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PRESENTATION

Operator

Good morning and welcome to Sunopta's second-quarter 2016 earnings conference call. By now, everyone should have access to the earnings press release that was issued this morning. The release, as well as the accompanying slides, are available on the Investor Relations page on Sunopta's website at www.sunopta.com.

This call is being webcast, and the transcription will also be available on the Company's website.

As a reminder, please note that the prepared remarks which will follow contain forward-looking statements, and management may make additional forward-looking statements in response to your questions. These statements do not guarantee future performance and, therefore, undue reliance should not be placed upon them. We refer you to all risk factors contained in Sunopta's press release issued this morning, the Company's annual report filed on Form 10-K, and other filings with the Securities and Exchange Commission for more detailed discussion of the factors that could cause actual results to differ materially from those projections and any forward-looking statements. The Company undertakes no obligation to publicly correct or update the forward-looking statements made during the presentation to reflect future events or circumstances, except as may be required under applicable securities laws.

Finally, we would like to remind listeners that the Company may refer to certain non-GAAP financial measures during the teleconference. A reconciliation of these non-GAAP financial measures was included with the Company's press release issued earlier today.

Also, please note that unless otherwise stated, all figures discussed today are in US dollars and are occasionally rounded to the nearest million.

And now, I would like to turn the conference call over to Sunopta's CEO, Rik Jacobs.

Rik Jacobs - *SunOpta Inc. - President and CEO*

Good morning and thank you for joining us today. With me on the call today, as usual, is Rob McKeracher, our CFO.

Today, we will highlight our second-quarter results and financial position, discuss our business progress and update you on our 2016 operational goals.

I would like to remind those on the call that there is an accompanying presentation on the Investor Relations page of our website, which we will reference today in our prepared remarks.

So, with that, please turn to slide 2. Slide 2 relates to forward-looking statements which the operator covered. So, if you could kindly turn to slide 3.

We are a pure play organic and non-GMO company with the largest organic raw materials supply chain in the world. We have built a scalable platform and have significant investments that allow us to grow in all of our key categories. We have ramped up our innovation efforts that are starting to hit the market and, as a result of that, I am increasing the confidence that the midterm goals we shared earlier this year can be achieved in the timeline we established.

Please turn to slide 4. Now, our Q2 revenue was essentially unchanged year over year on a normalized basis, which excludes the impact of acquisitions, commodities and currencies. The primary drivers of this deceleration in revenue growth are the largely expected decline in revenues in our domestic sourcing business and the unexpected short-term decline in revenues in frozen fruit, which I will explain in a few moments.

Revenue was $348 million or $352 million adjusting for the impact of the sunflower recall, which is about flat with Q1 of 2016. Given the transformation of our Company in 2015 with the acquisition of three businesses, we will continue to discuss sequential comparisons for comparability as well.

Gross margin for the quarter came in at an adjusted rate of 11.5%, which is ahead of our prior year by 80 basis points and essentially flat to the prior quarter. Adjusted EBITDA was $23.5 million, and adjusted earnings per share was $0.05, both somewhat ahead of our Q1 results but lower than our expectations.

Please turn to slide 5. Now, we continued to see strong growth in our international organic sourcing business where revenues were up 22% versus the prior year, and that comes on top of a very strong Q2 last year and is ahead of their first-quarter revenues as well.

Our growth rate there is clearly in excess of end markets, and it is a testament to the ability of our team to source scarce organic raw materials and ingredients.

We are making further investments in our sources of supply and have also proved the installation of a second (inaudible) processing line in our Crown of Holland facility, to keep up with the ever-increasing demands.

Margin in the quarter was somewhat negatively impacted by product mix, but still was in the range of our expectations.

Domestic sourcing continues to face the expected pressures of the strong US dollar and lower commodity prices. As a result, we have been contracting less acres for 2016 crops and continue to make strategic decisions on our portfolio to optimize future returns.

As it relates to sunflower, we are back in production at our Crookston facility following the recent recall, although we did record lower revenue in the quarter as a result of the temporary shutdown and lower post startup production.

We continue to supply our customers on a positive release basis to build that confidence in our product quality.

At the same time, we are also working with our customers and insurance carriers to handle their claims in accordance with our contractual obligations. We remain very comfortable with our insurance coverage, and Rob will get into more of the details on how we are treating the recall for accounting purposes.

Adding both platforms together, our revenue in global ingredients was flat, and the margin rate was 12.5%, which, again, is inside our midterm target range.

Please turn to slide 6. Now, we have made good progress against many of our targeted initiatives in the CPG platforms, but lower revenue and contribution within frozen food limited growth and profit margins during the second quarter.

In healthy beverages, we grew revenues by 17% year over year and 9% sequentially. We nearly doubled our East Coast aseptic revenue in Q2 versus Q1, but also saw growth at our other two aseptic facilities. While we still incurred around about $300,000 of startup costs in Allentown, the facility is now fully up and running, so we do not expect to take any other charges going forward. We are ahead of our plan in terms of filling out the new capacity added last year, and in Q3 we expect to begin production of a new almond beverage for a significant food service customer.

Based on the current shift patterns, our factories are filling up quickly. So now we are in the process of adding more shifts and increasing our line efficiencies further to drive utilization back to 80%-plus on a 24/7 basis so that we can realize the full margin potential of this platform. Our success here validates our investments to build a national production platform and reflects our strong innovation pipeline.

