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## Q1 2019 Sunopta Inc Earnings Call

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## PRESENTATION

**Operator**

Good morning and welcome to SunOpta's First Quarter Fiscal 2019 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 it's 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 other 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 during this (inaudible). Also, please note that unless otherwise stated, all figures discussed today in U.S. dollars are occasionally rounded to the nearest million.

And now I would like to turn the conference over to SunOpta's CEO, Joe Ennen.

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**Joseph D. Ennen** ***SunOpta Inc. - CEO & Director***

Good morning. Thank you for joining us today. With me on the call is Rob McKeracher, our Chief Financial Officer. First, let me say how excited I am to be joining SunOpta as the new CEO. While it's been only a little over a month since I started, I've been very impressed with the people I've met, the operations I've seen and the feedback I've received from customers. When I was approached with the opportunity to lead SunOpta, I was immediately drawn to the Company's strong position as a leader in the health and wellness food space. With a focus on sourcing organic and non-GMO ingredients, producing innovative plant-based beverages in our aseptic facilities and enabling healthy eating through our fruit platform, I saw a Company that aligns well with my passion for health and wellness.

With 30 years of experience in the food industry on both the branded and private label side, my unique experience as the former leader of Safeway's own brands organization. I'm excited to work with our customers and our team to bring an accelerated pace of innovation and to deliver improved results more consistently to shareholders.

My decision to join SunOpta was really a nobrainer, given how well we are aligned with major macro trends in the CPG industry. I'd like to spend a few minutes unpacking those reasons for you, so you can understand what I see in the Company and why I'm optimistic about our future. Those trends are, #1, the rapid increase in private label. Private label continues to win across the retail landscape as retailers look to improve value and build loyalty through their own brands. SunOpta is a partner with many of the leading retailers in the U.S. I believe private label will continue to take share from the large national CPG brand and we're positioned to win with these retail partners.

Second, the continued growth of organic products and our strong position in that market. Premium organic products also continued to take market share from the large national CPG brands. SunOpta's capabilities are well suited to serve these healthy food and beverage trends. I expect these products will continue to take market share and we are positioned to win as a contract manufacturer and ingredient supplier.

Third, the shift to plant-based beverages. Plant-based beverages have been on a long-term upward trajectory as consumers move away from traditional dairy for taste, health and sustainability reasons. Our national network of manufacturing facilities and a portfolio of products, which includes oat, almond, coconut, hemp and soy milk were winning in this business. We plan to continue to make investments to strengthen our position as a leading provider of plant-based beverages.

Fourth, the prevalence of snacking. In the U.S. alone, consumers now spend almost $75 billion on snack-food and we have a portfolio of healthier products that are made with conventional and organic fruit and other plant-based ingredients. Once again in snacks, we are well positioned with on-trend products in a growing market. Our recent results have been very strong, but more importantly, I believe there is untapped opportunity to expand this business.

Fifth, fruit is foundational to a healthy diet. Our frozen fruit business aligns well with consumer's desire to get more fruit into their diet. Frozen fruit offers consumers superior convenience, better value and higher nutrient retention. While we clearly have work to do to improve the performance of our frozen fruit business, the category has returned to growth.

And finally, the continued growth of certified ogranic ingredient is the reason why SunOpta is well positioned for the future. For decades, SunOpta's wholly-owned subsidiary Tradin Organic has been building relationships and establishing programs around the world to source certified organic ingredients. Consumers today are asking questions like where does my food come from? Is it authentic and was it sustainably grown? Are the farmers being treated fairly? Tradin has been a pioneer and being the answer to these important questions.

From our business in Sierra Leone, working with organic cocoa farmers to Indonesia where we worked with farmers to establish a supply of organic coconut products, to Ethiopia where we're now pioneering the production of organic avocado oil, Tradin has built the unique insulated business model that remains at the forefront of organic integrity and quality around the world. Tradin's revenues have grown five-fold, since SunOpta acquired it in 2008 and we will continue to build and leverage the expertise to create new sources of organic supply and drive growth.

