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SOY.TO - Q3 2017 Sunopta Inc Earnings Call

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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*

Christopher Walter Krueger *Lake Street Capital Markets, LLC, Research Division - Senior Research Analyst*

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

PRESENTATION

Operator

Good morning and welcome to SunOpta's Third 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 detailed discussion of the factors that could cause actual results to differ materially from those projections and any forward-looking statements made during the presentation to reflect future events or circumstances except as maybe required under applicable securities laws.

Finally, we would also 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 for joining us. Joining me today is Rob McKeracher, our Chief Financial Officer. This quarter, we continue to make progress against all four pillars of our value creation plan including further refinements to our portfolio with the announced exit from nutrition bar products, the implementation of additional food safety and productivity initiatives, intensified go-to market efforts which are beginning to add meaningful future opportunities to our sales pipeline while also winning selective new pieces of business and added key new talent at the plant and executive levels to further build out and sustain our improvements. Let me provide you with an overview of our third quarter business performance followed by a more detailed update on the value creation plan then I will turn it over to Rob to walk you through the financial results in more detail. As a reminder, we are still in Phase 1 of our transformation, therefore, most of the actions we have taken as our product portfolio through divestitures, rationalizations, category exits and margin improvements are not increasingly apparent in our current and near-term revenue levels. Recall, revenue growth is not the near-term focus; rather, we are ensuring w operate in categories where we have the right to win with pricing and promotional levels that allow us to build a foundation from which to grow. Nonetheless, we have had good success particularly during the third quarter building the pipeline of future sales opportunities. Of course in our industry there is a relatively long lead time for converting the pipeline of opportunities into sales.

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As a result, we expect to see tangible results from our enhanced sales activities during 2018 and a true reflection in the back half of 2018. We are committed to making the difficult short-term decisions as we lay a solid foundation for the future. We have always said our journey will not be linear and this quarter was an example of that as we had disappointing financial results during the third quarter.

Adjusted EBITDA for the quarter was $19.1 million which is relatively consistent with the second quarter. EBITDA margin improved 20 basis point sequentially. However, some of our productivity enhancements, to date, were not apparent in our margins as a result of the continued impact from bars and pouch performance and lower sales volumes. The under performance in gross profit relative to our internal targets was partially offset by a reduction in short-term incentive accruals which shows up as the reduction to SG&A. We generated gross margin of 11.8% on an adjusted basis, a decrease of 50 basis points compared to the prior year period and below the second quarter level. We remain on track with our productivity enhancement activities for the full year. However, the lower sales volumes have impacted utilization in many of our implemented productivity enhancements are being applied against a lower level of volume which negatively impacts the dollar realization of the enhancements in the near-term. With the pipeline of future sales opportunities building, we are confident we will see margin flow through as volume increases over time.

For example, in the consumer product segment, our normalized margins are holding despite the lower volume in both aseptic beverage and frozen fruit when compared to the prior year which illustrates that our cost reduction of productivity initiatives are taking hold. As our revitalized go-to market strategy gains traction in 2018, we expect the incremental margin on new revenues to be above our corporate average as we leverage our fixed cost and realize the benefits of our value creation plan.

During the third quarter we generated revenue of $320.7 million compared to $348.7 million last year representing an 8% decline. The decline reflected the lower volumes in aseptic beverage and frozen fruit as well as the impacts of product rationalizations including the wind-down of pouches that began during the third quarter. In healthy fruit, while we maintained revenue levels on the food service and ingredients side of the business we experienced some declines in retail as we positioned the business to maintain acceptable margins while transitioning from last year's field fruit pricing to new crop pricing. In addition, the healthy fruit platform continued to face headwinds from flat to declining consumption trends due in part to a price gap between frozen and fresh. Furthermore, we also compared to an exceptionally strong third quarter last year when a shortage of fruit supply early in the year contributed to a jump in volume during the third quarter as availability increased. The same shortage in supply is what gave rise to higher field prices in 2016 that were ultimately passed on to consumers and impacted consumption.

For example, last year during the third quarter we were raising prices when the category was still growing. This year we are taking prices down as the categories weak. Based on the syndicated data for the period ended October 7, on a dollar basis, the category is down 2.7% and 2.8% for the 12 and four week periods respectively. We are continuing to invest significant resources into our healthy fruit operations focused on broadening supply, enhancing food safety, improving manufacturing efficiencies and bringing innovation to fuel growth all aimed at ensuring we remain the highest quality and lowest cost solution for our customers.