In juice, we're very pleased with our innovative new lemonade launches and continue to see opportunities for broader distribution of these products.

We also just completed a test of a new packaging format with our largest refrigerated juice customer with very strong results. That means we will now turn that into a national program as quickly as possible with significant incremental volume potential. This packaging chain also provides an opportunity to evaluate how to further optimize our supply chain going forward, including how to best utilize our San Bernardino facility where we still do have challenges in sourcing enough local fruit for extraction.

Net net, our innovation around both products and packaging has created significant momentum, and we see further opportunities going forward.

In (inaudible) next we grew revenue 9% year over year, and we are about flat sequentially. The growth was driven primarily by pouches where we continued to see better utilization of the Allentown facility. As you may have seen through our recent 8-K filing, we also successfully settled the legal dispute with our largest customer.

In the face of rising legal costs, we elected to settle for a cash amount roughly equivalent to our expected legal costs had we continued to dispute. In return for some additional discounts, we were able to agree on the long-term manufacturing agreement for both our pouch and aseptic products.

Fruit snacks boasted about 10% sequential growth, and we have won several new listings. A number of our product innovations have been accepted by customers, and we expect to see solid volume growth during the second half of the year.

Finally, we recently signed a significant new contract in bars that will fill up capacity in our bar facility and could add up to $20 million of revenue annually. We expect to begin shipping to this customer in September.

With that, please turn to slide 7. Now, in healthy fruit, frozen fruit sales declined 20% compared to the first quarter, and we experienced more margin pressure than we expected and signaled during our Q1 conference call. While we did anticipate some impact from the timing of the strawberry harvest, the overall effect of the delay was more costly than we expected. Delayed start resulted in significant inventory rework and factory inefficiencies during the quarter. As well, the cost of strawberries increased 15% over last year, more than we had anticipated. And, while we can pass this through with pricing, the majority of that will not take effect until the fall. These factors had about a $4 million margin impact, which was further compounded by a temporary revenue portfolio experienced in the quarter.

First, our largest customer experienced lower sales of their private-label frozen fruit due to a decline in customer demand that we directly attribute to recalls of frozen products announced by competitors. These recalls involved both organic and conventional SKUs, and since Sunrise produces product under some of the same labels, we also experienced a decline in sales, even though none of the products we produced were implicated.

As organic forms a larger portion of our sales, we were disproportionately impacted by these challenges. At the same time, our second largest customer went through a major distribution center and store reset, and our largest food service customers delayed shipment until the second half of this year. Altogether, these revenues -- these factors resulted in a revenue shortfall of roughly $18 million and a significant loss of contribution from these sales.

Now, the good news is that synergies are on track. We maintained our customers, and the outlook for frozen in the back half of 2016 is positive. But we won't get back all the revenue and margin that we lost during the second quarter.

Finally, despite a delay, the strawberry harvest did occur, and we have sufficient supplies in place to meet anticipated demand.

With that, I will turn the call over to Rob to go through the numbers in more detail, and I will come back with an update on our operational goals and some closing remarks.

Rob McKeracher - *SunOpta Inc. - VP and CFO*

Thanks, Rik. I will take you through revenue margins and earnings, as well as highlight our EBITDA and cash flow performance during the second quarter. Please turn to slide 8.

Slide 8 shows our revenues broken down by segment. Revenues for the second quarter of 2016 were $348 million compared to $352 million during the first quarter of 2016 and $278 million a year ago. Taking into consideration the impact of the sunflower recall, revenue would have been about flat with the first quarter and up 27% year over year. Most of the year-over-year growth was driven by acquired businesses, as well as internal growth in aseptic beverages, resealable pouch products, and internationally sourced organic ingredients. After adjusting for changes in revenue, including the impact of acquired businesses, commodity prices, and foreign exchange rates, on a normalized basis consolidated revenues increased 0.3% compared to the second quarter of 2015, despite the challenges in frozen fruit during the quarter and lower sales of domestically sourced raw materials as we focus on enhancing returns in that business.

Global ingredients reported revenues of $158.5 million during the second quarter compared to $146 million in the first quarter of 2016 and $161.8 million a year ago. This represents a 9% increase sequentially, driven by seasonal sales of agronomy and other crop inputs, as well as higher sales of internationally sourced organic ingredients.

After adjusting for commodity prices and foreign exchange, revenues in global ingredients increased 2.7% year over year.

As Rik mentioned, the sales trends in this segment versus prior year remain quite consistent with strong growth of 22% in international organic ingredients, offsetting an 18% decline in domestic raw material sourcing and supply.

Consumer products reported revenues of $189.6 million, growth of 64% year over year due primarily to acquisitions, while down 8% sequentially compared to the first quarter of 2016. On a normalized basis, taking into consideration the revenues of acquired businesses, year-over-year revenue declined 1.7% inside consumer products, due primarily to pressures in the frozen fruit category for the reasons previously discussed by Rik.

In healthy snacks, pouch volumes were again strong in the Allentown operation, and snacks platform revenues remain consistent with the first quarter of 2016. As Rik mentioned, we expect to start delivering as a major new bar contract in the second half of 2016 and are pleased with the rising capacity utilization inside snacks.

In healthy beverages, we posted 17% normalized year-over-year growth, driven by 20% growth in aseptic. We were able to continue to add new aseptic business to our national network and posted solid sequential and year-over-year growth. Non-aseptic sales, including shelf stable and refrigerated juices, were up approximately 30% compared to the first quarter of 2016, driven by innovative new product introductions for private label, and we remain encouraged by the pipeline for non-aseptic beverages.