SupOpta's alignment and capabilities within these 6 macro trend is what convinced me to join the Company as the next CEO. Based on my observations, 6 weeks into the role, I'm even more confident, we are well positioned to win. Of course, there will be no surprise to shareholders when I say, the Company has not leveraged the strength and positioning of these platforms to drive consistent results. Developing consistency can be difficult in a turnaround, but it's imperative we develop a culture that strives to deliver consistent profitable growth. To achieve this, we need to be more focused, more nimble and more innovative, all while maintaining our strong focus on food safety and customer service.

As you know, in the fourth quarter of 2016, the Company launched its value creation plan as a broad-based initiative focused on increasing shareholder value through strategic investments in the people and assets of the Company. The 4 pillars of the value creation plan, portfolio optimization, operational excellence, go-to-market effectiveness and process sustainability continue to provide a framework for our efforts to improve operational performance and drive long-term sustainable growth.

The effort the Company has put into the turnaround over the last 2 years is evident in several areas, especially in foundational imperative such as food safety and quality, employee safety and customer service. Under the portfolio optimization pillar, SunOpta has sold, consolidated and exited several businesses, which weren't positioned to drive long-term value. SunOpta has also made strategic investments into its aseptic plant-based beverage business and our organic ingredient sourcing operations. We will continue to evaluate our portfolio to ensure we're making the best investment decisions that will deliver shareholder value. When it comes to operational excellence pillar, our focus on productivity and continuous improvement has been embraced in the organization and is now part of the mindset our employees bring to work every day.

Regarding the go-to-market effectiveness pillar, in the last 2 years, we've rebuilt the sales and marketing organization and have returned the Company to top line growth. I intend to leverage all the foundational work that has been completed under the value creation plan today to drive sustained profitable growth for all our stakeholders. But winning isn't just about the plan, it's also about the culture and we need the right cultural attributes to win as a business. And in that regard, we will build an organization that is #1, faster and more agile; #2, focused on the biggest priorities and #3, fanatical about the customer and saying yes to opportunities.

Going forward we have 3 strategic priorities. First, portfolio prioritization; second, speed of customer-centric innovation; third, productivity and pricing realization in frozen fruit. On portfolio prioritization, it's critical we position the Company in categories where it can sell. We have a plan to take a more focused approach towards evaluating what businesses we want to be in. And importantly, developing a clear long-term point of difference for how we're going to win.

As you've seen in the past, under the value creation plan, we will invest in parts of the business where the Company has structural rights to win and exit those it doesn't. We intend to action these opportunities with increased speed and decisiveness, while prioritizing capital and human resources to focus on the opportunities that deliver the best returns. The addition of new filling and processing capacity and capabilities at our Allentown beverage facility by the third quarter of 2019 is a good example of a priority investment that is designed to capitalize on SunOpta's positioning in the plant-based beverage space. This investment enables further development of our oat milk business and we are actively strategizing our next investment in the beverage space.

Tradin's recent acquisition of a small organic oil company expands its reach at both ends of its business. New sources of organic supply and broader access to high-end specialty markets. This acquisition also serves as a good example of a prioritized investment into an area of the business where we're positioned to succeed long-term. While I'm only in my 6th week with the Company, it's clear to me that SunOpta has not fully leveraged the unique field to table capabilities that Tradin enables. Tradin has not been fully integrated into how we source, build and commercialize new products and this has to change.

Regarding speed of customer-centric innovation, as I have already commented retailers, foodservice operators and fast growing nimble branded food companies are the primary growth engines in food and beverage today. SunOpta is uniquely positioned to provide a wide array of solutions to these companies. Our ability to innovate and deliver the value these customers demand to grow their own brands combined with our agnostic channel orientation, which includes foodservice positions us to win. In particular, we are at the forefront of up and coming plant-based food trends such as oat beverages, which we view as the next big thing in non-dairy. Taken together, our research and development capabilities, multi-channel category insights and foresight from Tradin on the latest trends in organic give SunOpta a solid platform to bring value enhancing innovation to our customers.

Our third priority, productivity and pricing in fruit is squarely focused on increasing gross profit in frozen fruit, which is the Company's biggest opportunity today to drive improved EBITDA performance. As we've discussed returning the healthy fruit business to historic margins remains a 2-year journey due to the seasonal nature of the business and the ongoing capital projects that will accelerate our cost reduction efforts. However, as we have assessed the current state of the business, it's clear the Company needs to do a much better job managing the dynamics of pricing in the frozen fruit market. This means balancing supply chain complexities, the cost of manufacturing and competitive pressures, all while executing contract that both meet the needs of customers and SunOpta. Importantly, innovation also needs to be a bigger part of our overall fruit strategy as we seek ways to find to add value to the fruit we process.

