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SOY.TO - Q1 2015 SunOpta Inc Earnings Call

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PRESENTATION

Operator

Good morning and welcome to SunOpta's first-quarter 2015 earnings conference call.

By now, everyone should have access to the earnings press release that was issued after the close of business yesterday. The release is available on the investor relations page of SunOpta's website at www.sunopta.com. This call is being webcast and its transcription will 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 yesterday, the Company's annual report filed on Form 10-K, and other filings with the Securities and Exchange Commission for more detailed discussions of the factors that could cause actual results to differ materially from those projections in any forward-looking statements.

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 in the Company's press release issued yesterday. 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, Steve Bromley.

Steve Bromley - *SunOpta Inc. - CEO*

Thank you. Good morning, everyone. On the call with me today are Rob McKeracher, our Vice President and Chief Financial Officer, and Rik Jacobs, our President and Chief Operating Officer.

This morning, I will provide you with a brief overview of our first-quarter 2015 financial and operational results. Rob will then discuss our financial results in more detail and Rik will provide an update on our operations. Finally, I will provide brief closing remarks before we open the call up to take your questions.

We made solid progress across our business segments through the execution of our core strategies in the first quarter of 2015. These efforts helped us to generate year-over-year improvement in revenues of 9.1% in our core foods business and 6.9% on a consolidated basis. While our topline was impacted by a number of factors, such as FX and commodity pricing, which Rob will describe in a minute, we believe that the continued growth in the demand for healthy foods is positive for our future.

On a reported basis, we generated earnings of $5.2 million or $0.08 per diluted common share, which includes earnings in our core foods business of $0.09 per diluted common share, and the note that also includes about $1.2 million of one-time costs that we do not adjust for. These earnings were offset by a loss of $0.01 per diluted common share attributable to our non-core operations.

We remain committed to making further improvements to better our position -- better position our business, sorry, for long-term revenue and profitability growth. In the first quarter, we continued to invest in our foods platform with the ongoing expansion of our healthy beverages platform and specifically our integrated aseptic operation in Modesto, California, and planned expansion in Allentown, Pennsylvania, which we will discuss in a moment, as well as our refrigerated juice operation in San Bernardino, which is now fully operational with the successful completion of our SQS certification.

As many of you know, in the quarter we also completed the acquisition of Citrusource, a leading supplier of premium not-from-concentrate private-label organic and conventional juice and citrus products in the United States. The business is performing in line with our expectations and so far the integration process is going well.

Importantly, we are excited to now be in a position to further align our core integrated two-touch strategy and leverage our healthy refrigerated beverage portfolio. This will provide us with the opportunities to bring innovative new products to market and better serve our customers with more consistent, year-round not-from-concentrate juice capabilities.

In addition, we addressed a number of the challenges we experienced in prior quarters around our Modesto aseptic plant expansion. The expansion is now essentially complete and the third processor and new filling lines are up and running.

Finally, our aseptic processing and filling expansion activities at our Allentown, Pennsylvania, facility are on schedule to come online in the fourth quarter of 2015.

Going forward, we will continue to invest in our core value-added foods operations in order to meet the needs of growing healthy foods markets, in turn driving top- and bottom-line expansion.

We also continue to focus on innovation, which is an important part of our future success. As we mentioned last quarter, Jim Gratzek is leading our innovation and R&D team and the expansion of our innovation hub in Edina, Minnesota. Rik will elaborate further on these efforts in a moment.

From a market dynamic perspective, as many of you will have read, millennials are now the largest consumer group and a major force in the further increase of both organic and retailer branded sales. Both of these sustainable consumer shifts are fully in line with our strategy. The strong performance of our global ingredients segment is another signal that our integrated natural and organic foods business is well positioned to serve this growing consumer trend towards more healthy and organic food products.

So to summarize, we started the year off well and continue to execute on our core strategies to better leverage our integrated platform. Our strong results in global ingredients and the progress we're making in consumer goods are a good indication of where we will continue to evolve and we are striving to achieve more tangible operational and financial results in the coming quarters.

With that, I will turn the call over to Rob, who will provide further details on our financial performance and balance-sheet position. Rob?

