FINAL TRANSCRIPT

High Liner Foods Incorporated

Conference Call for Results of the Fourth Quarter and Fiscal 2018

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CORPORATE PARTICIPANTS

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

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

Rod Hepponstall
High Liner Foods Incorporated — President & Chief Executive Officer

CONFERENCE CALL PARTICIPANTS

George Doumet
Scotiabank — Analyst

Jonathan Lamers
BMO Capital Markets — Analyst

Sabahat Khan
RBC Capital Markets — Analyst

PRESENTATION

Operator

Good afternoon, ladies and gentlemen. Thank you for standing by. Welcome to the High Liner Foods Incorporated Conference Call for Results of the Fourth Quarter and Fiscal 2018. At this time, all participants are in a listen-only mode.

Following the 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 difficulties hearing the conference, please press the * key, followed by a 0 for Operator assistance at any time.

This conference call is being recorded today, Wednesday, February 27, 2019, 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 and Communications for High Liner Foods. Ms. Keeler-Hurshman, please go ahead.

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

Thank you. Good afternoon, everyone. Thank you for joining High Liner Foods' conference call to discuss our financial results for the year-end and fourth quarter of 2018. On the call today, from High Liner Foods, are Rod Hepponstall, President and Chief Executive Officer; and Paul Jewer, Executive Vice President and Chief Financial Officer.

In a moment, I'll pass the call over to Paul, who will review the Company's financial performance for the fourth quarter and fiscal 2018. Rod will then provide an update on the Company's progress against its strategic objectives including the five critical initiatives as outlined last quarter, along with other key developments. We will then open the call up to questions.

Before turning the call over to Paul, I would like to remind listeners that we use certain non-IFRS measures and ratios when discussing our financial 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.

Listeners are also 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 when 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 outcome to differ from actual outcomes in its publicly available disclosure documents, particularly in its annual report and its 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 fourth quarter and full year ended December 29, 2018. That news release, along with the Company's MD&A and audited, consolidated financial statements for fiscal 2018, have been filed on SEDAR and can also be found in the Investor Information section of the High Liner Foods website. If you would like to receive our news releases in the future, please visit the Company's website to register.

Lastly, please note that the Company reports its financial results 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 & Chief Financial Officer, High Liner Foods Incorporated

Thank you, Heather, and good afternoon, everyone. Please note that all comparisons provided during my financial review of the fourth quarter of 2018 are relative to the fourth quarter of 2017, unless otherwise noted.

Before getting into the fourth quarter financial results, I'd like to update listeners on the recovery of losses related to the Company's product recall in April 2017. An $8.5 million recovery from the ingredient supplier was recognized in the third quarter of 2018, and subsequent to December 29, 2018, the Company recovered an additional $8.5 million from the ingredient supplier that will be recognized during the first quarter of 2019, reflecting the period in which the recovery became virtually certain in accordance with IFRS.

This increases the Company's total recovery related to the product recall to $17 million, reflecting a full recovery of the $13.5 million in losses recognized during fiscal 2017 related to the recall and an additional $3.5 million related to business disruption. No further recoveries are expected.

As I begin my review of the fourth quarter of 2018, please keep in mind that the product recall had the impact of lowering sales by $400,000 and decreasing gross profit by $1.5 million in the fourth quarter of 2017. I also want to remind listeners that net income for the fourth quarter and fiscal 2017 reflected a noncash income tax recovery of $11.2 million attributable to the reduction in the US Federal Corporate Income Tax rate from 35 percent to 21 percent that came into effect on January 1, 2018, under the US tax reform enacted on December 22, 2017.

Sales volumes decreased in the fourth quarter by 5.5 million pounds to 66.1 million pounds compared to 71.6 million pounds in the same period in 2017. The decrease reflects lower sales volume in our Canadian retail business and our US retail and foodservice businesses. Sales in US dollars decreased in the fourth quarter by $20.1 million to $242.9 million compared to $263 million, mainly due to the decreased volume mentioned previously and changes in product mix, partially offset by price increases related to raw material cost increases.