I want to assure you we remain committed to this business and we are building the competencies to be a successful long-term player in the frozen fruit business. As I continued to evaluate SunOpta's business and portfolio, I plan to share more of my thought and our strategic priorities in the future.

Now let me discuss first quarter commercial highlights for the consumer products and global ingredients segment before turning the call over to Rob to run through the rest of the financials. For the first quarter of 2019, we generated $305 million in revenue, which on an adjusted basis represents a 6.2% year-over-year growth rate. The growth was driven by both our consumer products and global ingredients segments. In consumer products, we generated continued growth in a healthy beverage platform reflecting higher volumes across the business.

On an adjusted basis, reflecting the profit neutral change to co-manufacturing agreement with one of our customers, revenue and healthy beverages grew 6% in the quarter. Looking ahead, we remain on track to commission and begin shipping product from the expanded capacity being added in Allentown in the early part of the third quarter of 2019.

The healthy snacks platform also posted strong results as customer promotional activity return during the quarter. Adjusted for exits from the pouch and nutrition bar operations last year, revenue in the healthy snacks platform was up 13.6%. As I indicated earlier, we believe there is substantial opportunity for further innovation in our snacks platform with premium and organic fruit and vegetable based snack offerings that serve demand for on-the-go and lunch box based snacking.

Revenue in the healthy fruit platform was essentially flat on an adjusted basis, reflecting increased volumes in retail, partially offset by the impact of strawberry shortages due to a late harvest in Mexico and also lower sales in fruit basis and toppings, serving mainly ingredient foodservice customers. As the Company mentioned last quarter, there was a delay in freezer berries coming out of Central Mexico due to the cold wet weather. Some farmers in the region experienced crop losses and the overall delay in receipt of raw materials led to higher purchase prices, lower production level and therefore supply chain challenges in meeting customer demand. We've been actively taking steps to compensate for the Mexican shortfall and to minimize the financial impact on 2019.

As an update on the California freezer pack season, it too has been delayed by cooler weather. However, at this point, field pricing remains in line with expectations and we expect to fully leverage our grower relationships to ensure the season is packed out according to plan. While no one wants to talk about how weather negatively impact their business, it is reality in this business. However, there are two dynamics we do control that have not been managed well. First, we were very aggressive with pricing in 2018 and as a result, we have some customers where our pricing is not sustainable. Second, we did not invest fast enough in productivity efforts to drive efficiencies in the plants. Remedying these issues and returning frozen fruit to healthy margins remains the organization's top priority.

The first phase of our cost reduction through automation project is on schedule and all of the new equipment has been installed and tested in our California plant. As previously mentioned, we expect to see the benefits of this productivity begin to flow through the P&L in the fourth quarter. On pricing, we are in active conversations with our customers to put in place enhanced and flexible pricing mechanisms that will allow us to better manage commodity volatility.

Moving to global ingredients, sales were up almost double digits at 9.7% adjusting for commodity and currency changes and the sale of the soy and corn business. This growth was driven by continued strong performance in organic fruits and vegetables, organic cocoa, and organic oils. The recent acquisition of Sanmark further enhances our sourcing capabilities in organic oils to create the new sales channel for us in the cosmetic industry. It is also complementary with our ongoing project to build an organic avocado oil operation in Ethiopia. The avocado project is progressing as planned, construction of the facility is underway, the processing equipment is in the country, and our grower team is hard at work wiring the supply chain. Domestically revenue in the sunflower and roasted ingredient business declined 9.8% on an adjusted basis primarily reflecting lower demand for in shell and kernel sunflower products partially offset by higher roasted snack volumes.

Now let me turn the call over to Rob to provide the financial details. Rob?