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

Thanks, Steve, and good morning, everyone.

I will focus more specifically on our financial results for the first quarter of 2015. Please note that the financial figures referenced on this call exclude the fiber and starch business, which was sold on December 22, 2014, and is reported as a discontinued operation.

Revenues for the 13-week first quarter of 2015 were $303 million, as compared to $322 million for the 14-week first quarter of 2014. As a result of our fiscal calendar, the first quarter of 2014 included an extra week of sales, which contributed $21.3 million of incremental revenue.

After adjusting for the extra week, as well as the impact of changes, including commodity prices, foreign-exchange rates, in particular the euro, and product rationalizations, revenues in SunOpta Foods increased 9.1% and consolidated revenues increased 6.9% versus the prior year. The increase in revenues is primarily due to stronger demand for organic ingredients in the US and Europe, partially offset by lower sales in snack-based food categories and competitive pressures on certain steel and industrial mineral products in Opta Minerals.

We generated operating income of $9.4 million or 3.1% of revenues in the first quarter, compared to $12 million or 3.7% of revenues in the first quarter of 2014. The decline in operating income is attributable to Opta Minerals and consumer products.

In Opta Minerals, lower volumes of higher-margin steel products and competitive pressures in their infrastructure segment resulted in an operating-income decrease of $1.5 million from the prior year, resulting in an operating loss of $0.5 million in the first quarter of 2015.

In consumer products, gross margin decreased by $6.2 million. Lower volumes of snack products, cost input pressure in frozen fruit, as previously discussed, costs associated with the retrofit of our premium juice operation, and costs related to expansion activities at our Allentown, Pennsylvania, facility to add aseptic beverage processing and filling capabilities were the primary drivers for the decrease in margin.

These pressures were partially offset by global ingredients as a result of increased volumes of organic ingredients, improved performance within our rationalized sunflower operations, and a margin shift of approximately $1 million from the consumer products segment as the result of the centralization of our raw material procurement.

SunOpta Foods' operating income, including corporate services, was $10 million or 3.6% of revenues, compared to $11 million or 3.8% of revenues in the first quarter of 2014 and $4.2 million or 1.7% in the fourth quarter of 2014. Included in the results for the first quarter of 2015 are approximately $1.2 million of incremental costs related to the retrofit of the San Bernardino juice operation, expansion activities at the Allentown aseptic facility, and the effect of West Coast port delays on export grain shipments to Asia. Excluding these costs, operating income for SunOpta Foods in the first quarter would have been $11.2 million or 4.1% of revenues.

As outlined in our last earnings call, our management team's primary focus remains the improvement of operating margins, especially within consumer products. We have initiatives in place on a number of fronts, including facility and capabilities expansion, cost-reduction initiatives, and growth through innovation. Rik will provide further details on the performance of our business segments during the first quarter as part of his operations update in a few moments.

Earnings for the 13-week first quarter of 2015 were $5.2 million or $0.08 per diluted common share, compared to $6.6 million or $0.10 per diluted common share during the 14-week first quarter of 2014.

From a cash flow perspective, as is typical for a first quarter we used $11.5 million in cash from continuing operations, compared to $12.1 million used during the first quarter of 2014. The cash used in operations is due to increased funding of working capital.

From an investing perspective, we used $13.3 million in cash to fund the upfront consideration of our acquisition of Citrusource and spent $5.7 million on capital expenditures.

Our balance sheet remains strong, and at April 4, 2015, our consolidated debt net of cash was $137.1 million, reflecting a net debt to equity ratio of 0.41 to 1. It is important to note that $43.8 million of this net debt belongs to Opta Minerals and is nonrecourse to SunOpta. Excluding this amount, our net debt to equity ratio is 0.27 to 1 within our core foods business at April 4, 2015.

Looking ahead, we will invest internally in support of our growth objectives and we continue to seek acquisition opportunities that make strategic and financial sense and that are consistent with our prudent approach to acquire companies that are accretive to earnings and leverage our integrated business model.

I will now turn the call over to Rik will discuss our operational performance in more detail. Rik?