In healthy beverage, we experienced sales declines year-over-year driven by the impact of a contract expiration with a private label, non-dairy customer in April and lower volumes due to timing with the large food service customer. As a result, utilization of our aseptic facilities was roughly 50% which pressured our gross margin. However, we remain an important supplier to our aseptic customers and we anticipate volumes with our existing customers will improve from current levels.

Additionally, we continue to be encouraged by the pipeline of new future sales opportunities particularly through expansion into adjacent categories such as broth allowing us to leverage our current asset base, capabilities and resources towards penetrating a billion dollar and growing product category. We have already had a couple of wins with good initial reorder rates and are working to further build the pipeline of future sales opportunities for 2018.

Healthy snack sales increased 1% as reported and it was up 13% on an adjusted basis normalizing for the impact from our decisions to exit pouches and bars. Profit performance continued to be impacted by our pouch and bar operations which collectively were a $1.2 million drag on adjusted EBITDA during the quarter. Finally, global ingredients generated 2.4% growth. Solid sales growth in international markets was partially offset by a decline in domestic sourcing and supply. We are pleased with the strong international trends and continue to invest in international processing capacity for both cocoa and sunflower and a focus on identifying new organic sources of raw materials to bring to market.

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Domestically we ended the quarter with a strong month led by recent wins in roasted snacks serving both the food service and retail channels. We continue to see organic and specialty ingredients as well as roasted snacks as key areas of the business that SunOpta is uniquely positioned to grow profitably.

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. And $20 million of working capital efficiencies by the end of the year. For 2017 these EBITDA benefits will be offset by structural investments made in the areas of quality, sales, marketing, operations, engineering and other functional resources as well as non-structural 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 it's being targeted in the first phase.

During the third quarter we continue to make progress against each of the four pillars of the plan and believe we are on track to achieve targeted productivity enhancements. Let me give you an update on our progress during the third quarter. First, our portfolio optimization efforts were apparent with the recent announcement that we are exiting the nutrition bar product category. Recall that our focus is to simplify the business investing where structural advantages exist while exiting businesses or product lines where the company is not effectively positioned.

As we discussed last quarter, the bar operations were not meeting our expectations representing a significant drag on resources and our overall profitability. We initiated a rapid response and evaluated opportunities to improve the operations. However, the conclusion coming out of that work was that the business was not effectively positioned and long-term did not have a right to win in the category.

Given our size relative to the competition, our customer profile and limited avenues to meaningfully penetrate private label we decided to exit the business. We anticipate the business to be substantially wound down by the end of this year. Our portfolio optimization efforts also include making investments in categories where we do have the right to win. We are progressing with investments, we're expanding capacity and capabilities in our Mexican frozen fruit facility and in our cocoa operations in the Netherlands as well as having identified investment opportunities in roasted snacks. While we continue to evaluate our operations for additional investment or divestiture and evaluate our product offerings on an SKU basis to optimize our portfolio and enhance our strategic positioning going forward, we are already ahead of our target of $5 million of EBITDA improvement projects. Since the initiation of the value creation plan, we have implemented portfolio changes expected to yield approximately $6 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 an implement cost savings initiatives through productivity in our manufacturing operations and lower procurement and logistics costs. As I noted, some of the benefits of these initiatives aren't apparent in our margin performance during the third quarter due to the significant under performance from the nutrition bar and flexible re-sealable pouch product lines. And the impact of lower volumes in aseptic and frozen fruit. As we convert our sales opportunity pipeline, we are confident that the positive margin impact of the process improvements to-date will be evident in the financial results as volumes build overtime. Since the initiation of the value creation plan, we have implemented process improvements and cost savings expected to yield approximately $5.3 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. During the third quarter, we continue to grow the pipeline of future commercial opportunities across the beverage, fruit and fruit snack categories with recent private label food service and contract manufacturing account wins, some of which represent new wide space opportunities for the company.

We have further enhanced our team with the hiring of the new chief customer officer for the consumer products segment as well as a new head of marketing and other new commercial talent that will focus efforts on growing the top-line.