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

Thanks Joe. Let me walk through gross profit and the rest of the income statement given Joe's discussion of the commercial activities and revenue during the quarter. I'll also cover our balance sheet and cash flow results. Gross profit was $28.2 million for the first quarter, a decrease of $5.5 million compared to $33.7 million for the quarter ended March 31, 2018. Consumer products accounting for $3.7 million of the decrease in gross profit reflecting the impact of the weather related delay to the fruit season in Central Mexico. The delay resulted in commodity price inflation due to a short supply of frozen fruit from Mexico, unfavorable production variances due to lower yields related to crop quality, rework of bulk inventories and substitution of higher cost U.S. grown product, and the lower plant utilization at our Mexican frozen fruit facility.

The negative impact of gross profit from the weather related delay is estimated to be $1.6 million in the first quarter of 2019. In addition the decrease in gross profit reflected lower volumes and plant utilization for fruit ingredients due to reduced demand. These factors were partially offset by the favorable impact within the healthy beverage and snacks platforms of improved plant utilization due to higher production volumes to meet sales demand and productivity driven cost savings.

Global ingredients accounted for $1.8 million of the decrease in gross profit primarily due to the sale of the soy and corn business and a modest decline in sunflower gross margin which more than offset improved margin in international organic ingredients driven by a gain on commodity futures contracts used to hedge the Company's organic cocoa position and higher sales volumes.

As a percentage of revenues first quarter gross margin was 9.2% compared to 10.8% last year. The gross margin would have been approximately 9.5% excluding the pro forma effect of disposed businesses compared to an adjusted gross margin of 10.7% last year on the same pro forma basis. The lower gross margin year-over-year reflected a 570 basis point decline in frozen fruit margins during the first quarter due largely to the impact of the weather related Mexican supply shortage I just discussed as well as the impact of lower average selling prices.

Looking ahead to the second quarter we expect to see revenue continue to grow over 2018 levels after taking into consideration the effect of disposed businesses. From an EBITDA perspective we expect the second quarter to look similar to the first quarter. We expect to see continued margin headwinds in fruit as a result of the late season and related supply and cost pressure and continued demand pressure in domestic sunflower impacting sales and production volumes. This pressure is expected to be partially offset by continued volume growth and production efficiencies in our aseptic beverage operations excluding costs associated with the commissioning of new equipment in Allentown in the second quarter.

Operating income was $0.3 million or 0.1% of revenues in the first quarter compared to $1.7 million or 0.5% of revenues last year. The decrease in operating income year-over-year reflects $5.5 million lower gross profit partially offset by $2 million reduction in SG&A due to the sale of the soy and corn business and rationalized overhead, lower benefit costs, professional fees, and other cost reduction measures and a $2.1 million decrease in foreign exchange losses. Excluding the operating results of disposed businesses as well as SG&A related to employee retention and transition costs, our segment operating income would have been $1 million for the first quarter of 2019 compared with $0.9 million for the first quarter of 2018.

Income attributable to common shareholders in the first quarter was $23.7 million or $0.26 per diluted common share compared to a loss of $6.3 million or $0.07 per diluted common share during the first quarter of 2018. Net income in the first quarter of 2019 included a pre-tax gain on the sale of the specialty and organic soy and corn business of $45.6 million. On an adjusted basis net loss was $7.9 million or $0.09 per common share compared to $6.4 million or $0.07 per common share in the first quarter of 2018. For the first quarter of 2019 adjusted EBITDA excluding disposed operations was $11.1 million compared to $11 million in the prior year. I'd like to remind listeners that adjusted EBITDA and adjusted earnings and 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.

At the end of the first quarter total debt was $454.2 million down $55 million from December 29, 2018 mainly as a result of the net proceeds generated from the sale of the soy and corn business. Total that at March 30, 2019 reflects $217.4 million net of issuance costs of 9.5% senior secured second lien notes due in 2022, $220.2 million drawn on our first lien global asset based credit facility with the balance representing smaller credit facilities leased and other financing arrangements. The global asset based credit facility is a syndicated credit agreement maturing in February of 2021 with an aggregate commitment of up to $370 million.

From a cash flow perspective, during the first quarter cash generated by operating activities was $1 million compared to $7.5 million last year. The lower cash from operations reflects lower quarter-over-quarter operating results due in part to the receipt of tax refunds in the first quarter of 2018 and the sale of the soy and corn business, which had a strong start to 2018. We invested $8 million in capital expenditures during the first quarter of 2019 compared to $6.7 million in the prior year. And for 2019 we anticipate capital expenditures of approximately $25 million.

