AGROPUR
Dairy Cooperative

# Quarterly Report

## FOR THE 13- AND 39-WEEK PERIODS ENDED AUGUST 3, 2019

## TO MEMBERS AND EMPLOYEES

**Dear Members and Colleagues,**

Here are the highlights of the third quarter of fiscal 2019:

- Sales up $199.9 million (12.0%) to $1.9 billion;
- Earnings from operations up $0.3 million (0.4%) to $97.4 million;
- In Canada the business environment remained highly competitive;
- In the US the cheese block price / cost of milk ratio was favourable;
- Net earnings down $25.1 million.

Highlights for the nine-month period:

- Sales up $400.8 million (8.2%) to $5.3 billion;
- Earnings from operations up $19.4 million (7.7%) to $272.4 million;
- Capital expenditures totalled $227.5 million, including $83.3 million for the Lake Norden plant expansion in the US;
- Net earnings down $45.4 million (excluding the accounting gain in 2018).

Our Canadian operations underperformed in the third quarter. While this was due in part to aggressive competition in Canadian markets, we also had to contend with a number of internal management problems. For example, the transfer of distribution operations from the Don Mills plant to our new centre in Etobicoke at the end of the quarter caused significant efficiency losses. Unfortunately, the impact of this change will continue to be felt in the fourth quarter. While the situation is gradually improving, it has necessitated substantial expenditures in order to close the gap in relation to our usual standards. A recall of frozen novelties produced at our Lachute plant also affected our performance for the period.

**Financial overview**

**Third quarter** sales increased $199.9 million or 12.0%, compared with the third quarter of 2018, to $1.9 billion. Factors in the increase included, in the US, higher cheese prices, higher sales volumes and the appreciation of the US dollar against the Canadian dollar. Among other things, the commissioning of the Lake Norden plant contributed to the increase. In Canada, sales increased primarily as a result of contracts with new customers.

Earnings before interest, income taxes, depreciation, amortization, restructuring costs, integration and other non-recurring costs (earnings from operations) increased slightly by $0.3 million or 0.4% to $97.4 million. In the US, earnings from operations increased compared with the third quarter of 2018. Factors that had a positive impact include the improved relationship between the cheese block price and the cost of milk, higher sales volumes and the additional contribution from our Lake Norden plant. Our US results were however offset by decreased earnings from operations in Canada. Our cost-reduction program generated $10.8 million in consolidated savings during the quarter.

The depreciation and amortization expense increased by $13.4 million to $58.5 million, partly as a result of the commissioning of the Lake Norden plant expansion, depreciation of which began in the third quarter. While the plant is only in the start-up phase, it is being depreciated at fully operational value. Restructuring, integration and other non-recurring costs amounted to $8.5 million during the three-month period ended August 3, 2019. The gradual ramping up of production at our new Lake Norden facility and restructuring of some Canadian operations accounted for the majority of these costs. Financial expenses increased by $6.7 million, year over year, due in large part to higher indebtedness as a result of major projects and higher interest rates. The subsidiaries' income tax expense rose by $4.8 million, essentially as a result of our US operations' increased earnings.

Net earnings before patronage dividends and the Cooperative's income taxes were therefore $2.5 million in the third quarter of 2019, compared with $27.6 million in the same period of 2018.

In the first **nine months** of the financial year, sales totalled $5.3 billion, a year-over-year increase of $400.8 million or 8.2%. Earnings from operations increased $19.4 million or 7.7% to $272.4 million, due to the same factors as those noted above in the discussion of the quarterly results. It should be noted that after nine months, our cost-reduction program has generated $23.4 million in consolidated savings.

Excluding the accounting gain recorded last year in connection with the acquisition of Ultima Foods, net earnings decreased by $45.4 million in the first nine months of 2019 compared with the same period of 2018 because of the following factors:

- $21.0 million increase in the depreciation expense due to the commissioning in 2019 of a number of major projects, including Lake Norden;
- $10.4 million increase in restructuring, integration and other non-recurring costs, including notably start-up costs for major projects;
- $16.9 million increase in financial expenses, due primarily to higher interest rates and increased indebtedness as a result of major investments.

Cash flows from operating activities were $164.4 million in the nine-month period ended August 3, 2019. Operations generated $241.0 million, cash patronage dividends in the amount of $16.2 million were paid in December 2018, and working capital required $60.4 million. The change in working capital was due in part to increased inventories.

Capital expenditures totalled $227.5 million during the nine-month period ended August 3, 2019. Of the numerous projects completed or in progress, the Lake Norden plant expansion is the one that required the largest investment this year.

With respect to member and share capital activities, redemption of shares and certificates of indebtedness totalled $40.4 million during the period.