Rik Jacobs - *SunOpta Inc. - President, COO*

Thanks, Rob, and good morning, everyone.

As per usual, I will review the performance of our two reporting segments within SunOpta Foods, global ingredients and consumer products. In addition, I will touch on our supply chain and innovation activities as they are both important aspects towards reaching our operating margin target of 8%.

To begin, we had solid demand across our global ingredients platform. This segment grew 1.1% year over year in the first quarter and we had a nice sequential improvement of 9% on the topline compared to the fourth quarter of 2014.

However, these numbers really hide the very strong underlying performance in this segment. If you adjust for foreign exchange, commodity price changes, and the impact of product rationalization, the underlying growth is really 20%.

And if you dive a bit deeper, our international sourcing and supply division actually grew revenue by a very strong 48%, while on the domestic side, which comprises mostly soy, corn, and sunflower, we actually decreased by approximately 5% due to the rightsizing of our sunflower operations and the issues we experienced from exporting our organic and non-GMO soybeans from the US West Coast ports to Asia.

Even though revenue declined in our domestic raw materials sourcing business, margins were up, as planned. It is also fair to say that we got a little help from foreign exchange in our internationally-sourced organic raw materials that we bought in dollars and sold in euros as a result of our hedging practices.

However, keep in mind that these FX gains from hedging our purchases are offset by somewhat lower realized margins as we fulfill the contracts. We saw some of this already in the first quarter and this effect will linger for the next two quarters as well.

The underlying growth continues to reflect investments the team has been making over many years in organic projects and supply-chain efficiency efforts across our global operations. And now that markets in both Europe and the US are growing, we are benefiting from these investments both on the revenue and the operating-margin front. In fact, we had very positive operating-margin expansion of 350 basis points to 5.8% as compared to the prior year.

Our team has done a really good job of executing on our key objectives and this segment is steadily approaching its target operating income range of 6% to 8%, which, as Rob has already indicated, includes some sustainable margin realized from our increased centralized global procurement office.

Our strong performance in global ingredients was partially offset by a number of commercial and operational challenges in the consumer products, which we outlined in our last earnings call. That said, while some of the challenges persisted in the quarter, our team did make good improvements to better position the business for growth ahead.

Sequentially from the fourth quarter of 2014, revenues were up 9% and our operating margin expanded 180 basis points. Obviously, as this segment is approximately 45% of our food sales, we need to further expand our operating margins in consumer products to a range of 11% to 13% so that in total we reach our 8% target.

Delving into the categories within CPG for a moment, as previously mentioned our San Bernardino facility received SQS certification and is now fully operational, and we will see increased sales from this facility in Q2 as we continue the integration of the Citrusource business into the facility, as well as win over more and more customers with our unique West Coast extraction and bottling combination.

On the aseptic side, our Modesto plant expansion is mostly completed, which means that we can now keep up with demand and start growing the business in new categories. The growth ramp-up is something that will take some time since we had to halt new initiatives and some of our customers had to find alternative supply for their products because of our capacity constraints last year.

Having said all that, we did have a record production week in March where we could really start to see the benefit of our investments translate into lower cost per case produced as we better utilized the facility.

Finally, we remain on track with our aseptic expansion in our Allentown facility and we expect to bring the processor and first line into commercial production in Q4. Having both East and West Coast production should enable us to deliver the lowest landed cost for our customers, while having the same high-quality standards across the business.

Our fruit snack business is doing well and we're bringing on some more business into that channel, but we did have a slow start to the year in our nutritional bar business due to a shift in the promotional calendars of some of our largest customers. We do think -- see things picking up over the balance of 2015 there.

Finally, as I explained last quarter, we did have pricing pressure in our pouch business due to some excess capacity in the market and in our frozen fruit business because of the delay in passing through input price increases to our customers. I'm happy to say that the price increases have been passed through to most of our customers in Q2 and that we are filling our pouch plants back up with some significant customer wins with two large national retailers.

On the supply-chain side, we are extremely proud of the decrease in our total recordable incident rate in March to below 3.0, which is considered world class in our industry. Safety for our employees is paramount to us and forms the most important foundation for our employee engagement, which will ultimately lead to lower costs and higher quality.