With that, I'd like to ask the operator to please open up the call to questions.

## QUESTIONS AND ANSWERS

**Operator**

Thank you, sir. (Operator Instructions) Our first question is from Amit Sharma from BMO Capital Markets. Your line is open.

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

Hi, good morning everyone.

**Joseph D. Ennen** ***SunOpta Inc. - CEO & Director***

Hey Amit.

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

Congratulations Joe for joining SunOpta, looking forward to working with you.

**Joseph D. Ennen** ***SunOpta Inc. - CEO & Director***

Thank you.

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

Let me just start with that. I mean, really you bring a pretty unique experience to the table from your days at Safeway. And you did touch on that a little bit in the opening comments, but can you maybe a little bit more dive into it like how does that experience at Safeway translates as you look to pivot SunOpta more to private label?

**Joseph D. Ennen** ***SunOpta Inc. - CEO & Director***

I would say, really understanding how the customer views partners and what they value is a huge value that I can bring to this organization really helping the organization understand how important speed is to the customer and helping them understand how to look at categories the way a customer looks at it whether a customer is trying to drive innovation in that category, trying to achieve a positioning of that category around superior quality, or if they're simply focused on cost. Those are the 3 broad filters that any customer would look at a category from a private label standpoint. And so, really helping the organization understand the speed requirements to work with customers and how to understand and read their balance of, is it about innovation, is it about quality, or is it all about cost.

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

And then granted it's early days for you right at SunOpta, but as part of when you are looking to take this job and since then do you see any reason to believe or to caution us against what targeted marginal levels are for each of these business is whether it is a beverage business, snack business, or the ingredient business at this time?

**Joseph D. Ennen** ***SunOpta Inc. - CEO & Director***

Historically we've articulated 10% EBITDA margin as our target. And while we're not there today I certainly believe if you look at the competitive set and where some of the businesses have been in the past, I have no reason to believe that with the right efforts and strategies and plans in place we can get to that level.

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

And then on frozen obviously the child for now right, it was really encouraging to see in the press release that you do see a margin improvement starting in the 4Q. Can you talk about that a little bit like what are the assumptions behind that margin improvement and talk about in the context of the crop delay in Mexico and you mentioned California may also be a little bit delayed, can you talk about that a little please?

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

Yeah, it's Rob, maybe I'll try that one and then see if Joe has anything to add. But it's -- we're obviously hard at work with what is the first phase of our fruit margin optimization plan, you know, the assets that had to go in prior to the 2019 pack plan are in place and tested and operating. We're right at the -- kind of right at the cusp of the season really beginning in earnest here in California. So we're feeling pretty good about the effort that's gone in there and really simply what that's going to lead to is lower labor costs in terms of conversion and potentially improve yield, which that'll get capitalized into the inventory here that we pack out in 2019. And then start to present itself on the P&L as a lower overall average cost of fruit come in the fourth quarter. And so, we still remain committed to and confident in our ability to deliver that mainly because we're adding automation and we can validate that the labor indeed is reduced. In terms of the Mexican and the supply shortage that we've experienced here in the first quarter certainly it pressures to a certain extent our system, thankfully we do have a broad network and scale to be able to keep customers and stock with fruit. But when you're faced with a larger shortage of supply really driven by weather it's not just SunOpta, it's of course everybody in the region, you're inevitably paying a little bit more for product and/or in our case compensating for it in a more costly way as we pack out of California to keep production levels up and then keep customers in stock. So despite that we do still expect fourth quarter profit delivered by fruit to be ahead of the prior year and ahead of last year in total. So that's still in place.

**Joseph D. Ennen** ***SunOpta Inc. - CEO & Director***

Amit I would just add kind of reflecting back to your previous question about the Safeway experience, as it relates to frozen fruit, one of the things that I can bring to this conversation having worked across 800 different categories at Safeway is, I saw every pricing mechanism imaginable especially on some of the more commodity driven categories and how those pricing mechanisms helped the customer stay competitive and help the manufacturer insulate themselves against some of the market volatility.

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

And then just lastly for me, Joe you also addressed one of the opportunities that we see very clearly is under leverage of your Tradin business. And obviously it has been doing really well, so not much to complain here, but I think it could do more than what it is doing today. Can you talk about that a little bit like obviously how you're thinking about it and what are some of the things that could be done to better leverage that really unique asset that SunOpta has?

