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FINAL TRANSCRIPT

High Liner Foods Incorporated

Conference Call for the Results of the Third Quarter of 2018

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to the High Liner Foods Incorporated conference call for the results of the third quarter of 2018. At this time, all participants are in a listen-only mode.

And following management's prepared remarks, we will conduct a question-and-answer session. Instructions will be provided at the 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, Thursday November 8, 2018, at 2:00 p.m. Eastern Time for replay purposes.

I'd like now 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 third 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 Rod, who will provide an overview of the five critical initiatives being implemented by High Liner Foods, including the organizational realignment included in our announcement issued earlier today. Paul will then review the Company's financial performance for the third quarter of 2018, and then Rod will provide further details on our short-term plans to stabilize the business, along with other key developments before opening up the call for questions.

Before turning over the call over to Rod, 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 different 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, particularity 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 third quarter ended September 29, 2018. That news release, along with the Company's MD&A and unaudited condensed interim consolidated financial statements for the third quarter of 2018 have been filed on SEDAR, and can also be found in the Investor Information section of the High Liner Foods' website.

If you'd 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 Rod.

Rod, please go ahead.

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

Thank you, Heather. Good afternoon, everyone. When I took over as President and CEO this past May, I did so with the belief that significant opportunities exist for both the seafood industry and High Liner Foods.

I still do, but it's clear to me that our recent results are not reflecting our potential.

Our disappointing performance in the third quarter reflects challenges in both the external operating environment and our internal operations. We have work to do.

We need to enhance coordination between our US and Canadian operational structures and improve our supply chain, including plant deficiencies. We are facing increased pricing on certain species, and we must improve our customer engagement model and increase our overall value proposition. We recognize the urgency of the situation and are taking swift action.

The five critical initiatives detailed in our news release today are designed to fix the most pressing issues facing our business in a methodical and sustainable way. I'm not interested in a quick fix; our critical initiatives will strengthen the foundation of our business, drive cost efficiencies, and position High Liner for long-term sustainable growth.

As I will explain in detail later on the call, completing this work will set the business up for success by ensuring that we have the most efficient supply chain, a strong handle on costs, the right talent in the right roles, a tighter integration with Rubicon, and a stronger strategic marketing platform to grow consumer demand for seafood and our value-added offerings.

We started the restructuring process in July, just two months after I joined the Company, focusing first on our executive realignment with the departure of our US president and chief supply chain officer, and we have moved quickly to realign the rest of the organization.

As announced earlier today, we have taken the difficult step of letting go approximately 14 percent of our salaried workforce. It's never easy to lose good people, but we need to act urgently to address our costs and streamline our organizational structure.

As a result of the full organizational alignment, we will generate approximately $7 million in net annualized run rate cost savings. There will be a onetime charge of approximately $4.5 million associated with the latest round of restructuring and 3.3 million of which will be recognized in the fourth quarter, with the remainder being recognized in 2019.

This figure gives us full confidence that we'll now achieve in excess of the $10 million net annualized run rate cost savings target we first communicated in August associated with our five critical initiatives.

We thank the parting employees for their contributions to High Liner, and are confident we have the right structure and team in place to execute our plans to reposition the business so that we can unlock our true potential moving forward.

The good news is that demand for seafood continues to be strong, and High Liner Foods is well positioned to meet this demand because of our established market position, well-known brand, and seafood expertise.

Later on the call I'll share key aspects of each of our five critical initiatives, but at this point I'd like to turn the call over to Paul for his financial review of the third quarter.

Paul?

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

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

Before getting into the third quarter financial results, listeners are reminded of the Company's product recall in April 2017. Related to this recall, we recognized an $8.5 million recovery of product recall loses from an ingredient suppler in the third quarter of 2018.

This recovery was recognized as business acquisition, integration, and other income expense in the consolidated statements of income, and has been excluded for the purpose of adjusted EBITDA and adjusted net income.

This is the first recovery installment from the ingredient supplier. The Company continues to expect it will recover from the ingredient suppler substantially all of the losses it incurred associated with the product recall, including 13.5 million in net losses recognized in fiscal 2017.

Future recoveries will be recorded in the period in which they occur or are virtually certain to occur, in accordance with IFRS.

