the upcoming California fruit season. The rollout of new sales and operations planning tools is facilitating this improved business plan.

Further, we are working with growers to enable additional fruit varieties to be sourced from Mexico, allowing procurement of lowest cost sourcing alternatives. We also continued to upgrade talent in plant leadership across the network of manufacturing operations, with approximately 40% of locations now employing new leaders. Since the initiation of the Value Creation Plan, the company has implemented process improvements and cost savings expected to yield $6.9 million of annualized EBITDA benefits.

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 we discussed last quarter, we have continued to grow the pipeline of future commercial opportunities across the Healthy Beverage, Healthy Snack and Healthy Fruit categories. We picked up new sales wins in private label non-dairy beverage into the natural and mass channels as well as continued growth through innovation into the broadline food service channel, leveraging our non-dairy control label.

We also expanded distribution of private label organic and conventional juice and had new sales wins in frozen fruit, serving mainly the food service and industrial channels, as well as commercialization of new custom fruit ingredient formulations and in contract manufactured fruit snacks. We continued to experience strong reorders of innovative private label broth, both organic and conventional, into the club and mass channels on products launched earlier in the year.

As I previously stated, we are also entering the new year with a stronger book of business in our international organic ingredients portfolio versus the prior year and expect the growth of organic ingredients to continue as consumer trends support increased consumption of organic foods.

Since the initiation of the Value Creation Plan, the company has implemented go-to-market improvements expected to yield $1.2 million of annualized EBITDA benefits. As we have noted, we continue to expect revenue growth in the back half of 2018, as a result of these efforts and our growing sales opportunity pipeline.

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 and value captured from the Value Creation Plan. During the fourth quarter, we made progress on the ERP implementation project at the Mexican frozen fruit facility and expect the new system to be operational during the second quarter. We revamped the process and tools used for sales and operations planning that we noted in our discussion of frozen fruit with continued focus on customer service and working capital levels.

We also hired a new internal audit leader, shifting the focus of the audit function towards value-added business process improvements that are designed to support and ensure the company sustains improvements made as part of the Value Creation Plan. Several enhancements have made -- have been made to the key performance indicators that we use to measure our business, including a more robust customer relationship management tool that provides transparency to our sales opportunity pipeline.

For fiscal '18, we also established an objectives, goals, strategies and measurement program that clearly defines our key priorities and has been cascaded throughout the company to ensure alignment in individual accountability at all levels of the organization. We are on track with all of our Value Creation Plan initiatives and look forward to updating you on our continued progress.

I will now turn the call over to Rob to go through the fourth quarter financial results. Rob?

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

Thanks, Dave. I'll take you through the rest of the key financial statistics as well as balance sheet and cash flow metrics for the fourth quarter. As Dave mentioned, fourth quarter revenue was $292.4 million, a 1.7% year-over-year decline as reported, but up 0.2%, 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 are being wound down.

The Global Ingredients segment generated revenues from external customers of $130.3 million, a decrease of 1.8% compared to $132.6 million in the fourth quarter of 2016. Excluding the impact of changes in commodity-related pricing and foreign exchange, revenues in Global Ingredients decreased 3.5%. The decrease in revenue reflected lower volumes of domestically sourced specialty soy and corn products, partially offset by higher volumes of organic cocoa, nuts and dried fruit as well as roasted grains and seeds. The Consumer Products segment generated revenues of $162.1 million during the fourth quarter of 2017, a decrease of 1.7% compared to $164.9 million in the fourth quarter of 2016. Excluding the impact of commodity prices and removing the bar and pouch lines of business, revenues in the fourth quarter increased by 3.4%. As Dave mentioned, the increase was largely driven by refrigerated juice and aseptic beverage products as well as fruit snack sales.

During the fourth quarter of 2017, sales of frozen fruit were essentially flat to prior year after adjusting for the impact of lower commodity prices, representing continued declines in retail sales, offset by increased food service and industrial sales.