**Joseph D. Ennen** ***SunOpta Inc. - CEO & Director***

Yeah, I think if you think about what Tradin is doing in terms of really working at a grassroots level with farmers and building value at the beginning stages of the supply chain and as you truly think about kind of farm to table they're doing a lot of heavy lifting of that front end of the supply chain. And my challenge to the organization and one of our strategic priorities is how do we recognize more of that value through the supply chain as opposed to just selling that on to somebody else to further process that ingredient.

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

Got it. I appreciate the thoughts. Thank you so much.

**Joseph D. Ennen** ***SunOpta Inc. - CEO & Director***

Thanks.

**Operator**

Thank you. The next question is from Jon Andersen from William Blair. Your line is open.

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

Thanks. Good morning and congratulations Joe. Look forward to working with you going forward.

**Joseph D. Ennen** ***SunOpta Inc. - CEO & Director***

Thank you.

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

Amit asked all the good questions as usual. So I will try and do my best here. I guess Joe, having said what you said about your experience with Safeway, I am just kind of wondering if you have perspective on kind of external perspective on how SunOpta is viewed as a private label supplier either now or historically and how much work and what kind of work needs to be done at SunOpta to move further up kind of the customer lists, private label customer lists and where you see kind of the biggest white spaces when you think about the private label business at SunOpta where you maybe are most under penetrated and have the most upside potential? Thanks.

**Joseph D. Ennen** ***SunOpta Inc. - CEO & Director***

Yeah. So just in terms of how SunOpta was viewed and I might just draw a bit more on what I've heard from customers, our current customers versus my experience working with SunOpta several years ago, I've received really positive feedback from our customers about our efforts around food safety, product quality, and customer service. Just in terms of the type of work that we need to do and how do we move up in that preferred vendor status. Again it comes back to speed of responsiveness, customer service, making sure that we have bulletproof food safety, and bringing them innovation and bringing them ideas on how to grow their business and how to help them win market share versus their retail competitors. And I think that lens -- and putting that lens on the business every day is going to make us a more valued partner. Just in terms of the white spaces, I mean I think you've heard us reference a lot around plant based beverages. There is certainly a lot of innovation and enthusiasm in that space as you look across both the dairy and shelf-stable. And I think that is a key white space for us. And then in the fruits space we have to view innovation as a lever to achieving pricing realization in fruit. You know [IQ assets] needs to be viewed as just a part of the business and our ability to get revenue realization for that fruit stream is very, very focused on driving innovation and creating ideas that add value to the fruit that we're procuring.

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

I suppose that would help on the pricing front where there's a solid innovation in fruit as well. Sticking with beverages for a minute I am kind of intrigued by what you said about oat milk, obviously oat milk, it's everywhere now and it's getting this huge buzz. I am not sure you've participated in oat milk historically, can you just talk about this new capacity that's coming online and maybe your ability to repurpose existing lines to participate in that oat milk segment. How big do you think this opportunity is and kind of weave that into the discussion of kind of the capacity expansion that you're doing in Allentown and how soon you can kind of be out there with an oat milk offering? Thanks.

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

Yeah, sure why don't I take that Jon and then if Joe wants to jump on, but yeah, our expansion $22 million in Allentown, it does a number of things. Think of our network across -- the national network of aseptic plants is one where when you add capacity that we are in Allentown, it enables more capacity to free up in other places because of course we kind of adjust appropriately the where made and in some cases the format that we're packing out for our customers. So Allentown, and as much about Allentown as it is about creating some more capacity in Alexandria and Modesto. That additional capacity just further enables our ability to grow in oats today. I mean, today speaking of oat, we're on everything from the ingredient side of that so extracting a creative base right through to packaging into a retail format. So we're there today and some of the things that we're looking at in terms of where to invest next would certainly be hinged on what we see as a really strong market demand and trend for oat. So we're there today, the Allentown does enable it, and I think there's future room for growth. I think if you want to think about the potential for oat relative to other plant based or non-dairy offerings, you just look back to some of our bigger coffee chains that number of years ago didn't have almond in it and now almond is a leader there in terms of consumers demand for dairy alternatives. So I think that when we look at the profile of oat and how the label reads it could be just as big as the big guys on non-dairy.