In conclusion, we are of course exposed to market conditions in Canada and the US. However, we must do much better in Canada on the factors that are under our control. We have therefore embarked on a comprehensive review of our processes in order to improve our ways of doing things and limit the occurrence of situations that could have been avoided. In view of Canadian results, we are reassessing our strategy with a view to restoring profitability to more acceptable levels. This process will require an in-depth review of our practices. We will give you more information on the actions we will be taking in the coming months.

**Robert Coallier**
Chief Executive Officer

**Émile Cordeau**
Senior Vice-President and Chief Financial Officer

## CONSOLIDATED EARNINGS

| (IN THOUSANDS OF CANADIAN DOLLARS) | 13 WEEKS 2019 | 13 WEEKS 2018 | 39 WEEKS 2019 | 39 WEEKS 2018 |
|---|---|---|---|---|
| Sales | **1,870,837** | 1,670,894 | **5,317,623** | 4,916,808 |
| Operating expenses excluding depreciation and amortization | **1,773,441** | 1,573,839 | **5,045,269** | 4,663,896 |
| Earnings before interest, income taxes, depreciation, amortization, restructuring costs, integration and other non-recurring costs (earnings from operations) | **97,396** | 97,055 | **272,354** | 252,912 |
| Depreciation and amortization | **58,482** | 45,117 | **152,737** | 131,775 |
| Restructuring costs, integration and other non-recurring costs[1] | **8,537** | 7,882 | **29,123** | 18,770 |
| Operating earnings | **30,377** | 44,056 | **90,494** | 102,367 |
| Net financial expenses | **19,760** | 13,039 | **47,814** | 30,917 |
| Loss (gain) on disposal of assets | **57** | 173 | **(533)** | (274) |
| Accounting gain as a result of a business combination | **-** | - | **-** | (47,660) |
| Income taxes of subsidiaries | **8,073** | 3,278 | **22,676** | 5,789 |
| Net earnings[2] | **2,487** | 27,566 | **20,537** | 113,595 |

## CONSOLIDATED CASH FLOWS

| (IN THOUSANDS OF CANADIAN DOLLARS) | 39 WEEKS 2019 | 39 WEEKS 2018 |
|---|---|---|
| **Operating activities** | | |
| Earnings from operations | **272,354** | 252,912 |
| Current income taxes | **(2,239)** | (1,726) |
| Restructuring costs, integration and other non-recurring costs[1] | **(29,123)** | (18,770) |
| | **240,992** | 232,416 |
| Patronage dividends paid | **(16,150)** | (16,178) |
| Change in non-cash items | **(60,425)** | 95,980 |
| | **164,417** | 312,218 |
| **Financing and share capital activities** | | |
| Bank loan, long-term debt and interest | **124,700** | 136,801 |
| Dividends on first preferred shares | **(31,390)** | (26,577) |
| Redemptions, net of issuance of members' shares and certificates of indebtedness | **(40,440)** | (40,070) |
| | **52,870** | 70,154 |
| **Investing activities** | | |
| Business combination | **-** | (68,059) |
| Investment acquisition | **(5,235)** | (1,000) |
| Proceeds from disposal of assets | **1,726** | 1,209 |
| Property, plant and equipment and intangible assets | **(227,525)** | (329,059) |
| | **(231,034)** | (396,909) |
| Effect of exchange rate fluctuations on cash position | **(174)** | (423) |
| Net change in cash position | **(13,921)** | (14,960) |

## CONSOLIDATED BALANCE SHEETS

| (IN THOUSANDS OF CANADIAN DOLLARS) | August 3 2019 | November 3 2018 |
|---|---|---|
| **Assets** | | |
| Current assets | **1,274,121** | 1,199,230 |
| Investments and loan | **14,472** | 9,014 |
| Property, plant and equipment and other long-term assets | **3,454,611** | 3,393,613 |
| | **4,743,204** | 4,601,857 |
| **Liabilities** | | |
| Current liabilities | **904,313** | 792,866 |
| Long-term debt | **1,478,912** | 1,395,779 |
| Deferred income taxes | **70,991** | 76,337 |
| Employee future benefits obligation | **46,253** | 25,054 |
| Other long-term liabilities | **21,812** | 4,035 |
| | **2,522,281** | 2,294,071 |
| **Equity** | | |
| Members' capital | **764,299** | 804,739 |
| First preferred shares | **770,000** | 770,000 |
| Reserve and others | **686,624** | 733,047 |
| | **2,220,923** | 2,307,786 |
| | **4,743,204** | 4,601,857 |

[1] Restructuring costs, integration and other non-recurring costs include costs for the business combination, the restructuring of certain activities and major projects start-up costs.

[2] Net earnings presented before patronage dividends and the Cooperative's income taxes which are accounted for only at year end.