Turning to slide 9, you will see that during the second quarter we generated gross profit of $36 million or 10.3% of revenues as compared to $29.7 million or 10.7% of revenues in the second quarter of 2015. After removing the impact of a non-cash acquisition accounting adjustment related to the Sunrise inventory sold in the second quarter, startup costs related to the ramp-up of production volumes at our Allentown aseptic facility and the impact of the sunflower recall, gross margin would have been 11.5%, an 80 basis point increase over the second quarter of 2015. The increased margin rate was driven mainly by increased efficiency and lower costs inside our beverage operations, partially offset by increased raw material costs for frozen strawberries that could not be passed on immediately to customers, as well as production efficiencies within our frozen fruit operation caused by the late harvest that Rik previously discussed.

For the second quarter, we reported operating income of $8.8 million or 2.5% of revenues compared to operating income of $2.6 million in the first quarter of 2016 and $9 million a year ago. Adjusting for the same items I just mentioned, as well as legal costs related to the now-settled litigation, operating income in the second quarter would have been $14 million or 4% of revenues.

On July 29, 2016, we entered into a mutual release and settlement agreement with a customer of ours to resolve a dispute related to the 2013 voluntary recall of certain pouch baby food products.

Pursuant to the terms of the settlement agreement, we will pay out $5 million in cash and provide up to $4 million in rebates against purchases of resealable pouch and aseptic broth products over the next four years. The future rebates are dependent on the customer placing minimum order quantities within each of the next four, 12-month periods. In connection with this settlement, we recorded a charge of $9 million during the second quarter of 2016 as we believe there is reasonable assurance that the minimum order quantities will be achieved.

Also, during the second quarter, we announced a voluntary recall of certain roasted sunflower kernel products produced at our Crookston, Minnesota facility. For the first half of 2016, we recognized estimated losses of $16 million related to this recall. This reflects the estimated cost of the affected sunflower kernel products we expect to replace and the estimated cost to reimburse customers for costs incurred by them subject to our contractual obligations.

Please note that our estimate of recall-related losses are provisional, based on information we have to date. We may need to revise our estimates in subsequent periods as we continue to work with our customers to substantiate their claims. The Company carries general liability and product recall insurance, and we expect to recover recall-related costs through our insurance policies, less applicable deductibles.

As a result, in the second quarter, we recorded estimated insurance recoveries of $15.4 million for the losses recognized to date. We expect additional visibility into the magnitude of costs and related insurance recoveries in the third quarter as we continue to work through the recall with our customers and insurance providers.

On a GAAP basis for the second quarter, we reported a loss from continuing operations of $4.1 million or $0.05 per diluted common share compared to earnings from continuing operations of $4.8 million or $0.07 per diluted common share in the second quarter of 2015.

Second-quarter results were impacted by a number of items that are not reflective of normal operations and have been excluded when calculating adjusted earnings. These items include $9.7 million of costs related to a legal settlement and associated legal fees, $7.9 million of costs associated with the purchase accounting, financing, and integration of the Sunrise acquisition, $0.5 million of product withdrawal and recall costs, $0.3 million of costs as we ramp up production at our Allentown aseptic facility, a $1.7 million gain on the settlement of contingent consideration, and $400,000 of other costs, including fair value adjustments to contingent consideration of previous acquisitions.

Excluding all of these items on an after-tax basis, adjusted earnings in the second quarter were $4.1 million or $0.05 per diluted common share. We realized adjusted EBITDA of $23.5 million during the second quarter of 2016 compared to $22.1 million during the first quarter and $15 million in the second quarter of 2015.

I would like to remind listeners that adjusted EBITDA and adjusted earnings are non-GAAP measures, and a reconciliation of these measures to GAAP can be found towards the back of the press release issued earlier this morning.

Turning to slide 10, from a cash flow perspective, during the second quarter of 2016, we used $34.4 million of cash in continuing operations, reflecting seasonal raw material purchases, especially fruit, which, although later than usual, it did come off the fields in the second quarter. During the second quarter, we invested $4.8 million to purchase capital assets, and we expect to incur capital expenditures of approximately $20 million for 2016. During the quarter, we drew $39 million in our operating facilities, primarily to fund working capital demands.

The seasonal outflow of cash in our business is greatest in the first half of the fiscal year due to the timing of raw material purchases from growers. The buildup in working capital is then reduced over the back half of the year, resulting in a positive cash flow expectation from now until the end of 2016. We expect cash flows from continuing operations for the full year of 2016 to be sufficient to cover capital expenditures, interest payments, and lead to lower total debt over the course of the year.

If you will please turn to slide 11, you will see our key balance sheet metrics. At July 2, 2016, Sunopta's balance sheet reflected total assets of $1.2 billion, a total debt of $557.8 million, and total debt to equity ratio of 1.38 to 1.

At July 2, 2016, our leverage was approximately 6 times pro forma adjusted EBITDA after factoring in the run rate EBITDA of acquired businesses and cost synergies expected to be realized in 2016. The increase in leverage reflects the seasonal increase in debt that I previously explained, as well as the temporary impact that the slowdown in the frozen fruit business had on EBITDA.

We continue to expect to delever in 2016, but given the slower EBITDA growth in the second quarter, the timetable for delevering by 1 to 1.5 times in the first 12 to 18 months following the Sunrise acquisition has been modestly extended.