Consolidated gross profit was $28.3 million for the fourth quarter of 2017 compared to $17 million for the fourth quarter of 2016. As a percentage of revenues, gross profit for the fourth quarter of 2017 was 9.7% compared to 5.7% in the fourth quarter of 2016. Excluding the impact of $1.3 million in costs associated with inventory write-downs related to our exit from the bars and pouch lines of business, adjusted gross margin for the fourth quarter of 2017 would have been approximately 10.1% compared to 8% in the fourth quarter of 2016. Adjusting further, if the bars and pouch lines of business were removed entirely from both years, the normalized fourth quarter 2017 gross margin would have been 10.7% compared to normalized gross margin of 9.1% in the fourth quarter of 2016.

In Global Ingredients, during the fourth quarter, we realized gross margin of 11.7% compared to 7.3% in the prior year. The prior year gross margin would have been 9.6% after adjusting for inventory reserves recognized at the end of 2016 and the estimated impact of the sunflower recall. This 210 basis point increase reflects improved performance in domestic ingredients as a result of portfolio optimization decisions, made as part of the Value Creation Plan, as well as growth and the impact of a strengthening euro on purchases inside our international operations. This benefit was partially offset by foreign exchange losses that are not presented as part of cost of goods sold on our consolidated statement of operations.

In Consumer Products, during the fourth quarter, we realized gross margin of 8% compared to 4.5% in the prior year. The prior year gross margin would have been 6.8% after adjusting for inventory reserves, the impact of purchase accounting and other costs recognized at the end of 2016. Adjusting further, if the bars and pouch lines of business were removed entirely from both years, the normalized fourth quarter 2017 gross margin would have been 9.8% compared to normalized gross margin of 8.7% in the fourth quarter of 2016.

This 110 basis point increase in margin reflects significant improvement in the beverage and fruit snacks operations, driven by productivity initiatives within our Value Creation Plan, which has resulted in lower costs and increased production efficiencies.

As Dave mentioned, these improvements were partially masked by weaker frozen fruit margins. The frozen fruit performance reflects lower-than-expected sales, due in part to an extended decline in consumer consumption trends, which led to lower production and in turn high inventory levels.

As a result of our inventory position, we recognized inventory reserves and experienced higher storage and handling costs during the fourth quarter, totaling approximately $2.5 million. As noted, a key focus area in 2018 will be rightsizing our fruit inventory levels to our current forecasted demand, which is expected to reduce storage and inventory obsolescence costs as well as working capital. The benefit of this effort will start to materialize in the second half of fiscal '18.

Also, in response to the unfavorable operating performance in frozen fruit and the extended period of market and sales uncertainty, during the fourth quarter of 2017, we recognized a noncash goodwill impairment charge of $115 million.

For the fourth quarter, we reported an operating loss of $3.9 million compared to $10 million in the fourth quarter of 2016. The operating loss in the fourth quarter of 2017 would have been $1.1 million, excluding $2.1 million of nonstructural SG&A costs and other costs related to plant closures, all incurred in relation to the Value Creation Plan, as well as a $0.5 million gain from the reversal of previously recognized share-based compensation expense as compared to an adjusted operating income of $0.5 million during the fourth quarter of 2016.

On a GAAP basis, for the fourth quarter, we reported a loss from continuing operations of $117.5 million or $1.38 per common share, which includes the goodwill impairment compared to $33.5 million or $0.41 per common share during the fourth quarter of 2016. Fourth quarter results include several charges and gains that are not reflective of normal operations and have been excluded in calculating adjusted earnings. These items include $4.5 million after tax of costs primarily related to the Value Creation Plan, reflecting facility closure costs and associated inventory write-downs, asset impairment charges, third-party consulting, employee termination and recruitment costs as well as the previously mentioned $115 million goodwill impairment charge and the effect of $8.9 million in discrete tax gains, due largely to the recent tax reform in the U.S.

For the fourth quarter of 2017, we reported an adjusted loss from continuing operations of $8.8 million or $0.10 per common share compared to $7.3 million or $0.08 per common share in the fourth quarter of 2016. For the fourth quarter of 2017, we realized adjusted EBITDA of $9.4 million compared to $9.4 million during the fourth quarter of 2016. Excluding the bars and pouch lines of business in their entirety, adjusted EBITDA for the fourth quarter of 2017 would have been $10.1 million compared with $11.3 million in the prior year.

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, along with tables breaking out the impact of bar and pouch lines of business.