In the third quarter of 2017, the product recall had the impact of increasing sales volume by 100,000 pounds and sales by $800,000 associated with the revision of estimated product returns and increased profit, gross profit by $2.7 million.

Sales volume for the third quarter of 2018 decreased by 9.4 million pounds: 64.2 million pounds compared to 73.6 million pounds. The decrease in sales volume reflects lower sales volume in the US retail and foodservice businesses and Canadian retail business, including a decrease of 3.4 million pounds from Rubicon after the departure of one of its major customers.

Sales in the third quarter of 2018 decreased by $41.5 million to $241.2 million compared to $282.7 million. Excluding the impact of a weaker Canadian dollar on the translation of US dollar sales from the Company's Canadian dollar-dominated operations relative to the conversion impact in 2017, approximately $2.8 million, and the impact of the product recall in 2017, $700,000, sales decreased by $38.5 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 in the third quarter of 2018 decreased by $4.3 million to $44 million compared to $48.3 million, with gross profit as a percentage of sales increasing to 18.2 percent compared to 17.1 percent.

Excluding $2.7 million of nonrecurring losses associated with the product recall in 2017, gross profit decreased by $7 million to $44 million, 18.2 percent of sales, compared to $51 million, 18.1 percent of sales due to lower sales volume, unfavourable changes in product mix, and US plant inefficiencies, partially offset by price increases related to raw material cost 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 $500,000 relative to the conversion in 2017.

Adjusted EBITDA in the third quarter of 2018 decreased by $3.1 million to $14.2 million, 5.9 percent of sales, compared to $17.3 million, 6.1 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 $400,000 in 2018 and $600,000 in 2017, adjusted EBITDA decreased by $3.2 million, reflecting the lower gross profit mentioned previously, partially offset by lower distribution and SG&A expenses.

Reported net income in the third quarter of 2018 decreased by $1.5 million to $4.5 million, diluted EPS of $0.13 compared to $6 million, diluted EPS of $0.18. This decrease in net income reflects the decrease in adjusted EBITDA mentioned previously; an impairment of property, plant, and equipment; and an increase in finance costs and income tax expense, partially offset by the product recall recovery of $8.5 million.

The Company’s effective income tax rate for the third quarter of 2018 was an expense of 56.3 percent compared to a recovery of 29.6 percent in the third quarter of 2017. The higher effective income tax rate was attributed to reduced interest expense deductibility associated with the Company’s tax-efficient financing structures due to a valuation allowance, partially offset by a reduction in the US federal corporate income tax rate from 35 percent to 21 percent, which are both attributable to the Tax Cuts and Jobs Act that was signed into law on December 22, 2017. The Company still expects the annual effective income tax rate to be approximately 20 to 25 percent for 2018.

Turning now to cash flow from operations and the balance sheet. Net cash flows provided by operating activities in the third quarter of 2018 increased by $11 million to $15.4 million compared to $4.4 million, primarily reflecting more favourable results from operations, including income tax refunds, partially offset by higher interest payments and less favourable changes in net noncash working capital.

Net interest-bearing bearing debt decreased by $9.3 million to $362.6 million at the end of the third quarter of 2018 compared to $371.9 million at the end of the second quarter of 2018 and by $25.3 million compared to $387.9 million at the end of fiscal 2017.

Net interest-bearing debt to rolling 12-month adjusted EBITDA was 5.7 times at the end of the third quarter of 2018 compared to 5.6 times at the end of the second quarter of 2018 and 5.9 times at the end of fiscal 2017.

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

Rod Hepponstall

Thanks, Paul. I'd now like to spend a little time discussing each of our five critical initiatives individually.

With these initiatives, High Liner is embarking on a significant undertaking to eliminate the challenges in our internal operations and strengthen the overall health of our business. We plan to complete these initiatives within 12 to 15 months, and have a strategic growth plan in place for return to profitable organic growth by 2020.

Critical initiative number one, Organizational Alignment Creating One High Liner Foods. It was immediately clear to me upon joining the Company that we needed to break down operational silos. High Liner has expanded rapidly and significantly through acquisition. To properly capitalize on our North American scale, we need to create a much tighter and aligned organizational structure.