From a liquidity perspective, we ended the quarter with approximately $75 million of available capacity on our asset bad credit facility, and this is at our peak usage. So we expect availability to increase over the back half of the year.

In addition, I would like to remind listeners that, due to the excess availability we have under our credit facility, we are not currently required to maintain compliance of any specified financial issues under that credit facility. We remain focused on debt and leverage reduction and expect noticeable improvement in these metrics by the end of the year.

With that, I will turn it back over to Rik who will conclude our prepared remarks.

Rik Jacobs - *SunOpta Inc. - President and CEO*

Thanks, Rob, and please turn to slide 12. Now, every quarter I update you on our progress against our 2016 operational goals, which I first laid out after taking over as CEO in the fourth quarter of 2015.

So first, in healthy beverage, we said we will increase gross margin in juice by at least $6 million, thereby achieving breakeven or better in that business, while also concluding our pipeline in aseptic beverage to achieve double-digit top-line growth. As you have already heard, we are more than achieving this goal in aseptic, having driven double-digit growth during the first half with the addition of new products and customers, as well as expansions with existing customers.

Within juice, we are one-third of the way toward our goal having added $2 million to juice gross profit during the first half. But, as I indicated earlier, we are very bullish on the back half of the year as a result of our product and packaging innovations.

In healthy fruit, we said that we were committing to successfully integrate Sunrise Growers and maintaining a strong growth rate while capturing the $5 million to $7 million of cost synergies we identified.

Through the first half of the year, we are on track to meet our cost synergy target with the closing of Buena Park and have successfully integrated the business. However, the challenging environment on sourcing and the revenue that impacted Q2 offset the Q1 strength in the business and, while we expect a very good back half of the year, it will not offset the Q2 shortfall.

In healthy snacks, we identified fruit snacks as a key growth area and as we look to drive growth of at least 10%. For bars and pouches, we plan to fill the available capacity with higher profitability of private-label products, especially in bars.

Thus far, we are tracking toward this goal. We have seen strong pouch growth during the first half, and the recent signing of a major new contract to produce bars should fill the majority of our capacity beginning in the second half of the year.

We also said that all three CPG categories must be heavily supported by increased innovation, and we plan for at least $10 million of new product innovation hitting the market in 2016. This goal has already been achieved with innovation adding significantly to our aseptic business in both retail and improved service. Several roasted snack innovations launched, as well as our lemonade success and new juice packaging introduction.

Now, even though we did not state this as an explicit goal, we are obviously not pleased with the operational challenges we have experienced, and this will continue to be a key area of focus for our Company as we work to improve the consistency of our execution.

Finally, we committed to controlling our costs and targeted to keep SG&A below 8% of sales. We will achieve this goal during the first half and are in a good position to deliver again in the second half of 2016.

I would like to take this opportunity to comment on the strategic review process. As you know, on the 27th of June, we announced that we retained Rothschild as a financial advisor, and we continue to evaluate a complete range of strategic and financial actions that Sunopta could undertake to maximize shareholder values. The board will provide further details as and when appropriate. We are not in a position to provide further details while the process is underway. Hence, we will not be fielding questions on today's call in relation to that strategic process.

So please turn to slide 13. Now, in conclusion, we are on track with most of our operational goals thus far in 2016. We continue to capture market share on organic ingredients, our aseptic business is delivering strong growth and improved margins, and momentum is building in snacks supported by strong innovation. We are executing against the Sunrise synergy plan and winning new business across the three CPG platforms. Where we have not achieved our goals is in the cost of non-nonperformance, basically not executing excellently all of the time. We recently reorganized our internal quality control organization and are holding everyone accountable for execution. We are correcting each challenge and are becoming stronger as a result. While we did not deliver the top- or bottom-line growth we expected during Q2, due largely to the unexpected and temporary shortfall in frozen fruit, we expect notable improvement in the back half of 2016 as a result of our increased pipeline.

In July, we are seeing a good uptick in revenue in all CPG platforms and continued growth in our organic ingredient sourcing business. While it is not our intention to provide quarterly guidance on an ongoing basis, given this unexpected volatility we experienced in Q2, we wanted to provide some additional visibility into our Q3 expectations. For the third quarter, we expect revenue to be $10 million to $15 million higher than what we reported in Q2, and we expect adjusted EBITDA to grow $2.5 million to $3.5 million over the second quarter as well.

For an explanation of how we calculate adjusted EBITDA, please refer to the reconciliation of non-GAAP financial measures that was included with the Company's press release issued earlier today.

So, with that, I would ask the operator to please open up the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Amit Sharma, BMO Capital Markets.

Amit Sharma - *BMO Capital Markets - Analyst*

Rik, can you provide a little bit more color on what exactly happened with the frozen fruit business in the quarter and how much of that is avoidable or could have been mitigated with further insight?

Rik Jacobs - *SunOpta Inc. - President and CEO*

Yes, I really would classify it as a one-time event. I mean, the strawberry harvest that we experienced is happening once every 10 to 15 years, maybe, that it is this late. If it is this late, what that really means is that, A), you have a lot of inefficiencies in your factories because you are hiring all these crews to basically sort the strawberries in your factories, but as you can imagine, if the strawberries are not coming in, you're still having to pay these workers. And, secondly, you have to go into your inventories rather than going straight into a retail or a food service package, and that also has a lot of cost because now you are utilizing (inaudible). That was the biggest impact when it came from a margin perspective. When it comes from a revenue perspective, I think everybody is aware of two very significant recalls in the frozen fruit category in the quarter that impacted especially the club channel, and the club channel is our largest customer, and we pack under the same level label. As a result of that, our products were also very negatively impacted.