From a cash flow perspective, during the fourth quarter, cash provided by operating activities was $48.9 million compared to $36 million in the fourth quarter of 2016, an increase of $12.9 million. The strong operating cash flow in the fourth quarter reflects our seasonal drawdown in working capital, due mainly to the timing of the fruit harvest in Q2 and grain crop changeover in the fall.

Cash used in investing activities was $16.8 million during the fourth quarter compared to $7.5 million a year ago. The increase in cash used reflected elevated capital expenditures, due in part to the buyout of leased assets associated with our exit from the pouch line of business. During the fourth quarter, we also drew an availability inside our first-lien asset-based credit facility to pay down $7.5 million in outstanding principal on our second-lien debt.

For fiscal year 2017, we generated cash from working capital of $19.6 million compared to cash used to finance working capital of $12.9 million in 2016, representing a $32.5 million year-over-year improvement. As previously mentioned, one of our key focus areas is to level set the inventory inside the fruit platform to the current forecasted demand.

For 2018, from a working capital demand standpoint, we expect a minor increase in working capital, mainly inventories, which would reflect lower fruit inventory, offset by increased raw materials, primarily in Global Ingredients in order to support expected growth in that business.

Also looking ahead to 2018, we expect to spend between $25 million and $30 million in capital expenditures, mainly in support of growth and productivity initiatives inside the Value Creation Plan as well as ongoing maintenance capital. From an interest perspective, we expect to incur cash interest of approximately $30 million, which does not include the quarterly dividend of roughly $1.7 million on our Series A preferred stock nor approximately $3 million in noncash interest expense.

From a tax standpoint, following the recent tax reform in the U.S., our normalized effective tax rate moves from approximately 30% down to 24% to 26%. At the end of the fourth quarter, total debt was $462.1 million, reflecting $215.8 million net of issuance costs of 9.5% senior secured second-lien notes due in 2022, $230.5 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.

Under the global credit facility, we are bound to incurrence covenants only and subject to excess availability, we are not required to maintain or report monthly financial ratios of any kind. At the end of fiscal 2017, we had approximately $60 million of available capacity within our operating credit facilities.

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 Jon Andersen with William Blair.

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

Wanted to start with frozen fruit. If you could talk a little bit about consumption. I know that's one of the issues that the category -- or you're experiencing in the category right now. What have you seen more recently in terms of consumption trends? And what are your expectations as you look to the balance of kind of 2018? And are there specific levers that you feel you can pull as the private label market share leader in the category to drive better performance as we move through the year?

David J. Colo - *SunOpta Inc. - CEO, President and Director*

Sure, Jon. This is Dave. So I think the consumption trends, as we quoted, that the overall category is still showing decline. It's down about 2% roughly as a category in the last reported periods. One of the things that we spoke about previously is that some -- the issues affecting the category, in general, is more prevalent supply of fresh fruit in the perimeter of the stores. And that's a trend that realistically we don't see going away. So I think the levers that we're going to be pulling as we go forward here are really focused around making sure that we've got the right category management approach to support our retailers in the frozen fruit space. So what I mean by that is, we're working on what's the proper assessment, the proper merchandising plans, the proper pricing and what's the proper innovation formats to be bringing to the category. We think the combination of those factors will help stabilize and return the category to growth. The primary fruits that are consumed in IQF, historically, have been strawberry and blueberry. And what we're seeing is, there are signs of growth within the category, specifically, around organic fruits as well as fruits that are not as common, if you will, as a strawberry or blueberry and maybe require more effort by the consumer at home to prepare. So thing such as tropical fruits, mixed blends, smoothie blends, things of that nature. So our focus is going to be not walking away, if you will, from the core fruits in the category but augmenting them with more innovation around the fruit types that we see growth in, particularly around organics, blends and more ease of use, if you will, in convenience items for the consumer in home.

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

Can you talk a little bit about the decision to lower prices? I think in the third quarter, there may have been some volume loss at, at least one customer. Talk a little bit about the kind of the pricing strategy in fruit, it sounds like you did lower prices. And have you seen a stabilization in your volume trends or customer base at retail? Or has there been additional kind of market share shift that prompted that response?