Since the initiation of the value creation plan, we have implemented go-to market improvements expected to yield approximately $1.2 million of annualized EBITDA benefits. The focus of the process sustainability pillar is to ensure the company has the infrastructure, systems and skills to

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achieve and sustain the business improvements in value captured from the value creation plan. During the third quarter we kicked off a new ERP project at our Mexican frozen fruit facility in support of our ongoing efforts to expand our presence in Mexico which is a key and growing source of supply. We also continue to focus on customer service and working capital levels as our sales and operations planning processes and support systems continue to be refined.

During the third quarter, we appointed a new general manager for the frozen fruit platform and upgraded several plant manager positions including the new chief customer officer for consumer products that I just mentioned. Since my arrival in February of this year we have replaced or added eight new senior leaders to the organization all of whom bring significant experience and leadership to their functional areas of expertise. I remain pleased with the quality of talent our organization is attracting and encourage that each of these new professionals sees the value creation opportunity at SunOpta.

I believe we have the team in place to achieve our goals and execute on the value creation plan. As I stated earlier, we are on track with our targeted productivity savings and look forward to updating you each quarter with our progress.

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

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

Thanks Dave. I will take you through the rest of the key financial statistics as well as balance sheet and cash flow metrics for the third quarter. As Dave mentioned, the third quarter revenue was $320.7 million, an 8% increase year-over-year, an 8% decrease, sorry, year-over-year as reported or 7.4% excluding the impact on revenues from changes in commodity related pricing and foreign exchange rates and removing the impact of bar and pouch lines of business that are being wound down.

The global ingredient segment generated revenues from external customers of $140.5 million, an increase of 2.4% compared to $137.2 million in the third quarter of 2016. The impact of changes in commodity related pricing and foreign exchange largely offset during the third quarter such that there was no net impact on revenue growth. Product segment generated revenues from external customers of $180.2 million during the third quarter of 2017, a decrease of 14.8% compared to $211.6 million in the third quarter of 2016.

Excluding the impact of commodity prices and removing the impact of bar and pouch lines of business that are being wound down, revenues in the third quarter decreased by 14.2% As Dave mentioned, the decline was largely driven by reduced sales of retail package frozen fruit and aseptic beverage products partially offset by increased fruit snack sales.

For the third quarter of 2017, gross profit was $36.5 million or 11.4% of revenues compared to $41 million or 11.8% in the third quarter of 2016. Excluding $1.3 million of cost related to plant closures, gross margin for the third quarter of 2017 would have been 11.8% compared to an adjusted gross margin of 12.3% a year ago. The decline in gross margin primarily reflected increased losses from the flexible re-sealable pouch and nutrition bar product lines, lower sales volumes in aseptic beverage and frozen fruit including the impact on plant utilizations as a result of lower production volumes and less efficient sunflower and roasting operations following the 2016 recall.

These factors are partially offset by implementation of product[divvy] initiatives, operational savings from the closure of a juice processing facility earlier this year, improved availability in field prices for fruit and increased sales of organic ingredients into the international market. As compared to the second quarter of 2017 on an adjusted basis, gross margin decreased 70 basis points reflecting the impact of lower sales and production volumes from plant utilization primarily in our aseptic beverage operations as well as favorable foreign exchange impact experienced in the second quarter on U.S. dollar denominated raw material sourcing within our international organic ingredient operations.

Focusing only on a consumer product segment, adjusting for cost associated with the value creation plan and removing the impact of the bars and pouch lines of business, the combined gross margin percentage for healthy beverage, fruit and the remainder of the snacks platform increased 20 basis points over the second quarter.

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For the third quarter we reported operating income of $5 million compared to operating income of $13.2 million in the third quarter of 2016 adjusting for $3.7 million of one-time non-structural costs related to third party consulting, employee recruitment and costs related to plant closures all incurred in relation to the value creation plan. Operating income in the third quarter would have been $8.6 million or 2.7% of revenues compared to $16.8 million or 4.8% of revenues in the third quarter of 2016 on an adjusted basis.

On a GAAP basis for the third quarter, we reported a loss from continuing operations of $6 million or $0.09 per common share compared to a loss from continuing operations of $3.4 million or $0.04 per common share during the third quarter of 2016.

Third quarter results include several charges and items that are not reflective of normal operations and have been excluded in calculating adjusted earnings. These items include $6.1 million after tax of costs primarily related to the value creation plan reflecting third-party consulting, employee recruitment and the previously mentioned costs associated with the wind down of the Carson City facility and the exit of the pouch business as well as asset impairment charges and employee termination costs.