We have already realigned and restructured our organization from top to bottom so that we are no longer working as separate Canadian and US businesses, and we can maximize our talent and take advantage of our North American scale. Our new structure is more efficient. For example, we have eliminated duplication of work and roles that were being performed independently on both sides of the border by creating roles with expanded responsibilities that span the full North-American-wide business. This was a significant contributor to the approximately $7 million in net annualized run rate cost savings generated by the realignment.

Our ability to execute on our critical initiatives rests on having the right structure, and I'm confident that this is now in place.

Now we must foster a single cohesive high-performing culture. We are committed to open and transparent communication with our team to help build this culture. I spent a lot of time on the road talking to our people, and our critical initiatives reflect feedback from across the organization on what we need to do better.

With our new structure in place, we can now advance the rest of our plan, which brings me to our second critical initiative, Business Simplification.

As the Company has grown, it's become more complex. We have an opportunity to simplify our product offering and still offer a diverse and appealing portfolio of species and products for customers and consumers. For example, right now we offer in excess of 1,500 products across more than 30 species. Our margins vary significantly across this product portfolio.

It's clear to me that we will be better off if we focused on the most profitable products and the categories and species demonstrating the fastest opportunities for growth rather than spread ourselves thin across such a diverse product line.

We are in the process of launching a comprehensive review of the Company's portfolio to identify where we need to double down and where we need to let go. There will be product eliminations as a result, but we aren't in a position to provide further details on this yet.

Simplifying our product portfolio has the additional benefit of reducing complexity across the business. From procurement through to marketing and sales, we expect product simplification will create efficiencies; lower costs; and more importantly, enable us to direct more resources to developing and innovating our most profitable and desirable products.

Turning now to critical initiative number three, Supply Chain Excellence. Improving our supply chain has been a key focus for a number of years, but unfortunately the process kept hitting roadblocks. Today we have a new leader, Paul Snow, as Executive Vice President, Chief Supply Chain Officer, who's overseeing an end-to-end supply chain structure for the first time. Our supply chain now brings together procurement, plant operations, transportation, and warehousing.

Paul and his team will increase the efficiencies of our manufacturing activities by further centralizing supply chain operations and standardizing practices. We will focus on creating cross-border operating systems to ensure that we have best practices and consistent procedures to optimize our operations across North America. And as we take the complexity out of our business, we will take the pressure off our supply chain. With less ingredients and fewer SKUs, it will be easier to tighten our operations and drive the efficiencies we need.

Critical initiative number four, Rubicon Alignment and Growth. Let me start by saying that the rationale for acquiring Rubicon remains sound, but we need to more closely align with Rubicon with High Liner so we can extract the value and synergies we know exist.

Now that our structure supports One High Liner Foods, it will be easier to align with Rubicon's business processes. We're also looking at how we can strengthen our business and expertise by learning from Rubicon and vice versa.

Rubicon's unparalleled expertise in shrimp offers us the opportunity not only to enhance our shrimp business, but also to learn from their best practices and apply them to our business. Rubicon will become our shrimp centre of excellence.

We see a lot of opportunity for Rubicon in the foodservice industry, and to facilitate this we have placed a senior High Liner foodservice sales executive into Rubicon. Through this cross-pollination initiatives like this and greater alignment, we will capitalize on the opportunities for growth in shrimp.

This brings me to my last critical initiative, which is really the point of all the initiatives, Profitable Organic Growth. The initiatives I've already outlined are integral to stabilize the business in the short term and put the Company in position to return to profitable growth, which as I've mentioned, we are targeting for 2020.

That said, we are not waiting until 2020 to start to formulate our strategic plans for growth; that work is already underway in earnest. To drive organic growth, the Company must invest in product innovation and demonstrate market leadership by helping shape consumer tastes and demand for our seafood.

We are changing our sales compensation to support the right sales process, emphasize products that are important to High Liner, and relevant in the industry. We are in the process of developing a comprehensive strategic commercial plan to increase demand for our most profitable products in the short, mid, and long term. With our new structure that supports operating as One

High Liner Foods, we can leverage all aspects of the organization to seize opportunities, regardless of which side of the Canadian-US border they may appear.

Ultimately, it comes back to how we engage with our customers and the end consumers.