Secondly, our second-largest customer, that is a very large national retailer, they decided to reset their shelves. The great news on that is is that we increased our share. We have seen revenue growth in July, but they did reduce their promotional activity significantly in the second quarter to facilitate this reset. That has impacted us as well.

And then, finally, as we mentioned, our largest food service customer, while we have committed minimum volumes that they should take, decided to take that in the third quarter rather than the second quarter. So that should come back to us.

Amit Sharma - *BMO Capital Markets - Analyst*

And I don't know if I heard it right, there seemed like you are a little bit more concerned about price elasticity of having to pass higher prices (multiple speakers).

Rik Jacobs - *SunOpta Inc. - President and CEO*

No, we are not concerned about that. We are -- in most of our contracts, we are allowed to pass the prices through. The only thing that Rob or I mentioned is that there will be a bit of a gap between us, basically taking in the inventory at a higher price and taking the price increase through. That price increase basically happens in the fall.

So, for a couple of months, you're stuck with a somewhat higher [cost] that you cannot offset with higher pricing.

Amit Sharma - *BMO Capital Markets - Analyst*

And, then, the next one, you talked about improving the consistency of performance, and clearly that is on top of the minds for most investors. Now, when you really think about this issue and we have had a number of issues in the last several quarters, all different issues, do you see this as a management bandwidth issue that would potentially be fixed by bringing in maybe more reinforcement, or is it simply the cost of operating in a segment where there are a lot of unknowns that something could potentially go wrong at any time?

Rik Jacobs - *SunOpta Inc. - President and CEO*

Look, I think everybody that is in the food business will experience some something every once in a while. I mean, if I just go look at the second quarter and I look at what we achieved in our healthy beverages, what we achieved in our healthy snacks, if I look at the pipeline going forward over there, what we achieved in our organic ingredients, international ingredients, I am very, very pleased with that, and I definitely would say that, in my opinion, we have turned a quarter, and I look forward to improved performance.

Now, what happened inside of frozen fruit, I would argue was largely outside of our internal control and has nothing to do with bandwidth. In fact, we have been strengthening the management team in Sunrise Growers, and all the management team that was there before the acquisition is still in place.

So I am -- overall, I am pleased with the progress that we are making. I look forward to notable improvement in the second half. Unfortunately, all of the gains that we have made in the second quarter were basically offset by A), the late strawberry harvest and B), a temporary slowdown in retail.

Amit Sharma - *BMO Capital Markets - Analyst*

And last one for me (inaudible) a little bit -- last one for me, you talked about sequential improvement in the aseptic business and on track to get 80%-plus utilization. Are you able to say where are we at this point?

Rik Jacobs - *SunOpta Inc. - President and CEO*

Yes. I would say that on a 24/7 basis we are probably close to 70% utilization right now. But remember that last year when we experienced a slowdown, we actually took some shifts out of our factories in order to obviously not have to pay people while we didn't have the production.

So, right now, we are aggressively hiring shifts and trying to get all of our factories back to the 24/7 as quickly as possible. Because -- and, quite honestly, even though we didn't, of course, come as nicely and smoothly as anybody would have expected, we feel somewhat vindicated with our decision to invest in a national platform because we are really starting to reap the benefits on that right now.

Amit Sharma - *BMO Capital Markets - Analyst*

Got it. Thank you very much.

Operator

Peter Prattas, AltaCorp Capital.

Peter Prattas - *AltaCorp Capital - Analyst*

I wanted to spend just a minute on aseptic first since that seems to be your biggest opportunity to improve going forward. Can you say, just given the growth you saw in the second quarter, where your utilization rates have looked into? I think you are at around 60% in healthy beverages or at aseptic during the investor day. So where are you now? And just given the wins that you have already in place, assuming no further wins, where do you get to in utilization rates exiting the year? Thanks.

Rik Jacobs - *SunOpta Inc. - President and CEO*

Yes, we are, as I just mentioned, to Amit, and you may not have gotten that, we are close to 70% utilization on a 24-7 basis, and exiting the year, I would expect that percentage to continue to grow given continued strong demand. We continue to see sequential improvements as well. Obviously, significant year over year, but also sequential improvement.

So I would say 75% by the end of the year and ramping up to north of 80%. And once we are north of 80%, that is when we start realizing the full margin potential of this platform.

Peter Prattas - *AltaCorp Capital - Analyst*

Excellent. And then, just on the impact of your frozen fruit supply here, I think you said $4 million was the impact for the quarter. I am just wondering how much of an impact will it be in Q3, and then are you completely normalized by the fourth quarter?

Rik Jacobs - *SunOpta Inc. - President and CEO*

Yes. We mentioned that the factory inefficiencies and the late harvest has an impact of about $4 million. Obviously, on top of that, there has also been an impact on the loss of contribution margins in that platform from the lower revenues. We believe that we are going to be basically back on track inside of the third quarter already, and so far our July numbers are proving that out.

Peter Prattas - *AltaCorp Capital - Analyst*

Great. And then my last question is regarding your balance sheet. Just looking at your credit facilities, where you have room there, I am just wondering how prepared are you to use those facilities to reduce your long-term debt?