For the third quarter of 2017, we reported an adjusted loss from continuing operations of $1.9 million or $0.02 per common share compared to adjusted earnings of $6.3 million or $0.07 per diluted common share in the third quarter of 2016. For the third quarter of 2017 we realized adjusted EBITDA of $19.1 million compared to $26.7 million during the third quarter of 2016. Please note that the drag from our bars and pouch lines of business is included in adjusted EBITDA. If we exclude the impact of the bars and pouch product lines from the third quarter results, adjusted EBITDA would have been $20.3 million.

I would 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 the bar and pouch product lines.

From a cash flow perspective, for the first three quarters of 2017, cash used in operating activities was $17.4 million compared to cash used of $35.3 million for the first three quarters of 2016. The $17.9 million improvement in cash used in operating activities reflects a $35.6 million reduction in cash used to fund working capital as a result of working capital efficiency initiatives which were focused on lowering inventory positions, maximizing purchasing terms and augmenting collection efforts for accounts receivable. These positive efforts are partially offset by cost incurred under the value creation plan. We continue to expect to generate increased cash flow during 2017 as a result of our efforts to lower working capital, however, the significant swing in foreign exchange between the euro and the U.S. dollar is expected to somewhat mask the improvement along with the impact of lower fruit sales on inventory levels.

During the third quarter, cash used in investing activities was $7.8 million compared to $5.5 million in the third quarter of 2016. Investing activities in the third quarter related primarily to the acquisition of the non-controlling interests in our Mexican frozen fruit facility as well as capital expenditures including the expansion of roasting capacity at our cocoa processing facility in Holland and other facility enhancements focused on food safety and productivity.

As previously mentioned, we expect our capital spending to trend higher in 2017 compared to prior years in support of the value creation plan. We expect capital spending for 2017 to be in the range of $27 million to $30 million. At the end of the third quarter, total debt was $489.8 million, an increase from the second quarter level due to increase in working capital driven by the timing of payments. At September 30, 2017 our leverage is approximately 6.5 times adjusted EBITDA on a trailing four-quarter basis after eliminating the negative impact on EBITDA from completed and forthcoming facility closures. We expect our total debt level to decline in the fourth quarter as we sell through free inventory and complete the 2017 green crop changeover. From a liquidity perspective, we ended the quarter with approximately $70 million of available capacity on our global asset-based credit facility and remain well positioned with sufficient capital resources to support the value creation plan.

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

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Jon Andersen with William Blair, your line is now open.

Jon Andersen: Thank you for the questions. I wanted to ask first about the consumer products business performance in the quarter. The revenue came in below our expectation and from your commentary sounds like yours as well. It seems as though it's concentrated in two areas; first let's talk about fruit and I'm trying to understand a little bit more about what you're seeing in the frozen fruit business. Is this truly kind of a category issue that should resolve itself with an improving of the price gap between fresh and frozen or, you know, and or are there some other things happening within that business from either a customer relationship standpoint, competition, price pressure, etc. If you could share some insight into that, good place to start I think.

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

Hi Jon, this is Dave. So, on the category as a whole I think we continue to see a slight decline. I quoted the last 12 week and four week syndicated data off roughly 3%. I think what's happening is as the pricing is starting to be lowered and passed through to retail. I think that spends lower to be reflected actually at the retail level so some of the pricing hasn't made it all of the way through to the consumer at this point and I think if that happens, I think we'll see the category normalize and hopefully return to some growth. So I think pricing pass through to retail is still impacting the category as a whole. On a broader category question, I think what we see, and what we're hard at work on, is we think that there's more at play here than just pricing and I think if you look at what's happening in retail, there's more focus on fresh both fruit and vegetables. Retailers are emphasizing more on the parameter to the store and as a result, that's going to require us to change how we go to market with frozen fruit, improve the quality, improve the usability, improve in some cases the packaging format that the fruit is in. We see a trend going to moving to larger sizes in the category is helping, going to more blends and bringing in more tropical fruits. So I think we see line of site on how to return the category to growth and how to bring better innovation and options to the retailers and therefore the consumer. So, we still feel good about the category, I think we're going through a meaningful transition in the category relative to both the pricing transition that's occurred over the last several years and the correction this year. But also the change in consumer behaviors. So that's how it would reflect that.