Gross profit decreased in the fourth quarter by $4.2 million to $40.3 million compared to $44.5 million. Excluding the losses associated with the product recall, gross profit decreased by $5.7 million to $40.3 million, or 16.6 percent as a percentage of sales, compared to $46 million dollars, or 17.5 percent as a percentage of sales due to lower sales volumes, raw material cost increases, changes in product mix, and US plant inefficiencies, partially offset by price increases.

In addition, the weaker Canadian dollar had the effect of decreasing the value of reported US dollar gross profit from our Canadian operations in 2018 by approximately $400,000 relative to the conversion impact last year.

Adjusted EBITDA decreased in the fourth quarter of 2018 by $1.1 million to $12 million, or 4.9 percent of sales, compared to $13.1 million, or 5 percent of sales. Excluding the impact of converting our Canadian dollar denominated operations and corporate activities to our US dollar presentation currency, a decrease of $1.7 million in 2018 and $300,000 in 2017, adjusted EBITDA increased by $300,000, reflecting lower distribution expenses and SG&A expenses across the Company, partially offset by the lower gross profit.

Reported net income decreased in the fourth quarter of 2018 by $15 million to a net loss of $800,000 with diluted loss per share of $0.02 per share compared to net income of $14.2 million with diluted earnings per share of $0.43 per share. The decrease in net income reflects a lower income tax recovery during the fourth quarter of 2018 compared to 2017 due to the $11.2 million noncash income tax recovery that was recorded in 2017 related to the income tax reform mentioned previously.

Additionally, net income decreased due to the decrease in adjusted EBITDA mentioned previously; an impairment of property, plant and equipment; an increase in termination benefits associated with the organizational realignment announced in November 2018; and an increase in finance costs. Excluding the impact of certain nonroutine and noncash items, which are explained in our MD&A, adjusted net income decreased in the fourth quarter by $2.6 million to $2.2 million and correspondingly, adjusted diluted earnings per share decreased by $0.08 to $0.07.

Turning now to cash flows from operations and the balance sheet. Net cash flows from operating activities increased by $78.4 million to an inflow of $56.9 million in fiscal 2018 compared to an outflow of $21.5 million in fiscal 2017, primarily reflecting more favourable results from operations, including income tax refunds and favourable changes in net noncash working capital, partially offset by higher interest payments.

Net interest-bearing debt decreased by $27.3 million to $360.6 million at the end of fiscal 2018 compared to $387.9 million at the end of fiscal 2017. Net interest-bearing debt to rolling 12-month adjusted EBITDA was 5.8 times at the end of fiscal 2018 compared to 5.9 times at the end of fiscal 2017. In the absence of any major acquisitions or strategic initiatives requiring capital expenditures in 2019, we expect the ratio will be lower at the end of fiscal 2019.

That concludes my financial review, and I will now turn the call over to Rod.

Rod Hepponstall — President & Chief Executive Officer, High Liner Foods Incorporated

Thank you, Paul. Good afternoon, everyone. As you heard, our fourth quarter performance is aligned with our expectations for this stage in our turnaround plan. We are cautiously optimistic that, despite persisting headwinds, High Liner is on the right track. Operating standards and fill rates are improving. Our balance sheet is getting stronger as we reduce debt levels and improve working capital, and we are advancing on our five critical initiatives to stabilize and improve our core business and return to profitable organic growth by 2020.

In the fourth quarter, we successfully completed our first critical initiative, our organizational realignment, which has not only resulted in approximately 7 million in annualized run rate cost savings but also means we are now working within a much more efficient, cohesive North American wide structure.

I really want to stress the importance of operating as one High Liner Foods. In many ways, when I joined High Liner Foods, I came to two companies, one in the United States and one in Canada, that happened to share the same name. Through the organizational realignment, we are now operating as one unified company. Our team is working more cohesively than ever before. We are making decisions together, sharing lessons learned, and testing out new ideas for how we operate, innovate, and reach consumers.