Rob McKeracher - *SunOpta Inc. - VP and CFO*

It is Rob here. Yes, we definitely have the ability. We negotiated that as part of both facilities that we can, draw on our operating ABL to repay some long-term debt, and that is something we are evaluating and will be evaluating over the course of the year. Obviously, we are at peak utilization right now on the ABL, and so I think, quite honestly, the consideration that we give for that would come later in the year than right now, given we are at peak. But definitely have the ability to do that and take advantage of that availability at a lower rate to reduce some of the higher rate interest of debt.

Peter Prattas - *AltaCorp Capital - Analyst*

Okay. That's it for me.

Operator

Eric Gottlieb, D. A. Davidson.

Eric Gottlieb - *D. A. Davidson - Analyst*

You talked about getting back to 80% in utilization. What kind of a gross margin impact would you expect something from where we are now to that level?

Rik Jacobs - *SunOpta Inc. - President and CEO*

I would say that is going to be a minimum of 3 points of margin improvement.

Eric Gottlieb - *D. A. Davidson - Analyst*

Okay. Got it. And then, talking about the $20 million order that was potential, right? What exactly is near-term expectations for that contract?

Rik Jacobs - *SunOpta Inc. - President and CEO*

I basically mentioned that, on an annual basis, that would be $20 million, and we will begin shipping in September. So take one-third of the $20 million is our expectations. Potentially a little bit higher because there needs to be a pipeline fill as well.

Eric Gottlieb - *D. A. Davidson - Analyst*

Got it. Okay. And then, --

Rob McKeracher - *SunOpta Inc. - VP and CFO*

I would say between $7 million and $10 million this year.

Eric Gottlieb - *D. A. Davidson - Analyst*

$7 million and $10 million this year. Okay. And then, I am going to jump around a little bit. How modestly extended is the 1% to 1.5% deleveraging?

Rob McKeracher - *SunOpta Inc. - VP and CFO*

And so, as we mentioned, post Sunrise, we were roughly 5.3 times adjusted pro forma levered at that point in time. And, of course, we thought we would bring it down 1 to 1.5 times in the first 12 to 18 months. I would suggest that we are anywhere from three to six months extended into 2017 from that timeframe established at that time. I think the important point to take away from this is that we do continue to expect to see debt reduction and leverage reduction, both over the course of this year and for the fiscal year itself. So it is not -- it is truly just a bit of a slowdown in the pace, due entirely to the results of the second quarter in fruit, which, while we cannot make that up, we do, as Rik mentioned, see that coming right back on to where it should be in the back half.

So to answer your question, it is about a three- to six-month delay.

Eric Gottlieb - *D. A. Davidson - Analyst*

Got it. Okay. One other question.

Rik Jacobs - *SunOpta Inc. - President and CEO*

I think it is important to note that we still fully anticipate to be well below 5 times leveraged by the end of the year, though, but the target was 4.3 times. I think we will be modestly higher than that by the end of the year, and we want wanted to be upfront about that.

Eric Gottlieb - *D. A. Davidson - Analyst*

Okay. Any insights into replacing that [9.5] debt? Have you been able to shop that around at all?

Rob McKeracher - *SunOpta Inc. - VP and CFO*

Yes. I mean, we announced, obviously, earlier on in the quarter that we expected in the near future to come out. Clearly, that hasn't taken place. What I would suggest to you is that, just given the mix of markets, as well as the goings-on in the Company that has not yet taken place, but it is still certainly a possibility prior to October 9.

Eric Gottlieb - *D. A. Davidson - Analyst*

Got it. And then, on your expectations for the next quarter, that $26 million, $27 million in EBITDA, what is your contribution expectations for each business, roughly?

Rob McKeracher - *SunOpta Inc. - VP and CFO*

The way I would characterize that is to actually try and give you a sense of what gives rise to that improved EBITDA. I guess I talked to the two segments focusing on margin because, quite frankly, we don't see a big change in terms of our SG&A load or some of the other items that factor into EBITDA.

But, in the first half of the year, in our global ingredients segment, it is quite normal to see a bit of a pickup in terms of our input sales -- agronomy and other inputs. So that is when the crops are being planted.

So directionally, could you see perhaps a $4 million decrease in terms of EBITDA dollars that are generated through the global ingredients segment, offset by an increase in consumer products? I think that is -- which would be around a $7 million increase if you did the math. I think that is kind of how I would frame that out there.

Eric Gottlieb - *D. A. Davidson - Analyst*

Okay. Very good. Thanks for the additional color.

Operator

Jon Andersen, William Blair.

Jon Andersen - *William Blair - Analyst*

I wanted to ask, first, on the fruit sales, the impact in the quarter, it sounds like the issue with the reset at your second largest customer and then the food service customer, which I guess would be the USDA, those would be transitory issues. Can you comment on the consumer demand impact? You saw a club in the quarter that was driven by some of the recalls, and are you seeing that demand kind of return to normal at this point?

Rik Jacobs - *SunOpta Inc. - President and CEO*

Yes, I think it is important to point out that, obviously, that was not our recall. It was a competitor recall. And there was one in Canada and there was one in the United States, and both of them were very, very significant. But both of them were in the organic space, and that is where we over index, right, given our legacy business and now also with the addition of Sunrise. And that is, by the way, also where this club customer overimpacts us.