In the quarter, we also started outsourcing our freight to a third party, which will lead to lower costs and higher service levels going forward, although the results will not yet be meaningful during the next quarter as we ramp up the number of facilities that use the new third-party model.

In addition, we are continuing to pursue margin improvements through operational cost-saving initiatives, such as processing efficiencies driven by process redesign and investments, new enhancement projects at key processing facilities, centralization of procurement, and capacity enhancement efforts. These are expected to contribute between $10 million and $12 million over the next 12 to 18 months on our journey to an 8% operating margin.

As Steve already mentioned, we are excited about our new innovation center that we will open in the beginning of June. The center allows us to work actively with multiple customers at the same time on new product developments. We have a pipeline of more than 100 active projects at present and some of these will be hitting the shelves in the coming months. Over the last six months, we restructured our R&D resources to focus not only on new product development, but also on product maintenance of our existing portfolio, as well as enhanced process development to lower the cost in our plant for sustainable margin growth.

In summary, while we are pleased with the quarter-over-quarter progress in our business, we still have further to come to meet our expectations. The underlying trends in our consumer product categories are positive and the supply chain and innovation efforts are getting much closer to having a meaningful impact on our bottom-line margin targets. As a result, we are confident in reaching our long-term targets.

I will turn the call back over to Steve for some brief closing remarks.

Steve Bromley - *SunOpta Inc. - CEO*

Thanks, Rik.

In summary, our management team remains focused on three key drivers to improve our overall business.

One, to grow areas of our business that offer the highest margins and enhance our integrated field-to-table business model. Our recent acquisition of Citrusource is a good example, as we pursue additional strategic M&A opportunities and we continue to focus on the divestiture of Opta Minerals. These efforts, along with our future innovation both in products and processes, are designed to drive growth in our core global ingredients and consumer products businesses.

Two, cost management is a top priority and, as Rik mentioned, we will get savings that flow to the bottom line over the next 12 to 18 months. From freight lane consolidation to productivity efforts designed to maximize available capacity, there are many opportunities for us to capitalize on.

And three, increased leverage as we optimize our existing infrastructure for continued growth. Our recent operational realignment is now complete and we are seeing benefits from our integrated business model, especially in our global ingredients segment today and we fully expect the same over time for our consumer products segment.

Before we take questions, I do want to let everyone know that starting with our 2015 second-quarter financial results, we will transition to a more standard reporting timeline and we will release our earnings at 7 AM and host our earnings call shortly thereafter. I will provide more further details, but we are doing this to streamline the timing between the release and the call, consistent with today's best practices.

So that concludes our prepared remarks. I would like to thank you for joining us on the call, and with that, Rob, Rik, and I are available to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Scott Van Winkle, Canaccord Genuity.

Scott Van Winkle - *Canaccord Genuity - Analyst*

Good quarter, guys. Good to see the improvement from Q4. I have a few questions. First, how significant is the incremental capacity coming in Modesto, relative to what you're doing there now or relative maybe to the size of Allentown, so we can think about when Allentown comes on later this year?

Steve Bromley - *SunOpta Inc. - CEO*

Sure, I will let Rik handle that.

Rik Jacobs - *SunOpta Inc. - President, COO*

Yes, so we commissioned our third processor, so now we have three processors in Modesto. By comparison, we will have one processor in Allentown. And with that third processor, we also installed two new filling lines, so what that third processor does, it basically allows us to keep more lines running at the same time.

So in comparison, Allentown will start with one processor and one filling line, a second filling line likely to be added Q2 2016, so compare that to the 10 lines we've got going in Modesto versus the one line in Allentown. Modesto will obviously be more significant, although the line we are installing in Allentown is a high-speed line.

Scott Van Winkle - *Canaccord Genuity - Analyst*

Okay. And then, can you expand a little bit on the juice facility? Good to see that up and running.

Rik Jacobs - *SunOpta Inc. - President, COO*

Yes, the juice facility is indeed up and running. We received an incredibly high SQS core of 96%, so that's fantastic.