With the heavy lifting of our organizational realignment behind us, we are now in a position to focus on our next critical initiatives of simplifying our business, optimizing the supply chain, and integrating Rubicon, which together lay the groundwork for our final critical initiative of return to profitable organic growth.

We're seeing important progress on our initiatives. I will now briefly touch on each one and highlight some of the key actions over the next few months. Regarding business simplification, as we told you last quarter, we're focused on eliminating complexity in our business to increase efficiency and maximize customer appeal, margins, and growth potential of our product portfolio.

Informed by significant financial and market analysis, we're streamlining our portfolio focus on the most profitable products and key species, and we'll move away from products that appeal to increasingly small market segments, the next step in executing against this plan and then over time turning our attention to simplifying raw materials, packaging, and ingredients.

Of course, our business simplification process will have a big impact on our supply chain. Less products, SKUs, and ingredients will drive efficiencies for sure, but that's not the only way we are approaching supply chain optimization. We are examining all critical supply chain connections to find ways to speed things up, eliminate duplication, and leverage the potential of our cross-border competitive advantage. These improvements will reduce costs and help us better manage working capital.

We're making headway. For example, we recently aligned our Canadian and American warehousing and transportation strategies so they are now operating as one. We're also aligning operational standards and capabilities so that the individual product can be made in multiple facilities and don't have to be shipped further than necessary.

All told, we've identified opportunities for improvement in our supply chain that will help us reduce cost by several million dollars on a run rate basis in 2019, which will in turn strengthen our competitive position in the market and improve margin.

Turning now to Rubicon, progress on integration is happening every day. With High Liner VP Keith Blanks now managing Rubicon's day-to-day operations and working alongside long-time Rubicon strategic leaders, such as Brian Wynn, we are already seeing enhanced information flow and sharing of best practices.

Shrimp remains the second fastest growing seafood category behind salmon, and we will see significant potential for growth. We're developing a collaborative go-to-market strategy that will bring together the best of Rubicon and the best of High Liner. We've integrated and streamlined the shrimp purchasing process across both Rubicon and High Liner, and High Liner is now able to leverage Rubicon's expertise in cross-selling shrimp to existing High Liner customers.

As I've said before, we're deliberately sequencing our critical initiatives to ensure that as we enter 2020 we'll be in a position to drive profitable organic growth with an integrated organization and a more effective supply chain. This will allow us to do a better job extracting the value from our existing business and in forging new opportunities.

To support growth on both fronts, we've put in place an integrated planning process to focus and drive activities of our North American sales and marketing team. This will allow us to plan our business more effectively and better manage our resources for maximum efficiency and results. We're working closer than ever with our suppliers, customers, and employees to identify ways to drive efficiency and lay the foundation for growth.

I spent a lot of time travelling recently, and while in China and Thailand, I saw firsthand the interaction between our suppliers and employees and the value proposition that High Liner brings to the table. My travels throughout North America meeting face-to-face with customers further deepened my understanding of our customers' needs and issues. These interactions on the ground with our stakeholders give us the insight we need to fuel innovation and ensure we establish the right strategic partnerships.

Looking ahead, we're poised to bring a number of innovations to market in 2019. We're aiming to strengthen our customer engagement models, understand consumer tastes, and increase demand for seafood products. Through insight, research, partnerships, and a unified North American platform, we're launching innovative products like Haddock Bites and Everything-Bagel-Crusted Cod products that are on trend, shareable, and appropriate for multiple eating occasions, including snacking. We're using our North American scale, taking innovation cross border and across multiple channels. It's about recognizing opportunities and ensuring High Liner Foods is there quickly.