On the -- anytime you go through a significant transition in a category from a pricing perspective, and what I mean by that, if you look historically in frozen fruit, the last three to four years it's been nothing but increases in pricing, right, the demand has been high, the category has been growing and now we're going through a position where the price has reached the level last year that consumption declined which led to an increase in supply, if you will, from a manufacture basis across the category so you've got manufacturers sitting on long positions and you factor in the fact that the new crop pricing, field prices, were much lower this year. So you've got this situation where you're trying to mange through a high cost inventory position from old crop, transitioning into lower pricing on new crop and trying to make that delicate balance as you try to manage pricing and maintain margins. You know, all of us are trying to manage through that with our customers. So that's led to some challenges that you have to deal with as you go through retailer by retailer and it's just some thing we're working through.

But as we said in the prepared remarks, we're mentioning a lot of investments in our frozen fruit business, we're expanding our facility in Mexico both from a capability point of view in that we're putting in retail bagging capabilities so that we can ship direct to customers from the facility. We're also expanding the different types of fruit that we can support or grow and manufacturing in that facility as we view Mexico as a key source of supply on a different number of fruits going forward which ultimately we feel will position us to maintain our position as a high quality, low cost supplier going forward. So there's' a lot of dynamics going on in the category but we feel good about how we're positioned and we think that as we progress over time we'll return this, our, business to growth.

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

Okay and on the aseptic beverage side of the consumer products business, is there any pressure that you experienced of late beyond the club [historic] contract exit? We knew that that was part of the story in the third quarter but that business had sounded based on the utilization rates

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that you quoted was perhaps a little bit softer and how are the efforts to offset that contract exit in areas like broth, kind of coming along and are there ways to kind of accelerate that going forward?

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

Sure I think the -- we've had no customer loss issues beyond the one that we explained in aseptic. I think what we experienced in the quarter was more of kind of a transitory issue where one of our large food service customers demand was softer than we anticipated in the third quarter, more of a timing issue than anything else. We're seeing that particular customers volume come back nicely here in the fourth quarter so I think it was a situation where we had some working capital or inventory management going on at a key customer and from a consumption point of view, we don't see any concerns in that area. But we see as far as how to grow the business, I mean, we've spoken about the category and where we see opportunities in adjacent categories and you know, in the broth category in particular, it's a billion dollar category, it's growing in high single to double digits and we feel we're well positioned in that category. We've developed some new innovation on different broth types and formulas if you will and we're aggressively out building a sales opportunity pipeline with a lot of different customers across multiple channels. So, we feel good about that. If you exclude the impact of the contract loss that we spoke about in the aseptic non-dairy business with a particular customer, year-over-year we're up about 7.8% overall in our aseptic non-dairy business.

So that should provide some context about this -- how the platform is doing overall excluding the loss of that one customer.

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

That's really helpful. So, I've got two more. First, a lot of talk in the prepared comments around the building of the commercial pipeline and obviously this is critically important because as you transition out of 2017 and into 2018, that's going to be a focus for all of us. Can you talk a little bit more about the complexion of the pipeline? Is there any way to kind of talk about what you're seeing in terms of the magnitude of that build? The new business opportunities and how that will be -- how and when that may be reflected in the top-line as we move into kind of 2018 and beyond?

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

Sure, yeah, first I'll tell you that the sales opportunity pipeline as we call it, it's pretty robust across all of our product categories. So frozen fruit, healthy beverage, healthy snack and across the different channels within each category. And by that I mean whether it's mass, club, traditional retail grocery, the specialty channel, even our contract manufacturing base, food service, etc., we have obviously our commercial teams working across all of those channels against all of our product categories to identify opportunities for growth.

As you know, the way this works is you're in the queue, you've identified the customers and you get in the queue for the next time the category comes up for bid. So we feel like we're well positioned when those bids come up to be competitive and win business going forward. The way that we've spoken about this on previous calls, and I still view it the same way, is that given the timing of when the categories become available to us to big and the timing of when the shipments would hit, the reality of it is, it's going to be the back half of 2018 before we start seeing those opportunities reflected in revenue growth.

I feel like Q1 of this year we're not going to see revenue growth and then as we get into Q2 and in particular 3 and 4 of next year, that's when we should see the opportunities reflected in the revenue.

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

Okay, and then on the -- last one for me, on the portfolio optimization side, you've done some things that are, revenue, I guess, reducing in terms of exits around pouches and nutritional bars, those will obviously be profit enhancing although impact top-line in the near-term, where are you with respect to that kind of -- that portion of the value creation program? Are we done with kind of the revenue reducing exits largely and now more in kind of reinvestment mode in the core businesses?

