

FINAL TRANSCRIPT

High Liner Foods Incorporated

Q3 2016 Earnings Conference Call

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen. Thank you for standing by. Welcome to the High Liner Foods Incorporated Conference Call for the results of the third quarter of 2016. At this time, all participants are in a listen-only mode.

Following management's prepared remarks, we will conduct a question-and-answer session. Instructions will be provided at that time for you to queue up for questions.

If anyone has any difficulties hearing the conference, please press the * key, followed by 0 for Operator assistance at any time.

This conference call is being recorded today, Wednesday, November 9, 2016, at 2:00 p.m. Eastern Time for replay purposes.

I would now like to turn the call over to Heather Keeler-Hurshman, Vice President of Investor Relations for High Liner Foods. Ms. Keeler-Hurshman, please go ahead.

Heather Keeler-Hurshman — Vice President, Investor Relations, High Liner Foods Incorporated

Thank you, and good afternoon, everyone. Thank you for joining High Liner Foods' conference call to discuss our financial results for the third quarter of 2016.

On the call today from High Liner Foods are Keith Decker, President and Chief Executive Officer, and Paul Jewer, Executive Vice President and Chief Financial Officer.

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Today's call will start with Paul reviewing the Company's financial performance for the third quarter, followed by Keith, who will provide an update on the business and progress on strategic goals before opening the call up for questions.

Before turning the call over to management, listeners are reminded that certain statements made in today's call may be forward-looking statements that are subject to risks and uncertainties. Management may use forward-looking statements as they discuss the Company's strategy and business in the future. Actual operating or financial results could differ materially from those anticipated in these forward-looking statements.

High Liner Foods includes a thorough discussion of the risk factors that can cause its anticipated outcomes to differ from actual outcomes in its publicly available disclosure documents, particularly in its annual report and Annual Information Form.

Please note that High Liner Foods is under no obligation to update any forward-looking statements discussed today.

Earlier today, High Liner Foods reported its financial results for the third quarter of 2016. That news release, along with the Company's MD&A and unaudited condensed interim consolidated financial statements for the third quarter of 2016 have been filed on SEDAR, and can also be found in the Investor information section of High Liner Foods' website. If you would like to receive our news releases in the future, please visit the Company's website to register.

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Lastly, please note that the Company reports its financial information in US dollars and the results to be discussed today are stated in US dollars, unless otherwise noted.

High Liner Foods' common shares trade on the Toronto Stock Exchange, and are quoted in Canadian dollars.

I will now turn the call over to Paul. Paul, please go ahead.

Paul Jewer — Executive Vice President and Chief Financial Officer, High Liner Foods Incorporated

Thank you, Heather, and good afternoon, everyone. Before beginning my financial review of the third quarter of 2016, I'd like to remind listeners that we use certain non-IFRS measures and ratios when discussing our results, as we believe these are useful in assessing the Company's financial performance. These measures are fully described and reconciled to IFRS measures in our MD&A.

Sales volume decreased in the third quarter of 2016 by 3 million pounds, or 4.4 percent, to 64.4 million pounds, primarily reflecting lower sales volume in the US retail and foodservice business, reflecting the impact of lower demand for traditional breaded and battered frozen seafood products.

Sales in US dollars decreased in the third quarter by 2016 by 9.3 million, or 3.9 percent, to \$230.8 million. For the first time in several years the Canadian dollar was actually slightly stronger in the quarter on a year-over-year basis, increasing the value of reported sales by approximately \$300,000 relative to the conversion impact in the same period last year.

In domestic currency, which is before the impact of converting our Canadian operations to the US-dollar presentation currency, sales decreased by \$9.3 million, or 3.6 percent, to \$251 million.

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This decrease reflects lower US sales volume and the change in product mix resulting from lower consumer demand for breaded and battered frozen seafood products, which we were unable to offset fully with sales from our new frozen seafood products that align with emerging customer trends and preferences.

Gross profit increased in the third quarter of 2016 by \$2.5 million or 5.8 percent to \$46.4 million, reflecting an increase in gross profit as a percentage of sales, partially offset by lower volumes. Gross profit as a percentage of sales was 20.1 percent compared to 18.3 percent last year, primarily due to lower raw material costs and higher supply chain optimization savings despite some loss in efficiency associated with the transfer of production from the New Bedford facility to our other facilities.

Adjusted EBITDA increased in the third quarter of 2016 by \$800,000, or 4.9 percent, to \$17.9 million. And as a percentage of sales, adjusted EBITDA increased by 70 basis points to 7.8 percent compared to 7.1 percent last year.