As I made it clear last quarter, this turnaround is not a quick fix, but I'm encouraged by the progress we've made to date, and I remain confident that we will generate in excess of $10 million in cost savings identified when we introduced this plan. My confidence is, in large part, due to the quality of our people, who are motivated and incented to succeed. Our compensation plans now align our entire workforce to the execution of our critical initiatives. By successfully implementing our plan, we'll create a more competitive, innovative, and agile High Liner Foods, better positioned to drive future growth and value creation moving forward.

In closing, we know that we have a lot of work ahead of us and challenges to overcome, but I'm encouraged by our progress we're making. Demand for seafood remains strong. Our fourth quarter financial results were in line with our expectations for this stage in our turnaround plan. And I'm confident that we're on the track to return to profitable, organic growth by 2020.

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

Q&A

Operator

At this time, I would like to remind everyone, in order to ask a question, please press *, then the number 1, on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

And your first question comes from George Doumet with Scotiabank. Please go ahead.

George Doumet — Scotiabank

Yeah. Good afternoon, and thanks for taking my questions.

Rod Hepponstall

Hi, George.

Heather Keeler-Hurshman

Hi, George.

Paul Jewer

George.

George Doumet

Rod, thanks for the update you provided on the turnaround plan. I know it's early days for the simplification component of it, but can you give us a sense of the magnitude of product eliminations that could possibly happen? And I'm just wondering also if there's an opportunity to change our plant's footprint at all at this point.

Rod Hepponstall

I'm sorry, what was the second part of that question?

George Doumet

Just wondering if there's a possibility of changing our plant's footprint at all, like how they're scattered in the locations, and if there's—yeah. On that topic. Thanks.

Rod Hepponstall

Perfect. So let me address your first question that is around impact on our simplification project. First and foremost, that project is on track and on plan, and we are moving them forward diligently with it.

The impact of species is roughly a little bit north of five. We're still working through the ultimate SKU impact, but north of five species will be impacted by the simplification process.

As it relates to any consideration to our plant's network at this point in time, that has not come under consideration.

George Doumet

That's helpful. And as you spoke about the species, I'm just wondering if you can maybe share your outlook for pricing as it relates to the key species and over the next maybe the remainder of the year.

Rod Hepponstall

Yeah. I mean, we've had significant inflation in the category throughout 2018. We will certainly manage any inflation that comes our way with the appropriate pricing action, but at this point in time, I don't see any activity that would suggest that we'll have maybe similar inflationary activity than we would in 2018. Of course, we don't have a crystal ball, but we're certainly positioned to manage that going forward.

Paul Jewer

And think I would add to that, George, at this stage, is obviously any uncertainty with regards to tariffs. We have anticipated that there might be an increase on March 1st. That doesn't look like it's going to happen, fortunately. So we'll wait and see what occurs on any cost increases related to tariffs.

George Doumet

Okay. That's helpful. I guess in the context of inflation remaining kind of the low- to mid-single digits, do we still think that we can deliver flat volume growth or positive volume growth in 2020?

Rod Hepponstall

Well, as we mentioned previously, right, we are dealing with external/internal headwinds. So our plan is to return to profitable organic growth by 2020. So we're focused on fulfilling the commitments we've made as it relates to $10 million on an annual run rate basis in 2019 and completion of our five critical initiatives.

George Doumet

Okay. Yeah. Thanks. Just one last one before I go. Maybe a housekeeping for Paul. Can you maybe share with us what you're thinking about CapEx and working capital for 2019?

Paul Jewer

Yeah. So from a CapEx perspective, we actually think we'll be a bit lower in 2019 than what we've been over the last couple of years, probably closer to $10 million on an annual basis. And in terms of working capital, I mean, obviously it's an area we continue to work on. A number of the initiatives could help provide some modest improvement in working capital. Although we did have quite a successful year on the working capital front in 2018, particularly in terms of managing inventory levels while maintaining good fill rates and customer service levels. So I wouldn't expect a significant improvement above and beyond what we've achieved in 2018 at this stage, but it is something we're continuing to work with the initiatives.

George Doumet

Thanks. That's it for me. I'll get back in line.