David J. Colo - *SunOpta Inc. - CEO, President and Director*

Yes. I think as we've talked about before, this has been a kind of a transition year, where you're coming from the 2016 crop that was a higher cost crop into the 2017 crop that was a lower cost crop, specifically related to strawberries. And we had a long position as we were coming into the new crop for 2017. So basically we held pricing to work through that higher cost inventory. As a result of that, we lost some distribution with some customers and recognized that you can only hold pricing for so long as you try to work through those long inventories of higher cost. And that's ultimately what led us to start taking pricing down, was to prevent further loss in distribution and really position ourselves to be competitive in the marketplace, reflective of the lower cost of the crop that came in, in 2017. So that's the correction that you've seen us make here in the last half of Q3 and Q4. That put some margin pressure on the business. As we go into 2018, we're doing a much better job of putting in an S&OP process so that we understand what's our carry-in position as we go into the new crop of this year, what's our forecasted demand look like for the business so that we don't overprocure fruit and put ourselves in a long position similar to what we were in, in the prior year. So we had a lot of focus on improved processes to make sure we rightsize the inventory relative to our forecasted demand, not only on strawberries but with all other fruit that we procure to support our business. So I think we're going to be in a much better position as we go throughout the year, rightsizing inventories, making sure that we have a cost structure that's competitive with the market and then take pricing actions and some of the other actions I mentioned, Jon, relative how we think we can return this category to growth.

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

That's really helpful. A couple more on fruit. How quickly or how soon will you be ready to stand up the new bagging operation in Mexico? And then the ability to source more fruits from Mexico and do tropical blends? What kind of time frame are we talking about before that's up and running and you're able to kind of ship and we see products on shelf using that distribution method and/or those new varieties?

David J. Colo - *SunOpta Inc. - CEO, President and Director*

Yes. The Mexican retail bagging operation is going through commissioning currently. So we plan to bring that online in basically the start of April of this year, so in the very near future. And we'll have retail bagged items shipping from Mexico in Q2 of this fiscal year. Our additional sourcing of different fruit varieties in Mexico, we've laid out a 5-year plan for that. And as each year goes by, we'll be sourcing more fruit types and more pounds of each fruit type. We've already started that process. So this year, as an example, we'll be sourcing mango, blueberries, blackberries, et cetera from Mexico. It starts out with small volumes as we build a grower base, and then it grows over time. So that's a multiyear effort to expand the varieties that we can procure from Mexico and then expand the volumes of those varieties as well.

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

Great. On the EBITDA -- productivity-driven EBITDA enhancement target, that's $30 million by the end of 2018, I guess, there were, somewhere in the neighborhood I think of $10 million of nonstructural costs this year. And I know there were other things happening in 2017 that masked some of the underlying improvement that you were able to get. Should we be thinking about 2018 as a year where we see a nice step up in the underlying EBITDA of the company to the tune of kind of $20 million based on the productivity target and the absence of some of the nonstructural costs, I guess $20 million of nonstructural costs? Or does the fruit dynamic here kind of set that back. I know you don't provide guidance, but just trying to kind of quantify or triangulate how to think about '18 in the context of what we just saw in 2017?

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

Sure. Jon, it's Rob. I'll take that. Our target as far as the first phase of Value Creation Plan, the $30 million, which is added -- is now actually closer to $33 million, given some of the additional portfolio decisions we made, still keep that $20 million in your 2018 target intact. And so we continue to implement additional issues. And really in 2018, you will hear that it mainly comes out of the operational excellence pillar. That's the one that's got the most left to deliver, if you will. But that $20 million is intact. If you look beyond the $20 million in terms of puts and takes in the business, there is some rollover of SG&A that comes up a little bit to sort of get to the full run rate of our investments that we made this year. But then looking beyond that, I think it'd be fair to expect, and I think it was in the prepared remarks, we're expecting back half revenue growth. And so I think it's kind of a situation where we've got really good things, improved margins and growth in all parts of our business really with the exception of fruit, as Dave mentioned. And that's going to kind of stand out, it would be fair to expect it to stand out in the first half, but by the time we get to the second half, start to see more cylinders in the engine going and sort of overcoming that first half headwind a little bit. So we don't give guidance, but I think the way you've asked the question, and certainly our productivity is intact, kind of leaves folks hopefully with some line of sight as to what we're seeing the trend line look like over 2018.