So now, obviously we needed SQS certification in order to bring customers back into the facility. The first customer coming in is obviously Citrusource with a lot of their products that are currently being packed elsewhere. We will also start doing extraction on behalf of Citrusource that they will be selling to their customers, and both of those activities are starting June 1, basically.

Scott Van Winkle - *Canaccord Genuity - Analyst*

And visibility on external customers, incremental external customers?

Rik Jacobs - *SunOpta Inc. - President, COO*

There is good visibility on that, but we need -- now that we have SQS, we need to go through their internal audit process, which is -- it should take probably a couple of months, I would say.

Scott Van Winkle - *Canaccord Genuity - Analyst*

Okay. And then on the global ingredients business, is there an easy way to quantify what the margin benefit would have been from commodity pricing or -- obviously, it impacted revenue. I am wondering, commodity pricing, how it flowed through to the EBIT line for the global ingredients business?

Rik Jacobs - *SunOpta Inc. - President, COO*

I think if you look at net net commodities, we all know that soy and corn are way down, but some of the internationally sourced organic raw materials are up, so the commodity line actually is a net even, I would say.

As we alluded to, they did benefit from a margin transfer, internal transfer, from consumer products into raw materials of about $1 million incremental in the quarter versus last year. So, I don't think that the commodity pricing net net has had a -- would you want to add anything, Rob?

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

No, I think, Scott, the more significant thing that has gone on in the quarter is certainly the foreign-exchange topline for that business, the European piece of it. The commodity price --

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Rik Jacobs - *SunOpta Inc. - President, COO*

(multiple speakers) about $10 million.

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

It's about $10 million versus the same quarter last year, depressing, if you will, the topline.

Scott Van Winkle - *Canaccord Genuity - Analyst*

Great, great. And I was thinking gross margin percent. I mean, I know with lower commodity prices on soy and corn, you should be picking up maybe a little margin percent trying to hold margin dollars flat. Did you lose a little bit of margin percent on higher-priced ingredients coming from Europe or maybe from currency?

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

Yes, certainly you will get expansion as prices are coming down on a percentage basis and the other way around as prices increase, but net net in global ingredients I wouldn't suggest that is anything worth calling out this quarter.

Rik Jacobs - *SunOpta Inc. - President, COO*

The only thing I would add is that if you look at some of our most profitable raw materials, domestic raw materials, are the ones that we actually ship to Asia. And we did have -- I think Rob called it out -- what was it, Rob? $350,000, some margin impact from not being able to ship that inventory (multiple speakers)

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

Yes, it's actually about $450,000, and literally it's just getting our --

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Steve Bromley - *SunOpta Inc. - CEO*

(multiple speakers) cans.

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

Our containers are stuck at the ports and can't get over to Asia on the scheduled timeline.

Scott Van Winkle - *Canaccord Genuity - Analyst*

Great, thanks. One last general question, you're playing in the supply chain for almost every channel of distribution and a large volume of customers in this kind of natural healthy food space. Some of the retailers and even some of the brands have talked about a little weakness interquarter in the natural organic space.

Do you have any commentary you could talk about, maybe about how it is playing by channel? Obviously, you don't want to talk about any customers, but how it will play by channel or if maybe you saw little bit of weakness towards the end of the quarter in the natural organic channel?

Rik Jacobs - *SunOpta Inc. - President, COO*

Yes, I think -- to start with, we are, as Steve always calls it, channel agnostic because we do trade in all the channels.

I think club continues to be strong. Having said that, we did have some impact specifically in the club channel from some of our customers changing a promotional calendar from Q1 into Q2 or Q3, so that was a little bit of a drag for us in the club channel.

I think grocery as a whole is doing very, very well, and indeed I do see as more and more of the traditional grocers are basically picking up natural and organic, that does put pressure on the natural and organic channel.

Scott Van Winkle - *Canaccord Genuity - Analyst*

Great, thank you very much.

Operator

Tim Tiberio, Miller Tabak.

Tim Tiberio - *Miller Tabak - Analyst*

Thanks for taking my question. My first question is, I guess, focused on global ingredients. Excluding the FX impact in Europe, can you just talk to us about which categories that you are seeing the most robust growth from in the international category?