Turning to our engagement model, we are pursuing the following opportunities: optimize our product portfolio on a North American basis by introducing successful products sold in Canada into the US market; revising our approach to promotional activities and trade spend to improve our return on these activities; incorporating data analytics that deliver on a category-first approach, meaning we will offer the right products and promotions for distributors, operators, and consumers—we will take the noise out of a complicated category and deliver on customer and consumer demand driven by facts; and working more closely with our customers and industry partners to collaborate on innovative ingredients and flavours to grow overall demand for seafood in North America.

I would be premature to share more details on our growth initiatives at this point, but I do look forward to sharing more with you on these initiatives on future calls. While we are optimistic about our growth prospects, we do expect that our current headwinds will persist in 2019. The challenges are related to rising raw material costs, including the impact of recently imposed US import tariffs, and the loss of a major customer, which will have a significant impact on both the top and bottom line next year.

With respect to tariffs, we expect to be able to fully recoup the approximately $10 million in increased costs that we estimate will apply to the import of certain species into the US, most notably haddock, tilapia, sole, and flounder. We'll mitigate these through supply chain initiatives and also through price increases, which may have an impact on demand.

To summarize, there is no doubt we have some heavy lifting ahead of us. As I mentioned, we expect this will take us 12 to 15 months to fully complete the suite of critical initiatives, but we are confident that this significant undertaking will eliminate the current challenges in our internal operations, strengthen the health of our business, and position High Liner Foods to drive future growth and value creation moving forward.

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

Q&A

Operator

Certainly. At this time, if you do want to ask a question, just press *, then the number 1 on your telephone keypad. And if you do want to withdraw yourself from that question queue, simply press the # key.

And your first question comes from George Doumet of Scotiabank. George, your line's open.

George Doumet — Scotiabank

Yeah. Good afternoon, guys, and thanks for taking my questions. On pricing, I was just wondering if you can quantify how much we took of it in the quarter?

Rod Hepponstall

George, I don't have that information. I'll turn that—

Paul Jewer

Sorry, pricing related to tariff increase?

George Doumet

No, just I think you've called out general pricing in the quarter, so maybe like an average number of pricing that we took across our species.

Paul Jewer

Oh, I don't have an inflation number in front of me. As you know, the tariff increase was 10 percent on those key species, and so we did price for that tariff increase in the quarter.

George Doumet

Okay. So do price at all for any general, I guess, non-tariff-related inflation on maybe cod, for example, or haddock or other species?

Paul Jewer

Yeah. Just routine price increases in that regard, I would say, in the current quarter.

George Doumet

And do you know that number?

Paul Jewer

The run-up in the raw material costs for those species primarily occurred earlier in the year.

George Doumet

Okay. And can you quantify that amount?

Paul Jewer

I don't have that number in front of me, George—

George Doumet

Okay.

Paul Jewer

–but it would be relatively small.

George Doumet

Okay. Thanks. And how much of the 9.4, I guess, million pound reduction in volume do you think was a response to like maybe the higher price versus maybe other things, such as execution or, I guess, general secular trends?

Rod Hepponstall

Yeah. George, I would say there is—the headwinds we're facing as it relates to general market conditions are related to that 9.4 million pounds, which directly relates back to why we've implemented these five critical initiatives, right? Our opportunity to align the organization, simplify our business, and create a much more efficient organization will lead to enhanced profitable organic growth for us.

So we understand that we've got some work to do in that area.

George Doumet

Okay. And just one last one, if I may. I guess obviously in the context of this environment, how much of the 10 million in cost savings do we expect to, I guess, fully hold on to a year out? I'm guessing that we probably are going to have to make some rehiring maybe down the road or reinvest into the business. So maybe how you see that kind of … that number playing out over the next, like you said, I guess, 15 months or so?

Rod Hepponstall

Yeah. George, we are certainly committed to doing what's right for our business from a reinvestment perspective and so on. But as mentioned earlier, we do have some headwinds that will certainly impact our ability to drop that $10 million directly to the bottom line.

George Doumet

Okay. Thanks.

Operator

And your next question comes from Sabahat Khan from RBC Capital Markets. Your line's now open.

Sabahat Khan — RBC Capital Markets

Thanks, and good afternoon. On the tariffs that you talked about, have you had discussions with some of your retail partners around potential pricing? And the recovery that you're talking about, is that pricing you may already have implemented? Or that you're looking to talk to your customers about?

Paul Jewer

No. We've absolutely talked to our customers on the pricing and have … and as I said, have implemented price increases for the species where it was appropriate.