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

Okay, that's helpful. On fruit it sells -- the frozen fruit business, what role does pricing play in the fruit margin optimization program, I mean, you've kind of committed or talked about good margin progress in fruit during the course of the next 2 seasons. I know a lot of that is driven by automation and I think the Santa Maria the co-location of the facility in Santa Maria next year, how much does pricing play a role and do you think that that's something that you're going to be able to -- that's a lever you're going to be able to pull in the near-term if needed and it sounds like it is needed given some of the weather related delays and cost issues in that business?

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

Yeah sure, I'll take that one as well Jon. As we've modeled out the return and again it is a two crop season or two year return just simply due to the magnitude of what we need to do pricing and/or maybe top line enhancement, revenue enhancement that's -- we model that to be about 30% of the way back to historic margins. So in terms of specifically pricing to answer your question that is an important part of it. We need to both do a better job managing it to make sure that we're not in a position where we're not adequately passing along commodity prices in the volatility whether it be price or availability of fruit. But part of that pricing realization as well as Joe already commented is also on I guess what I might refer to as value enhancing mix. So it could come by way of innovation where the more value we're adding to the product enables us to price at a higher kind of per pound if you will level or potentially in streams that aren't necessarily direct to retail. So innovation that helps enhance that profitability mix because we're making better use of other streams of the berries that we're bringing in here to other channels be it food service, be it K to 12 what have you.

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

Is there a -- as you look at the next two seasons and we expect a margin improvement this year Q4 or coming out of Q4 we expect another one next year with the 2020 harvest. Is there a bigger leap this year, a bigger leap next year, is it comparable in each year or is that just too hard to predict at this point?

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

It's not hard to predict. I mean, at the end of the day we've modeled it and would expect it to be -- came into the year expecting to be kind of 2 halves if you will. So first presenting itself in the fourth quarter of this year and then again in the fourth quarter of 2020. I think with the dynamic at the grower level we're seeing this year which is and I think it was in prepared remarks obviously we've talked about Mexico, but even a slower or slightly delayed start to the California season. What we're going to caution against is just that a higher cost of fruit and/or inefficiency that we've experienced thus far keeping customers in stock, some of that does get associated with or tied up to the inventory we have today and will be a partial counter to the benefit we're seeing come through in the fourth quarter. But I think structurally about the business, the fact the assets are in, the labor is being reduced. We know that the efforts we're taking will yield the benefit designed at a gross basis. It's how does that get netted against some of the pressures we're seeing earlier. So I'd suggest at this point probably more of the benefit comes in 2020 but we're certainly going to see it starting in the fourth quarter this year.

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

Okay. And last one I guess for me is, Joe mentioned portfolio prioritization. That's one of the 3 key priorities. And I guess I was trying to understand if that meant maybe there hadn't been enough or enough either reinvestments in core businesses or consolidation and/or divestiture of non-core businesses. Is that the right way to read that and how do -- how much change do you think we could see going forward to the portfolio relative to some of the changes that have already been made?

**Joseph D. Ennen** ***SunOpta Inc. - CEO & Director***

I think the way to think about that is a real simple focus around where to play and how to win. I think we're in a lot of businesses, we have a lot of priorities, and the ultimate growth drivers for us are going to be making the right strategic choices about what businesses to really pour our investment and our energy be it people, capital into. So I think you should think about it in that regard. That answer your question?

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

Yeah, it does. Now that's helpful. And then I guess the last one for me will be, the second quarter, the look at the second quarter Rob, relative to what we heard from you last quarter I think the message last quarter was that it would be reasonable to expect fairly level EBITDA year-over-year in the first 3 quarters of the year. And then a step up in the fourth quarter with the fruit margin optimization. It sounds like based on your comment today that Q2 at least may not be up to that kind of the same level as Q2 a year ago. Is that a fair point and obviously I guess if that's the case, it's related to the weather related issues on the fruit business and some of the higher costs you're dealing with there.

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

Yeah, that's exactly how I interpret that Jon. You said it well.

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

Okay, thanks everybody. Congrats Joe and good luck going forward and I look forward to seeing you soon.