Operator

And your next question comes from Jonathan Lamers with BMO Capital Markets. Please go ahead.

Jonathan Lamers — BMO Capital Markets

Good afternoon.

Rod Hepponstall

Good afternoon, Jonathan.

Jonathan Lamers

On the US gross margin decline in Q4, the MD&A attributed that first to plant inefficiencies. Can you comment on or explain what inefficiencies you saw? And how this is a separate issue from volumes declining?

Paul Jewer

Yeah. So obviously, the volume decline and, I would say, the mix shift in volume had an impact on the gross margin line, so we continued to see a shift from value-added product to unprocessed product.

In terms of plant efficiency, as you can imagine, as we see declines in value-added product, that has an impact on our absorption at plant level. So we did see some of that impact in Q4, which impacted margins.

In terms of run rate, the plants actually showed some improvement in Q4, particularly over where we were earlier in the year. So we are moving in a better direction going into 2019 on plant performance in terms of run rate and in terms of service levels, although we do believe we still have an opportunity on the cost side on the plants. And our supply chain initiative for 2019 is very focused on that.

Jonathan Lamers

On that topic, Paul, would you happen to have the industry data for how much breaded and battered volumes were down for either whole year '18 or Q4?

Paul Jewer

I don't have it in front of me, but it was, I would say, low single-digit decline both in Canada and in the US. Our data there is stronger on the retail side obviously, but in terms of the visibility we have into foodservice, I would suggest that that would—we believe it's a relatively similar story in foodservice as well. Unprocessed volume is slightly up, and value-added volume is slightly down.

Jonathan Lamers

And a question on the Canadian market, the product mix appears to have been particularly favourable in Q4. Could you comment on that? And is that a dynamic you would expect to continue into 2019?

Paul Jewer

Yeah. Certainly, a dynamic we hope to continue to move forward as we manage mix and focus, in particular, on the top four organic growth initiatives. But we did have some business we exited from in Canada in—that was in 2017 that wasn't in 2018 that was variable margin business for us. So that also did have a favourable impact on mix. But it's actually the primary reason that you saw the volume declines in Canadian retail in that period as well.

Jonathan Lamers

And just to follow up on the CapEx guidance. I mean, you're in the process of reevaluating your existing manufacturing. So as you progress through that, is it possible there may be some incremental equipment required in addition to that CapEx? Or should we consider that 10 million to kind of include the full envelope?

Paul Jewer

Yeah. At this point, I would consider the 10 million to include the full envelope. Most of the opportunities on the supply chain side that we've identified thus far do not require additional CapEx. What

I would say is if we do identify opportunities above and beyond our budget that we believe have a substantial return on invested capital associated with them, then we will do the right thing and pursue those. But we haven't identified anything incremental at this stage that's required.

Jonathan Lamers

And just on that supply chain optimization project, how significant would the transportation alignment that Rod mentioned be relative to that $3 million target that's been announced?

Paul Jewer

I would say the majority of the opportunity is on the plant side, but I don't want to minimize the opportunity, frankly, on the distribution and logistics side either. But part of the distribution and logistics benefit will help us deal with what, as you've heard from many in the industry, is a rising cost for distribution in the industry overall. And we're targeting that supply chain savings at this point. Obviously, our target is to try to exceed that, and if we are successful in that, part of that will come from incremental benefit on the distribution and logistics side.

Jonathan Lamers

Okay. Thanks. And just lastly, on the two products mentioned in the prepared remarks, the Haddock Bites and one other. When were those introduced to the market? And how significant should we think of those being?

Rod Hepponstall

So both those products were introduced both cross-channel and cross-border multiple channel, fourth quarter of last year, tail end of the year. The Everything-Bagel-Crusted Cod is at two major retailers in the US at this point. And I would tell you on an LTL basis, not only the feedback we're getting from consumers but certainly from sales would suggest they are products that are on trend and have certainly potential opportunity for us. So we're very, very pleased with the initial results, particularly in that product. And the product for Haddock Bites was launched around the same time period. While we don't have the same level of consumer response on that, we firmly believe that that product, which is on trend as it relates to shareables and snackables, holds significant promise for us as well.