Operator

And your next question comes from Jonathan Lamers from BMO Capital Markets.

And if anybody else does have any questions, please press *, 1 on your telephone keypad.

Jonathan, your line's now open.

Jonathan Lamers — BMO Capital Markets

Good afternoon. On the—

Paul Jewer

Good afternoon, Jon.

Jonathan Lamers

Yeah. US sales volumes were down 15 percent year over year this quarter. I understand the Rubicon customer loss was part of that. If I carve that out, they were still down 11 percent year over year. That's the worst quarterly decline we've seen in years. Can you provide us with a little more commentary on what happened? I mean, were there any customers or shelf spaces lost? Were there any timing issues this quarter?

Rod Hepponstall

Jonathan, thanks for the question. There's no question that our US foodservice business has seen some losses in volume. Can't specifically quantify that directly, tie that to a specific customer. But again, when looking at the opportunity ahead, we firmly believe there's significant opportunity for High Liner, and hence why we have initiated the strategic initiative under profitable organic growth.

We see the market as a tremendous opportunity. We see seafood growing, we think it's a healthy market for us, and we are well positioned from not only a species but an entire product portfolio to play and certainly win in the marketplace.

Jonathan Lamers

Okay. And just to confirm, you have not executed any of the product eliminations yet, have you?

Rod Hepponstall

No, we have not. We are in the process of reviewing and tying that back to the appropriate data that supports the execution of the project.

Jonathan Lamers

Paul, would you happen to have the IRI data on the breaded and battered declines in retail for Q3 or year to date?

Paul Jewer

No, I don’t have the numbers. The category did continue to see some declines; I just don’t have the exact number in front of me.

Jonathan Lamers

Do you know if High Liner held its share this quarter?

Paul Jewer

The issue is more about the category decline than it is about High Liner-specific decline. But we believe we need to do work, as Rod’s outlined, to improve our performance in the category overall.

Jonathan Lamers

Switching to the restructuring plan. Of the $7 million in net annualized savings that have already been executed on, will all of that fall to the adjusted EBITDA line?

Rod Hepponstall

So, Jonathan, as mentioned earlier, we’ve got headwinds in our business. We referenced increased raw material costs, customer loss, and so on. So we don’t anticipate all of the—in excess of $10 million that we anticipate on delivering in that annualized cost savings, particularly the $7 million and particularly to your question, dropping to the bottom line.

Jonathan Lamers

Will any portion of that benefit Q4? Or does that start in 2019?

Rod Hepponstall

That will start in 2019.

Jonathan Lamers

And the rest of the $10 million in savings, which of the critical initiatives will that come from?

Rod Hepponstall

Primarily our supply chain excellence projects is where we see the benefit as we drive the efficiencies and operational excellence in that category.

Jonathan Lamers

Thanks. And just on this customer loss, I know that Rubicon lost a large big-box retailer earlier. Was there a new customer loss this quarter? Or is that the same one you're referring to?

Paul Jewer

No, that's the one we were referring to. The full impact was felt in this quarter of that previously talked-about loss.

Jonathan Lamers

Okay. I have one more question I want to ask. On this review of the capital structure you announced, can you tell us anything about that? I understand it's the board's responsibility, but can you tell us when it might be completed? And whether the scope of the review might include consideration for dividend cuts?

Rod Hepponstall

Yeah. Jonathan, to your point, that's really a question directed to the board. But from certainly our perspective, we concur it's the appropriate time to look at the capital allocation. When we have more information available, we'll certainly share it.

Jonathan Lamers

Okay. Do you have a view as to where—what an appropriate leverage level for this business would be?

Paul Jewer

No. I mean, at this point clearly our focus is on leverage reduction, as we've said before. Our target would be well below where we're currently at.

So we're going to continue to work hard at trying to drive incremental cash flow that we can use to reduce the debt.

Jonathan Lamers

Okay. Thanks for your comments.

Operator

And we've now reached the end of our question-and-answer session, so 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 the headwinds facing our business, I have full confidence that we now have the right plan in place through the execution of our critical initiatives to strengthen High Liner Foods, and get us back on track to profitable organic growth by 2020.

Thank you.

Operator

And this does conclude today's conference call. You may now disconnect.

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