Steve Bromley - *SunOpta Inc. - CEO*

Sure, there is a bunch. Rik, take that one, too.

Rik Jacobs - *SunOpta Inc. - President, COO*

Yes, I think the most significant one is -- there is really two categories -- is fruits and vegetables, and that's because we have very, very deep supply chains all over the world so we are able to source where other people are not. Quite honestly, as we pointed out earlier, it is at a higher cost and some of that had to be passed on quicker to our consumer product customers.

The other category that is on fire, quite frankly, is feed, feed in Europe, as well as feed in the United States, and that is because more and more demand for organic chickens, organic eggs, organic meat, you name it.

So I would point to those two. Overall, we have done very well in all categories. Those would be the two that I would point to as the outliers to the upside.

Steve Bromley - *SunOpta Inc. - CEO*

And then, lots of really growing categories, like coconuts and stuff that is growing, but those are the big ones, for sure.

Tim Tiberio - *Miller Tabak - Analyst*

That's very helpful. And then, just back to the CPG category, I think you addressed this, but I was wondering if we could take a different tack on this. When you look at the year-over-year performance in the CPG sectors, there has obviously been some puts and takes since you have gone through this expansion process. And I'm just wondering when we look at just on a year-over-year basis, excluding the additional capacity, including Citrusource, structurally there does seem to be a little bit more margin pressure in the healthy snacking, as well as pouch business.

I know you're pushing through some price increases, but I was just wondering if you could quantify what you think is the structural pressure that we should extrapolate going forward. Obviously, we can lay in some of the benefits that you should be seeing as the improved fixed-cost absorption and reignite the topline growth, but I just want to get a sense of how much additional margin pressure you have seen since last year and how we should factor that into our models?

Steve Bromley - *SunOpta Inc. - CEO*

Okay, yes, sure. Rob, why don't you run Tim through some numbers there?

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

Just focusing, Tim, for a minute on truly the year-over-year comparative, and you will see the operating margins in consumer are down $7 million.

Right off the top, there is really $3 million that needed to be explained. We have alluded to the fact that obviously last year's first quarter was a 14-week period, and if you were to simply do the math on what that actual week means to consumer, it is about a $1 million impact on operating margins, decrease, because now we are back to a standard 13-week quarter.

In addition to that, obviously there is centralized procurement as more and more of our raw material sourcing coming through global ingredients, that's essentially transferred $1 million of margin from consumer over to global versus the last -- versus last year's quarter.

And then on top of that, there is $1 million more in corporate overhead allocations, and really that's a function of the fact that we had divested the fiber business back in 2014 and, as a result, the remaining components of our food business bear more of the overhead cost.

So really, $3 million of the $7 million is explained that way. The remaining $4 million is really focused in on a couple areas. I would put $2 million of it right into fruit-based products, so whether that's IQF frozen or our bases and toppings. And really, what we've got there is a combination of changing customer mix and certainly higher input costs that, as Rik had mentioned, are now being passed on to our customers here in the second quarter.

About $1 million of it is the slower start in healthy snacks that Rik talked about and a lot of the promotional changes in the calendar that some of our customers went through this year versus last.

And then, thirdly, there is about $750,000 in costs related to our juice facility and getting that up to the point where we can get our SQS certification, as well as startup costs of East Coast aseptic.

So if you run that down, that at a very high level explains the year-over-year decrease in operating margins in consumer, Tim.

Tim Tiberio - *Miller Tabak - Analyst*

Okay, that's extremely helpful. It sounds just on the surface that while there is some additional pressure, there is no reason as you accelerate the cadence through the year that you couldn't get back over 7% to 8%, maybe not in short order, but definitely by the end of the year.

Are we thinking about that correctly, that this has not structurally changed in the last quarter so that you can actually recover this as some of the expansion projects are coming in?

Rik Jacobs - *SunOpta Inc. - President, COO*

Yes, I think you are pegging it right. We will continue to see in the short term, like I tried to explain, if you have capacity issues and your customers have to seek alternative supply, you can't turn that alternative supply off overnight. But towards the back half of the year, we definitely see that, and really if we're just continuing to do the demand properly, grow the demand properly, and our cost initiatives are taking hold, then obviously the demand should be helped by the tremendous efforts we are making right now on the innovation side.