This improvement reflects the higher gross profit I just discussed, along with further benefit from supply chain optimization activities that lowered our distribution expenses, partially offset by higher SG&A expenses. Lower fuel costs related to distribution activities also contributed to increased adjusted EBITDA.

Reported net income increased in the third quarter of 2016 by \$500,000, or 8.7 percent, to \$6.6 million with diluted earnings per share of \$0.21. This increase in net income reflects higher

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adjusted EBITDA; lower business acquisition, integration and other expenses related to nonroutine activities; lower finance costs; and a lower effective income tax rate, partially offset by increased share-based compensation expense.

Excluding the impact of certain nonroutine and noncash items, which are explained in our MD&A, adjusted net income increased in the third quarter of 2016 by \$2.1 million, or 30.7 percent, to \$9.2 million. And correspondingly, adjusted diluted earnings per share increased by \$0.07 to \$0.30.

Turning now to the balance sheet. The net noncash working capital balance was a \$195.8 million at the end of the third quarter of 2016. This is \$31.4 million lower than the balance one year ago, reflecting improved inventory management, the sale of the New Bedford scallop inventory, and increased provisions partially offset by decreased payables.

Net interest-bearing debt was \$252.4 million at the end of the third quarter of 2016, which is \$66.7 million lower than the balance at the end of the third quarter of 2015. This decrease reflects the repayment of debt with cash flow provided by operating activities and the receipt of proceeds on the sale of New Bedford in September, which increased our cash balances.

For the rolling 12-month period ended October 1, 2016, cash flow from operating activities was \$81.1 million, of which \$17.4 million was generated in the third quarter of 2016.

We are very pleased with the strength of the cash flow generated by the business in 2016, which has allowed us to reduce our net interest-bearing debt to adjusted EBITDA ratio calculated on

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a rolling 12-month basis to 3 times at the end of the third quarter of 2016 from 4 times at the end of fiscal 2015.

We expect this ratio to remain consistent in the last quarter of 2016, as increased working capital requirements related to the seasonality in our business will reduce free cash flow available to reduce further our debt.

That concludes my financial review for the third quarter of 2016. I would now like to turn the call over to Keith for his update.

Keith Decker — President and Chief Executive Officer, High Liner Foods Incorporated

Thank you, Paul, and good afternoon, everyone. We are pleased that the financial results for the third quarter continued to show improvement in gross profit and adjusted EBITDA resulting from lower raw material prices and incremental supply chain optimization savings in 2016.

As Paul shared, these improvements were despite the loss of some efficiency and our plants related to the production transferred from the New Bedford facility that we sold in September. This loss in efficiency is temporary as the people at our plants work through issues associated with integrating new production into their respective operations.

The optimization work completed in the plants last year allowed for a much smoother transition period following a plant closure than the Company has experienced in the past. We expect plant throughput rates to steadily improve throughout the fourth quarter, and we remain on track to

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hit our target of achieving at least \$20 million in annual savings on a run rate basis by the end of this year.

We expect the trend of year-over-year improvement in gross profit and adjusted EBITDA experienced in 2016 thus far will continue in the fourth quarter. And while we expect our sales volume trend to improve, we do not expect to return to volume growth until our new product sales can offset the decline that the traditional breaded and battered category is experiencing.

We are disappointed that the ongoing trend of lower demand for traditional breaded and battered frozen seafood products continues to negatively impact our year-over-year sales volume. The growth we experienced in unprocessed products and in important growing species, such as Atlantic salmon, was not enough to offset the decline in our traditional breaded and battered business.

Available market information related to retail sales in both Canada and the US continues to show overall declines in the frozen seafood category at a rate in excess of the declines we are experiencing in our own business.

This reinforces the importance of certain key initiatives we are currently working on, as we believe they will not only help to reduce the overall impact of this trend on our business going forward, but will also better position High Liner Foods to deliver more frozen seafood products that align with emerging consumer trends and preferences.

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Before opening up the call for questions, I'd like to share with you that earlier today the Company's Board of Directors approved a quarterly dividend of C \$0.14 per share on the Company's common shares payable on December 15, 2016, to holders of record on December 1, 2016.

The quarterly dividend of C \$0.14 per share represents a 7.7 percent increase from the C \$0.13 per share quarterly dividend paid on September 15, 2016, to common shareholders of record on September 1, 2016.

Operator, I would now like to open the call for questions. Thank you.

Q&A

Operator

If you would like to ask a question at this time, please press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, press the # key. We will pause for just a moment to compile the Q&A roster.

Your first question comes from George Doumet from Scotiabank. Your line is open.