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

Yeah, I mean Jon it's Rob. You know, we're always evaluating of course or portfolio but certainly sitting here now and if you think to what we've [actioned] in terms of the juice facility and then midpoint this year bars and pouch, obviously we've taken action with the businesses that, as Dave said in the prepared remarks, we try to give it a go and make sure we're not exiting something that we like but the reality is, this isn't going to create long-term value so we move. So I think it's fair to say for now that we aren't anticipating further revenue deterioration with the caveat that we're always evaluating our portfolio but certainly going forward you're going to hear more about how we're optimizing our portfolio with investment

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

Okay, thank you. Appreciate it.

Operator

(Operator Instructions) Our next question comes from the line of Amit Sharma with BMO Capital Market, your line is now open.

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

Dave, thanks for the (inaudible) to the frozen food. I do have a follow-up on that. You talked about the category maybe shifting to the parameter. Can you talk about what's the opportunity there? Is there simply getting back to the historical growth rates that the category has or does that help you as you look forward from a category perspective in terms of growth?

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

I'm not sure I understand the question Amit, are you asking do we see opportunities to move our portfolio to the parameter?

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

If the category does move more to the parameter, the frozen food, is that going to help overall consumption trends or are you simply getting back to where you were prior to this year's volume weakness, as in the category.

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

Right, I see. I think the positive thing that we see is that people continue to pursue a healthier diet, right? And fruit is part of that diet whether it's fresh or frozen, I think that does help the overall category and I think where we see the opportunity is, if you look at innovation and we talked about this historically in frozen fruit, it's been woefully lacking and behind a lot of the other categories that we all watch. So where we see opportunity is how do you position frozen fruit for more of a convenience factor, ease of use, portability, even functionality for the end consumer and that's what we're focused on from an innovation perspective is, it can be things as simple as packaging changes, standup versus lay down bags, improving re-sealability features on the packaging, getting the frozen fruit to taste more and perform more like fresh through some opportunities, primarily processing and packaging related and then the other thing that we're seeing is I think from a convenience point of view, frozen fruit does have an advantage because it lasts longer, if you will, versus fresh and the different types of fruits that people are interested in is moving more towards tropical's and more towards the berry blends.

The other -- so obviously we're going to focus on innovation in those areas. The other thing that we think is an opportunity is maybe on this whole portability and single serve opportunity. How do we position our portfolio to take advantage of those areas? It's interesting because as we look at this what we're finding is people are more and more interested in single serve options relative to frozen fruit; whether it's for their kids, whether

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it's for meal occasions throughout the day, whether it's breakfast, lunch, dinner, or even dessert, how do we position the portfolios so that we've got the right offerings and package formats to take advantage of those particular areas that we see developing.

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

And when you talk about retailers probably holding onto pricing a little bit more and that's having a negative impact on the category volumes, is that still a timing factor in terms of like that [pass-through] will come when you talk to your main customers or is that something (inaudible) see as an opportunity to make up for margins?

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

No I think -- this is fairly common when you go through a pricing transition of this magnitude. This pricing will be passed on eventually at retail. There's typically, in my experience, you know, you can see a two, three, maybe even four month lag. So, I think that will ultimately flush through and you'll see the lower prices reflected on the shelf and, again, I think that will help consumption.

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

And just the last question on the topic, if you look at your quarterly EBITDA or even next quarter if volumes do come back to where they should be given the pricing, is there a way to quantify the impact on our EBITDA from that as you improve utilization?

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

Yeah, I mean in real simple terms one of the things that I've looked at Amit is just maybe speaking of the beverage business and aseptic in particular just kind of looking at the second quarter and the third quarter and that timing gap, the loss of the one customer aside, you're looking at as much as a hundred basis points movement as a percentage of revenue just to get back to a bit more stable level of revenue and then having our utilization the factories get back north of 60% which is where we were for the first half of this year of you dipping, as we said, the prepared marks to 50% here in the third quarter. So, it does show you the opportunity obviously we've got the assets in place and the capacity to bring the revenue in but that's -- I'd look at that as kind of one of the -- to give you a flavor for as we get back to normal what things can rebound by.

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

So a hundred basis points for the beverage and we should expect a similar opportunity for frozen, is that the way to look at it?

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

Yeah, frozen I'd say is more of a direct contribution from revenue. Beverage is really the one that is truly impacted the most by production capacities.