So that is why we were impacted because we got a lot of calls from consumers -- more than 30 a day, I would say -- for a significant period of time. Is this also your guys' product that has impacted us? No, it is not. But, you know, that if you're getting 30 calls, obviously, that represents a lot more consumers out there that are confused by which product is impacted and which one is not.

Now, all that product has obviously now been removed from the shelf. It has all been replaced. It has gone away. We have just gotten the second quarter IRI data, and the good news is that, if you look at an overall retail basis, which measures everything, except for the (inaudible), that is the category continues to grow at about an 8% rate, despite this temporary slowdown in organic.

So I see the organic sales coming back, but definitely the category as a whole is intact. And that is important.

Jon Andersen - *William Blair - Analyst*

Okay. On the guidance, the sales guidance for the third quarter, is the $10 million to $15 million increase, is that over $348 million the recorded number or the adjusted revenue number of $352 million for Q2?

Rob McKeracher - *SunOpta Inc. - VP and CFO*

All that sequential guidance we gave is over the year reported numbers.

Jon Andersen - *William Blair - Analyst*

Okay. So the $348 million in Q2?

Rob McKeracher - *SunOpta Inc. - VP and CFO*

Right.

Jon Andersen - *William Blair - Analyst*

Okay. And, again, just for clarification, the new business that you quoted, I think, at about $20 million on an annualized basis, that was bar business, right? That wasn't beverage business. Is that accurate?

Rik Jacobs - *SunOpta Inc. - President and CEO*

Correct. In the beverage business, obviously, that number is larger than that. (multiple speakers)

Jon Andersen - *William Blair - Analyst*

Yes. That was kind of my follow-up, Rik. You talked about a major new customer on the almond milk side. Can you talk about maybe the impact of that addition, either in the second half of the year or on an annualized basis?

Rik Jacobs - *SunOpta Inc. - President and CEO*

Yes, I would say that just that one alone is probably between $4 million and $5 million, and obviously there is a significant pipeline fill that needs to happen by the beginning of September. And this is one of the customers that we have a strategic relationship with -- a long-term relationship. We are able to supply them with all of their nondairy needs, and it is not only this almond milk that is going through the roof. There is other nondairy beverages that are increasing rapidly as well.

Jon Andersen - *William Blair - Analyst*

Excellent.

Rik Jacobs - *SunOpta Inc. - President and CEO*

Not just with almond milk.

Jon Andersen - *William Blair - Analyst*

You mentioned the juice business and the San Bernardino plant and maybe some lingering inefficiencies on the extraction side. Can you talk a little bit more about that? What some of the -- what is driving some of those inefficiencies and what the outlook is there? It sounded like you may be even taking a bigger picture view of how to maybe rationalize some of that.

Rik Jacobs - *SunOpta Inc. - President and CEO*

Yes, exactly right. Look, if you look at the plant in San Bernardino, it is really basically made up of two parts of that plant. The one part of the plant is the extraction where you take oranges and lemons and you basically make it into juice, and the second part of the plant is a bottling plant where you basically take juice and you put it in a bottle.

Now, starting with the bottling plant, we have got very good utilization over there of 75%-plus. The plant is running well. But -- with this very new innovative packaging that we are coming out with is for our largest customer that represents more than 60% of the volume. That is not a packaging format that we currently have. That doesn't -- what we have -- the ability and also I think the obligation to present our customers with the best innovation out there.

Now, just so we're clear, for these largest customers, we already are contract manufacturing some of that volume on the East Coast. We are doing currently that volume in San Bernardino on the West Coast. So it will require an incremental investment in our bottling facility, and that is what we need to evaluate, whether or not that gives us a higher return than a higher focus on contract manufacturing.

The second part is on the extraction side. And, on the extraction side, I am assuming that most of you guys are aware of this greening disease that has really been hitting the orchards in Florida, now starting to hit the orchards in California as well. That means that there is a significant decrease in the crop of local oranges and lemons that are available. And, as a result of that, there is a continued underutilization of that asset. And that is what we need to address is, does it make sense to continue to run something even if your longer-term future suggests that you may not be able to get to full utilization?

Jon Andersen - *William Blair - Analyst*

Okay. Thanks. The last one for me is just on the domestic sourcing -- ingredient sourcing business and kind of your current thoughts there on the outlook for that business and maybe your view on the strategic importance of the business in the context of other things that you are focused on. Thanks.

Rik Jacobs - *SunOpta Inc. - President and CEO*

Yes, so I mean, look, on the domestic sourcing, we have made a very, very conscious decision that we are not going to sit there and chase any market share gains or revenue gains. We have made a conscious decision and have done so for the last 18 months to really focus on those items that where we can make a decent margin and where also there is a good strategic fit.

So, as I think we have been mentioning, we have reduced the sunflower acres that we are planting. We have reduced a number of varieties of soy and corn that we are utilizing. So really what it is all about for us is in that domestic sourcing business, make sure that we get a decent gross margin and a decent return. Of course, while that is going on, that has a negative impact, if you like, if you look at an overall basis on the growth rate of our business. But, quite frankly, what we are doing internally, we are kind of not even looking at that 18% decline. What we are looking at is $1 margins and percentage margins are we able to eke out of whatever revenue we generate.

Jon Andersen - *William Blair - Analyst*

That makes sense. Thanks for the color.

Operator

Chris Krueger, Lake Street Capital.