George Doumet — Scotiabank

Yeah. Good afternoon, guys.

Keith Decker

Hey, George.

George Doumet

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I believe in the past few quarters our outlook was for very modest volume growth. I'm just wondering what has changed there to no longer expect it to return...for volume growth to return in the near term?

Paul Jewer

Yeah. So I think a couple of things, George. One is we've seen some decline in our US retail business that Keith referred to that is in excess of what we anticipated, primarily again in breaded and battered products particularly in the more discount end of the spectrum.

And also in foodservice while we continued to see good execution on performance in our broad-line distributor business, despite them having some slowdown in foodservice sales overall, we have seen some more significant declines in our national account business.

And as Keith and I referred to, our new innovation has not delivered sufficient revenue growth to offset that decline at this stage.

George Doumet

That's helpful. And on that topic, can you maybe give us an update in terms of the innovation, maybe something in the 2017 product pipeline that maybe it relates to foodservice in the US that you think can maybe help generate some volume growth?

Keith Decker

We have some products that are businesses that we have scheduled to go into distribution in the first quarter. I can't comment specifically on them because they're not in distribution yet. But

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to Paul's comment, we have put new business opportunities out there that will be incremental in coming.

I think the bigger opportunity is really on the retail end in terms of products that we are launching there and the uptake of those, because it's important that we at some point cycle over the traditional breaded and battered declines that are occurring into category. And it's not specific to High Liner Foods; this is a category issue.

And I think that the faster that we could execute on new products into the market, the faster we'll be able to lap over this trend.

George Doumet

That's helpful. And just one more, if I may. A bit of a step-up in the SG&A in the quarter. Just I think you mentioned the culprits there as being some incentives. Can you maybe just provide a little more colour there? And just trying to get a sense of a normalized run rate there?

Paul Jewer

Yeah. So a couple things. One is some timing in terms of marketing spend, and the second—you're right—is the incentive piece. You'll recall this time last year High Liner was significantly underperforming our expectations, so as a result there was not much in the way of incentive expense a year ago.

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While the third quarter was obviously a little softer than we would have liked, our performance in the first two quarters has been good. So we have higher incentive expense year to date than we did a year ago.

There's really nothing else specifically I'd highlighted on the SG&A line. We did have on the distribution line, as I mentioned in the script as well, some positive impact associated with supply chain optimization and lower fuel costs.

George Doumet

All right. Thanks a lot. It's very helpful. Okay. Bye.

Operator

Your next question comes from Sabahat Khan from RBC Capital Markets. Your line is open.

Sabahat Khan — RBC Capital Markets

All right. Thanks, and good afternoon. If we can maybe look at the unprocessed part of your business. Do you think to get more leverage there is it products you can produce internally? Or would you have to do more of that growth through acquisitions?

Keith Decker

I think it's a combination. We had bought the Atlantic Trading Company with the intent that we would expand our presence in Atlantic salmon. We have seen that our Atlantic salmon sales are starting to increase, along with the some pretty nice improvements in unprocessed sales across our core white fish species.

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So these are products that clearly are part of our existing pipeline. And our focus is on continuing to develop our aquaculture side of our business where we believe that there is still opportunity for us to grow. Whether that comes with an acquisition or not, I think that that's really a function of finding the right target and ascertaining whether that fits within our organizational structure and our valuation model.

But a lot of the products that we're coming out with while they maybe unprocessed in nature, there is a subset of those that are clearly focused on unprocessed plus some type of a glaze, a sauce, a rub, et cetera. And we are seeing good uptake on those, and that's an intention to continue to focus in that direction to utilize plant overheads.

Paul Jewer

And, Saba, Keith referred to this in the script, our unprocessed product have actually experienced growth in the quarter. Unfortunately, it was more than offset by the decline in the processed area.

Sabahat Khan

Okay. No, thanks for that. And if we maybe step back a little bit, is it that if you get enough of this unprocessed product out there that'll help offset some of the declines in the processed? Or is just the overall seafood category not performing as well relative to other proteins? If you can maybe provide some context on that?

Keith Decker

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Well, I think that from an overall seafood category it's not necessary that. I think there's a transition shift taking place. We see it particularly in the retail sector on core breaded and battered. There are some select national accounts that Paul mentioned in his comments that had some softness in the third quarter, but it's a bigger issue when it comes to retail and the consumer trend away from traditional breaded and battered into prepared items with more of a premium nature, or more of an unprocessed nature.

Sabahat Khan

Okay. And then one last for me; if we could maybe get an update. I know a while back we were talking about getting some product into some of the fast casual chains. I'm not sure if that's what you were referring to earlier with new innovations, but any update on how that's working to get some of your seafood products listed there?