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

Got it and then Dave you talked about a pretty substantial pipeline next year. You know, Amazon has talked about making a much deeper push into the organic naturals, can you talk about are they a customer today, is that an opportunity, have you had any meaningful conversations with them in order to make them a large sized customer?

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

Yeah, I mean we don't really disclosure who our customers are but I can tell you, we participate in that area and we do think that it's going to be a good opportunity. I think as you look at what Amazon is doing and what they're doing with the acquisition of Whole Foods, they're putting an emphasis on their store brand, if you will, not only in the stores but they're also backward integrating it into their Amazon shopper platform. So I think that will benefit companies like ours. We're well positioned in the natural channel already to take advantage of some of those trends and so I think we see that as an overall positive for companies like ours.

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

When you gave your pipeline, is ecommerce part of the pipeline or not yet?

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

Yes, it's definitely part of the pipeline. I think I would tell you prior to the Amazon Whole Foods acquisition it was top of mind but not top priority. With that acquisition I think that's accelerated the priority for a lot of manufactures such as ourselves. So, it's definitely part of how we're looking a the pipeline going forward.

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

Got it and the last one for me Dave, about the capacity and the right sizing of the production capacity, look, this is a -- it's commendable that you are being proactive with taking out the capacity where it's not utilized property. My question really is do you have enough visibility where you can stay ahead of the curve in terms of what's happening at retail? Or are we going to be in a situation where we will be reacting to what's happening at the retail or at the category level?

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

Yeah, I think it's -- you know, the upside of the fact that we have low utilization at some of these plants is we have plenty of opportunity for growth with our existing asset base, right, and I think that's what we spoke to in our prepared comments is we -- some of these top line opportunities were' looking at come to fruition. You know, we've got the capacity ready, willing and able to take advantage of that. What I'll also tell you though is we're looking forward in more from an innovation perspective and having the right packaging formats, where we see opportunities for growth we will probably have to invest in some capacity to make sure we have the right type of capacity to support the growth, right?

So I think the fundamental equation of do we have our assets in the right locations, I'd say check the box there. We feel really good about our manufacturing footprint in all of the categories in which we compete I think as our innovation pipeline evolves, I think what you'll see it doing is investing in that existing footprint with some different manufacturing capabilities to support the innovation.

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

Got it. That's all I have, thanks so much.

Operator

Our next question comes from the line of Chris Krueger with Lake Street Capital Markets, your line is now open.

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Christopher Walter Krueger - *Lake Street Capital Markets, LLC, Research Division - Senior Research Analyst*

Last two guys you've really covered most of my questions but I have kind of a different one here. Last week there were numerous stories in the media about the Food and Drug Administration proposing to revoking the claim that soy can prevent heart disease and I know there's like a little heart healthy label on a lot of soy products out there and just wondering what your opinion is on that and if it really matters much to you, and what percent of your business is soy related?

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

Sure, I'll take that one Chris. We don't discl -- obviously soy has traditionally been a big part of our business, we don't disclose the proportions but I think it's fair to say that a long time ago it was a very big proportion and over the years it's been proportionally whittled down both as a result of declines in terms of demand for soy and the fact that our portfolio has broadened and to use beverage as an example, coconut, almond, rice, you name it, right, we're not tied to any one commodity. Now, when it comes to soy itself I would suggest this isn't the first time that there's been bad press or a bad halo perhaps put around it. It's been this way for a while. I do believe that it will continue to remain a staple product.

When you look at both the customers and the channels we serve, a lot of ours [has] to food service. At the food service label, level, the label claim of heart health is somewhat irrelevant, meaning it's not on the package it's behind the counter and actually in a lot of other applications where our product goes, either as an ingredient or as a beverage it's not being promoted as with that label that they're proposing be retracted. So I don't think they'll have a significant impact on us. The important thing is that the breadth of our portfolio and the fact that we can serve non-dairy alternatives or plant-based alternatives including soy or excluding soy is what is important for SunOpta.

Christopher Walter Krueger - *Lake Street Capital Markets, LLC, Research Division - Senior Research Analyst*

All right, that's helpful. That's all I've got, thanks.

Operator

I'm showing now further questions in queue at this time. I'd like to turn the call back to Mr. Colo for any closing remarks.

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

Thank you operator, and thank you all for participating in our third quarter conference call. Before we close, let me reiterate 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.

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