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

Two quick housekeeping questions. The impairment charge in the frozen fruit business, what impact does that have on annual kind of DNA? In other words, how much do we need to reduce kind of the add back to EBITDA for that write-down?

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

It was a goodwill impairment charge, which goodwill subject to annual review. I doesn't bear with it any amortization. So no impact on ongoing G&A. It's literally just taking $115 million off of that balance in the balance sheet.

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

Great. That's helpful. Let's see, I had one more. Well, I'll come back and get back in the queue.

Operator

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

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

Rob, a very quick one. The $2.5 million excess cost in the frozen fruit, are you expecting more of those excess costs as a regular inventory write-down or excess warehouse-related cost in the first half as well?

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

Yes. The part that will certainly continue here until we can get rightsized is excess storage, right. So obviously holding more pounds of frozen inventory, we're incurring more storage costs on that, a little bit of handling. So I do expect that to continue in the first half. As we get past the point where we've done our 2018 berry harvest, that's when you can start to see it subside and the level of our stock relative to the demand plan be more in sync.

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

So similar magnitude of impact in the first half to what we saw in the fourth quarter?

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

It should be a little bit less. I'm not anticipating as much on the obsolescence inventory write-down side, if you will. But certainly, storage, handling, those will continue. So I'd scale it back a bit in the first half at a quarterly run rate, but it will still be there.

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

Got it. And then Dave, you did say that you passed the higher cost inventory in frozen. So just to confirm that, so now the inventory that you're holding, the cost structure or cost base of that, is reflecting the lower strawberry prices that we saw in 2017?

David J. Colo - *SunOpta Inc. - CEO, President and Director*

Yes. For the most part it is, it's there. What -- so the cost base is more in sync with where our sell price is, but the cost profile of the business, obviously, as we just discussed, is not.

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

Sure. Absolutely. And then as we look forward, David, and then you talked about looking at your California cost footprint. Can you talk about that a little bit? If you do decide to reduce your footprint in California, what does it do to your cost structure in this business? And then how much of that is reflected in your current cost-saving goals under the Value Creation Plan?

David J. Colo - *SunOpta Inc. - CEO, President and Director*

Yes. I think the -- as we look to go into this crop and run less pounds that we ran in the prior year, what I meant by the utilization of our facilities is that we obviously have more capacity than we're going to need to process the crop this year. So basically, we're going to run -- we have 3 primary facilities in California that process berries. Last year, we ran all 3. This year, we'll definitely run 2 of the 3 with probably a limited amount of pounds potentially to go through the third facility. So that's what I meant by kind of rightsizing and cost optimizing the footprints this year. As we go forward, we constantly look at network optimization and are we producing the products in the right locations. With the investments we're making in our Mexican operations over time, we can definitely see a trend where we would grow and source and produce potentially more product coming out of our Mexico facility, which would also have an impact on how much we process out of California. That's going to be more of a 2- to 3-year transformation as opposed to just this year, Amit, but that's kind of directionally how we see this playing out.

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

And just if you can give us any indication of what does that do to your cost structure or the margin structure as you moved from a higher cost facility to a lower cost one?

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

Yes. I mean, it obviously improves. I think the -- one of the most important things that we're talking about here is also diversity of where we're getting the product and diversity of our footprint. We don't want to have, certainly, all of our eggs in the California basket or in all the Mexico basket. So if you think about where the fruit is coming from and the fact that in California, there is always shifting in where the acres exist. Could it be -- it's a meaningful benefit to margin, obviously, to be more balanced through Mexico, but we're not going to -- there is not a single solution here. It's very much a spread and diversify your growing region and your footprint to maximize (inaudible).

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

No, that's fair. And the last one is on Mexico. NAFTA, is that an issue if the NAFTA tree does fall off? Does it do anything to your cost structure there?

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

I mean, it's -- TBD, I guess, would be the answer. It certainly depends on if that does take place, what would happen to the cost base. But again, kind of going back to my previous comment, for that reason, we don't want to be overly exposed to any one jurisdiction here. NAFTA is not going to cause more fruit necessarily to be planted right away. So we want to make sure that we've got a good balance and a good footprint as to where we both get the raw materials and process them. So it's -- I don't have an answer yet until we will learn more about where those negotiations land.