Jonathan Lamers

Great. And just on the topic of the volume outlook, now that you've had an opportunity to realign the sales incentives, and I believe those were in place at the start of '19, are you seeing any improvement in orders from your customers or in consumer demand?

Rod Hepponstall

I'd say it's probably a bit early to tell from maybe a calendar year 2019 perspective, but what I can tell you is the organization is absolutely aligned from top to bottom as to the objectives we have to drive profitable organic growth by 2020.

Jonathan Lamers

Okay. Thanks for your comments.

Operator

Again, to ask a question please press *, 1, on your telephone keypad. And our next question comes from Sabahat Khan with RBC Capital Markets. Please go ahead.

Sabahat Khan — RBC Capital Markets

All right. Thanks. Just kind of a quick follow-up on the 2020 outlook, just based on what you're seeing in the industry. I guess how much of the industry growth is baked into that in terms of are you expecting the overall backdrop in the value-added space still to be weak and you expect to grow against that? Or do you think by 2020 you could see an inflection across US and/or Canada?

Rod Hepponstall

Well, I think what we're focused on is where High Liner has the best opportunity to take advantage of growth opportunities as well as potentially take share in the marketplace. Our innovation is absolutely focused on the consumer trends and voids we have in our product portfolio to help drive that profitable growth by 2020. So the outlook, it's probably a bit premature for us to specifically get into detail on at this point.

Sabahat Khan

Okay. And then just in terms of your capital allocation, the US taking a step down in the CapEx, I guess is that just not a lot of opportunities out there in terms of investment? Is that part of your kind of leverage reduction? And how are you thinking about maybe your dividend payout within the context of targets? So I just want to understand how you're approaching sort of capital allocation and the leverage reduction strategy.

Paul Jewer

Yeah. So I think you hit on both fronts, in terms of CapEx. We've invested a lot in CapEx over the last number of years in the business, and we don't have as much in the way of what I would call routine CapEx requirements at the plants in 2019, which are our primary areas where we spend CapEx. But obviously, as our leverage is high, we've been working hard, whether either on working capital or CapEx, to find ways to generate cash to use to reduce the debt. So that certainly factored into our thinking there as well.

In terms of your question on the dividend, I mean ultimately, that's a question for the board. But at this point, the capital allocation review is still underway. And we'll give a further update when we release our first quarter results in May on that as well.

Sabahat Khan

All right. Great. And then just one last one from me. As the outlook calls for some softness through 2019, I guess from our point of view, how should we think about that flowing through the results? Is that, do you think, more of a top-line thing? Or do you think that the hit's going to be more on the margin side because of all the initiatives that you're undertaking relative to last year's results?

Rod Hepponstall

Sorry. Can you repeat the first part of that question, Sabahat?

Sabahat Khan

Yep. So in terms of the outlook, it just kind of indicates that the 2019, is this a bit of a cautious commentary regarding 2019? So from your point of view, do you see the challenge more on the top-line results through 2019? Or do you think it's going to be—or do you see a risk potentially on margins as we look at results versus prior year?

Paul Jewer

Yeah. So I think, clearly, there'll be more challenge on the top line front, given what we've talked about, in terms of the industry headwinds that we have to face, and the fact that our profitable organic growth initiative really is one of those latter of the initiatives because the others help that initiative be successful. So I expect, just in terms of phasing, you'll see more benefit on the cost side earlier in 2019 as our attention then shifts more and more to working on the profitable organic growth initiative.

Sabahat Khan

All right. Great. Thank you.

Operator

And there are no further questions at this time. I will turn the call back over to the presenters.

Rod Hepponstall

To close, I want to thank you for joining our call today. Despite persistent headwinds, I'm cautiously optimistic that High Liner is now on the right track for a return to profitable organic growth by 2020. Thank you.

Operator

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