**Joseph D. Ennen** ***SunOpta Inc. - CEO & Director***

Thank you too.

**Operator**

Thank you. The next question is from Chris Krueger from Lake Street Capital. Your line is open.

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

Hi, good morning.

**Joseph D. Ennen** ***SunOpta Inc. - CEO & Director***

Hey Chris.

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

Good morning, Chris.

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

Hi. Most of my questions have already been asked and answered. But Joe, can you talk about the -- what you see in the broad market, I don't think you guys commented too much on that. What do you think the potential is there, are there new customers in the pipeline, stuff like that?

**Joseph D. Ennen** ***SunOpta Inc. - CEO & Director***

Yeah, I think relative to our opportunities if you think about our expansion in the aseptic space and our ability to go out and sell against that expanded capacity we feel very good about our ability to drive against that. If we look at the frozen fruit space, the team is working on some really interesting innovations in that space, and so we're excited about that as well. So certainly there is more work to do in dialing up the innovation pipeline and pushing the revenue. But I think that there is -- I have not heard any kind of big warnings from the team around the customer pipelines dry if anything quite the opposite.

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

In Allentown after that's up and running will all 3 of the facilities Modesto, Alexandria, and Allentown be capable of producing all that plant based stuff in broth?

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

Yeah, I'll take that one Chris. There are certain differences between the facilities. Allentown being the newest doesn't have the full suite of capabilities that Alex or Modesto has, but by and large there's going to be a lot of interchangeability in terms of what we can do across the 3 in terms of both format and what we pack out. And of course the benefit of that is, we'll be having that national network and being in a position to be cost advantaged when it comes to our position to deliver to customers is obviously is a key kind of competitive differentiator for us.

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

All right. That's all I got. Thanks.

**Joseph D. Ennen** ***SunOpta Inc. - CEO & Director***

Thanks.

**Operator**

Thank you. We have another question from Amit Sharma from BMO Capital Markets. Your line is open.

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

Hi, thank you so much for taking the follow up. Just a quick one from me. Rob, you mentioned the pipeline build in aseptic in 3Q, is that related to the broth business that the increased capacity and how much of a build could it be?

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

Yeah, that's a good question. So on broth specifically, I think folks probably remember, we got into that category quite quickly last year. Very small amounts shipped in the third quarter but then it really came in the fourth which of course brought seasonality is really third and especially fourth quarter centric. So what we're able to do this year and helped and aided by the additional capacity at Allentown is start our pack out or our planning in terms of building the broth ahead of time. So we'll be actively in production here in the third quarter building up supply to meet the demand for the fourth quarter and because of that ability to manage our supply chain in that regard I think we'll see a lot more efficient production planning.

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

Can you help us understand like how big is that broth business from a top line perspective so that we can model it accordingly?

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

Yeah, I would say we've commercialized last year roughly $50 million in new business in broth and a little less than $20 million shipped last year. So if you put that in the context of our overall beverage platform all things equal, the wrap around effect if you will of that revenue sets about a 10% growth on the overall beverage platform.

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

And then the rest of the portfolio besides broth is still growing at mid single-digit?

**Joseph D. Ennen** ***SunOpta Inc. - CEO & Director***

Yeah, we're seeing good growth in demand for plant based certainly. In this past quarter juice wasn't growing for us, it was down single-digits a little bit but that's partly seasonality. So yeah, we're certainly not seeing a reversion in any of the other categories we're serving especially on the non-diary side.

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

And broth is a good margin business as comparable to the rest of the beverage businesses?

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

Yes -- no, we're certainly, I mean, that's -- as we look at our portfolio of what we serve out of our aseptic capabilities especially given that we've been tightening capacity, the market to a certain extent is tight on capacity. We're definitely ensuring that what we fill the capacity with is margin accretive.

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

Got it. Thank you so much.

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

Thanks Amit.

**Operator**

Thank you. I am showing no further questions at this time. I would like to return the conference back to Mr. Joe Ennen.

**Joseph D. Ennen** ***SunOpta Inc. - CEO & Director***

Thank you operator and thank you all for participating in our first quarter conference call. I look forward to speaking to you in the future and updating you on our strategic initiatives over the coming months. Have a great day.

**Operator**

This concludes today's conference call. Thank you for your participation and have a wonderful day.