Keith Decker

Yes. So we have been clearly focused on that. I would anticipate that we will start to see some benefits of that in the first quarter of this year, as we've been working through test markets on various products. So I do believe we are making some inroads there. And it's a function of working through their menu cycle, their test cycles to a launch date.

Sabahat Khan

All right. Thank you.

Operator

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Once again, if you would like to ask a question, press *, then the number 1 on your telephone keypad.

Your next question comes from Jonathan Lamers from BMO Capital Markets. Your line is open.

Jonathan Lamers — BMO Capital Markets

Yes. You may have quantified this, what was the benefit of the supply chain optimization activities in Q3?

Paul Jewer

Yeah. So in Q3 in total it was 6.5 million compared to 2.9 million in Q3 last year. So on a year-to-date basis that's 14.7 million versus 5.2 million year to date in 2015. So we have seen continued improvement on the supply chain side. Obviously volume decline hampers that improvement a little, and we did want to call out in the script that we did have some disruption associated with the transfer of all of the volume from our New Bedford facility to our other plants.

Not surprising that we would have that, but we see that as a temporary issue as opposed to something that would impact our ability to get the savings that we anticipated.

Jonathan Lamers

And have these disruptions continued in Q4?

Paul Jewer

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Yeah. We're still working through some of them in Q4 because, don't forget, we just closed that plant in September and sold the operation in September. So we expect that we'll continue to work through those in Q4, but in Q4 we will also start to see the benefit associated with costs avoided from not having that plant as well, which we really didn't have that positive impact in Q3.

Jonathan Lamers

Okay. Thanks. And from the industry data you receive, can you comment on the trends in breaded and battered products overall?

Keith Decker

So the latest Nielsen/IRI data that we've received would suggest that the category is off roughly 11 percent in that traditional breaded and battered segment. And so we've seen that consistently quarter after quarter starting in the first quarter of this year and continuing through the third quarter, and even through the latest four weeks.

So it is a category that is challenged and it's not just High Liner, but it is also the other players in the segment, which have larger market shares. It is interesting to note that we are experiencing better than the industry trends.

In fact, we have the number one selling frozen seafood item in the country for the latest period, but the category, of course, is still negative, and we're doing better than the average. So it's saying that it's a positive.

Jonathan Lamers

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Okay. And can you provide us with any commentary on sort of the foodservice channel versus the retail channel?

Paul Jewer

Yeah. So in Canada we had growth in both foodservice and retail. In the US, as Keith mentioned in the script, we had a decline in both foodservice and retail. And in foodservice I highlighted the national accounts being the area where there was some decline as opposed to the broad-line distributors.

Although if you follow the broad-line distributors you've seen that there's been some softening in the foodservice market overall in the US. And in retail, the decline was driven by discount and private label products in our portfolio.

Jonathan Lamers

Okay. Thank you for your comments.

Paul Jewer

You're welcome.

Operator

Once again, if you would like to ask a question, press *, then the number 1 on your telephone keypad.

Your next question comes from George Doumet from Scotiabank. Your line is open.

George Doumet

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Yeah. Just two quick follow-ups. Just looking at the higher-priced salmon, just wondering when you guys expect that the flow through the P&L? And do we expect some pressure there at all on volumes?

Keith Decker

That started flowing through our P&L actually in the late part of the second quarter, and we were cost-averaging up through that period of time. To date, we were expecting some drop in velocity; however, we have not seen that drop in velocity on the shelf at the higher price.

So at this point we are now clearly into the higher-priced inventory in the marketplace.

George Doumet

All right. That's helpful.

Paul Jewer

Sorry, and as Keith mentioned, we actually have seen growth in Atlantic salmon, and Atlantic salmon as a species continues to be growing in the North American market overall.

George Doumet

All right. Great. Thanks. And one last one, if I may. I know this is early days, but any risk at all to procurement operations, I guess, in light of any potential changes we can see in trade agreements, I guess, information as of this morning?

Keith Decker

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Yeah. I will say, George, I can't even comment or speculate on what has happened in the last 24 hours. It'll unfold as it unfolds.

George Doumet

All right. All right. Thanks a lot, guys.

Operator

Once again, if you would like to ask a question, press *, then the number 1 on your telephone keypad.

We do not have any questions over the phone line at this time. I will turn the call over to the presenters.

Keith Decker

Well, thank you, everyone, for your participation in today's call. We look forward to updating you with results for the fourth quarter on our next conference call in February.

Operator

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

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