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

All right. And then just one more, on the aseptic business. Dave, you did talk about picking up new volumes. Just remind us, so you will lap Costco loss in April, right? Where is the utilization now? And just on that lost business as well, have you had any conversation with them in terms of is there a path back for you to get back into at least that retailer as well?

David J. Colo - *SunOpta Inc. - CEO, President and Director*

Yes. I think in Q4, our utilization across the aseptic network increased from the mid-50s to the mid-60s. So we're at about, in Q4, around 65% utilization. As we look at the opportunities we have in our sales pipeline, I mentioned in the prepared remarks that if we're successful in converting a portion of the sales pipeline, we're really going to be in a position where we're looking at putting those facilities on alternative production schedules to support the anticipated growth, which obviously -- that would provide good news and help from a cost structure point of view as well. So we're optimistic about what we see in the beverage business. Particularly as it relates to the loss business in the club channel, we've definitely been having conversations with that specific retailer, with our new sales team that's in place, all of the new capabilities that we're bringing to bear. We do have good growth occurring in that channel with our organic juice business, our conventional juice business. We've launched some broth items into the channel, and we're having ongoing discussions about ways to help bring growth back to the non-dairy aseptic product category within club as well. So we're working hard at it, and we're making good progress.

Operator

We have a follow-up question from the line of Jon Andersen.

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

Your FX loss was up $3 million, I think, that's embedded in -- or captured in SG&A. Can you talk a little bit more about what that consists of and what your expectation for that is going forward based on, I guess, your credit hedge positions and some of the currency moments, because that seemed like a pretty big increase year-over-year that affected EBITDA in the quarter?

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

No. You're bang on there, Jon. That FX loss, and in my prepared remarks I'd indicated, that's not obviously included in gross margin. But fundamentally, the majority of that is us taking action, if you will, to protect our margin as it relates to us buying products generally in U.S. dollars and having exposure when we sell into euros. And so the way to really to think about that is, the large loss in the fourth quarter reflects the significant swing in the euro relative to the U.S. dollar. And it really reflects kind of mark-to-market losses on the forward currency derivatives, the protection that we put in place, which from a modeling perspective, if you will, you should really just think about that going forward as an offset to margin. And so you get some of the benefit in the gross margin line, and there's some of the loss in the FX line side. Accounting rules require you to value your derivative instruments and put them on that line called foreign exchange. But the reality is what we're doing is, we're taking away foreign exchange exposure, if you will, in our supply chain as we buy and sell in different currencies.

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

Okay. One other quick one for me. The bar and pouch exits, are those fully complete now? What was the full year EBITDA drag from those? And do we start now with kind of a clean sheet in '18?

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

They're substantially complete. And so substantially complete basically means that, as we work to build inventories to enable the customers of those businesses to properly transition to new suppliers, there is a very small amount of sell-through that would happen, likely be done by the end of the first quarter here, you're talking $2 million to $3 million, likely not -- not been revenue and then no real margin impact expected there. In terms of what's left, there is the wrap up, there is the closure costs, that there will be some of that coming through likely in the first quarter as it relates to us finally vacating that bar facility in Carson City, which I would expect the majority of that to be reported outside of EBITDA. So there's a little bit of trailing cost that we just couldn't recognize in the fourth quarter and that will come through as we finally complete those actions. But substantially complete is probably the best way I'd refer to that. From an EBITDA perspective, if you go towards the back of the press release that we issued this morning, in the non-GAAP tables, we've got a column in our EBITDA reconciliation that highlights the EBITDA drag from those 2 businesses, both for the quarter and the year, in an effort to provide users of these financials, what would the business have been without all bars and pouch. So if you go to the back, it was EBITDA of $5.8 million for the full year related to bars and pouch.

Operator

And that concludes today's question-and-answer session. I'd like to turn the call back to Mr. Colo for his closing remarks.

David J. Colo - *SunOpta Inc. - CEO, President and Director*

Thank you, operator, and thank you, all, for participating in our fourth quarter conference call. Before we close, let me remind you of what we will do. We will focus on food safety, quality and execution. We will be focused and decisive as we execute our strategic plan. We will focus on long-term value creation, and we will make decisions with a long-term focus, even if those decisions do not maximize near-term earnings. 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

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.