Chris Krueger - *Lake Street Capital - Analyst*

Just a couple quick ones. Back on your Investor Day a few months ago, you guys spent some time highlighting the opportunity of aseptic soup broth as a big market opportunity. Just wondering what kind of progress have you made there and what can you update us on on that topic?

Rik Jacobs - *SunOpta Inc. - President and CEO*

Yes, well, first of all, as part of the settlement that we reached in the disputes, you will have noticed that we will be contract manufacturing some of the aseptic broth products there already.

Secondly, we have been actively pitching this to our retail customers and already have gained some listings. The most significant one was a West Coast retailer that has more than 2000 stores.

So we are making progress, and we are very excited about that. Having said that, Chris, it doesn't mean that we are -- I am not continuing to focus on our nondairy as well, and nondairy continues, even though in the retail markets as observed, you don't see a lot of growth in nondairy. That is absolutely not the case for us. We are seeing growth in nondairy because of our innovation and also because of our channel approach, whereby a large part of our volume is sold in food service where nondairy aseptic continues to steal share from dairy, quite frankly.

Chris Krueger - *Lake Street Capital - Analyst*

Okay. And then, just my other question, now that we are into the month of August, how is the growing season going for your contracted growers?

Rik Jacobs - *SunOpta Inc. - President and CEO*

Yes. I think so far, the growing season is going well. We did plant less acres, and that is totally by design as follow-up to the answer that I just gave. We just want to plant what we know we can sell with a decent margin, as opposed to ending up in long positions that we then have to get rid of at zero margin, as we had to do last year, quite frankly.

So we have reduced our acreage quite significantly, but the acres that we have on the contract are so far looking to have good yields this year. And I think that is the same across the Midwest, by the way, not just in the acres that we have planted.

Chris Krueger - *Lake Street Capital - Analyst*

Okay. Thank you.

Operator

(Operator Instructions) Amit Sharma, BMO Capital Markets.

Amit Sharma - *BMO Capital Markets - Analyst*

Rob, a quick one for you. The interest expense, how should we model for the back half? Similar to what we saw in the first hour, or is there some miscalculation there?

Rob McKeracher - *SunOpta Inc. - VP and CFO*

From a cash perspective, I guess two things. You will notice that at the start of the year, there was roughly $8 million to $9 million of the fees that it took to establish the second lien loan that amortized over the course of the year. So the one thing I would caution everyone is that there is a non-cash component to our interest that you need to really reduce from a modeling perspective. You will see it in the notes to our 10-Q how much of that is left. I think it is around $2 million or so. But there forward, most of it is, let's just say, easier to calculate. You will be able to do it at an assumed rate of as much as 9.5% on the second lien loan, and then you can use our effective rate as we disclosed on our operating line.

So interest expense on the face of the statements will look lower in the second half than the first half because we had more of the amortization come off in the first half.

Amit Sharma - *BMO Capital Markets - Analyst*

Got it. Thank you for that. And then, Rik, turning back to the consistency question and management, can you maybe tell us what are some of the things that you are putting in place internally so that you are more confident that performance and the consistency of performance could get better execution, could get better from where it has been previously?

Rik Jacobs - *SunOpta Inc. - President and CEO*

Yes. Look, I mean, we have historically -- with the revenue generation, which is really obviously the sales side, we have been actively hiring people that have retail sales experience because we firmly believe, from a strategic point of view, that that is where the future of this category is, that is where consumers are doing their value-based organic shopping, if you like. So we have been hiring people that have experience in retail sales.

Along with that, we believe comes our obligation to make sure that we take an overall category approach. So we have also been hiring category management resources. So that is kind of on the revenue generation side.

And I think on the last one there, I think you are -- well, I don't think, I know -- you are seeing a significant impact of the whole new innovation center that we put in place last June. We were cautiously optimistic with our $10 million this year. Quite frankly, we're blowing that out of the water on all kinds of different things.

So that, from a consistency perspective, I think is well on the way, and I think it is evident by what we are able to produce right now.

The second part, I think, that we need to have an increased focus on is obviously in our operations. Because we have had, for the last year and also for the first half of this year, too high of a level of cost of nonperformance. We think that that is unacceptable and, therefore, we are continuing to focus their to add more resources, to make sure that we have a structure that is appropriate, i.e. splitting out quality from operations.

So that, I would say, is a significant -- continues to be a significant focus going forward for all of us.

And then, I would say, finally, when it comes into the areas of the support areas, I think we are well staffed over there. We have experienced some turnover, and I am confident that we have the right teams in place over there. So it is really around revenue generation and cost maintenance.

Amit Sharma - *BMO Capital Markets - Analyst*

Got it. Thank you very much.

Rik Jacobs - *SunOpta Inc. - President and CEO*

Okay. So thank you, operator, and I would like to leave you, if I can, with five key takeaways from my perspective. We have a well-defined strategy focused on efficient two type supply chains to ultimately build private-label brands in our three defined categories: healthy beverages, healthy food and healthy snacks. And we are tracking well against most of our operational goals as well in 2016. We see a tremendous opportunity in the private-label and food service categories we serve, and the customers continue to seek value-oriented healthy foods.

We continue to capture market share in organic ingredient sourcing, and our innovation pipeline is building momentum for our consumer business. Our debt capital structure is secured through 2021, and it offers us ample flexibility to grow our business and deliver our midterm targets. We remain focused on execution, filling our production capacity and achieving operational excellence.

So thanks for participating in the conference call and have a great day.