We want to expand our margins to 11% to 13% in the medium term because that's the target for that segment to get us to an 8% overall.

Tim Tiberio - *Miller Tabak - Analyst*

Perfect. Thanks for your time.

Operator

Bob Gibson, Octagon Capital.

Bob Gibson - *Octagon Capital - Analyst*

You have done a fantastic job of reducing your corporate expenses year over year and quarter over quarter. Can I get a little color on how you did that?

Steve Bromley - *SunOpta Inc. - CEO*

Sure. We won't take credit for the dollar. The Canadian dollar declining certainly was part of it, but (multiple speakers)

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

Yes, I think, Bob, what you see there, it is really a combination of two things, and by the way, our overall SG&A load really isn't that dramatically different year over year. We certainly helped as both the euro and the Canadian dollar weakened relative to the US, that was of a benefit, but --

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Steve Bromley - *SunOpta Inc. - CEO*

That's the SG&A line, but we get the opposite benefit, of course -- not benefit, because the euro earning don't convert as well.

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

Exactly, exactly. So from strictly a corporate perspective, what you really see there is the distribution of overhead charges into the segments. I wouldn't want to leave you believing corporate expenses overall are down. Certainly, it's something that we are managing and we are ahead of last year mainly on foreign exchange, and overall you'll see SG&A isn't that dramatically different.

Bob Gibson - *Octagon Capital - Analyst*

Okay, so does that mean you guys are going to start paying yourself in US dollars?

Steve Bromley - *SunOpta Inc. - CEO*

No.

Rik Jacobs - *SunOpta Inc. - President, COO*

We wish.

Steve Bromley - *SunOpta Inc. - CEO*

Great idea, but the answer is no. Thank you.

Bob Gibson - *Octagon Capital - Analyst*

Okay, and then, secondly, can you give me a dollar amount for the FX impact on the topline?

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

Yes, it's about -- overall, it's just under $12 million and about $10 million of that is SunOpta Foods.

Bob Gibson - *Octagon Capital - Analyst*

Thanks so much, guys.

Operator

Chris Krueger, Lake Street Capital.

Chris Krueger - *Lake Street Capital - Analyst*

Just a couple of questions. On your aseptic beverage efforts, I know that WhiteWave Silk brand has recently launched the cashew milk and I think it's been off to a pretty good start. Can you talk about any -- whether or not you're getting into a cashew into that segment or if your sunflower milk has made any progress or any other kind of unique potential products that could give you an edge?

Rik Jacobs - *SunOpta Inc. - President, COO*

Yes, if you look at the nondairy category as a whole, they are continuing to take share from the dairy category, right? The dairy category is declining, nondairy is growing. Nondairy, if I get the numbers correct, it's about, I think, 9% of the total dairy right now.

So, obviously, it was all started by soy and by rice. The next big mover was almond. I think almond growth is slowing somewhat, so everybody is now looking into what the next big thing out there.

Some people are betting on cashew. Other people are betting on oat. Personally, I think oat has some really good legs because it's got a nice profile with good proteins and all that.

We will -- as you know, we don't really have our own brands, so as a result we are packing whatever our customers want us to pack and that does include a little bit of cashew already as well.

Chris Krueger - *Lake Street Capital - Analyst*

Okay. Then next question, the California drought, which has been pretty significant, are you guys impacted by that at all, whether it be sourcing almonds or the water used for your facilities?

Rik Jacobs - *SunOpta Inc. - President, COO*

Look, we -- obviously, sustainability is a core part of our DNA, so we have already been working on a lot of water conservation areas even before this even became more public.

None of our facilities at present are impacted by it. In other words, we have not gotten any edicts from any water district that we need to reduce or anything like that.

And when it comes to the almond specifically, we all see the pictures of farmers ripping out trees. I do expect that there will be less of an almond crop this year than there was last year.

Chris Krueger - *Lake Street Capital - Analyst*

All right, thanks. That's all I got.

Operator

Mitch Pinheiro, Imperial Capital.

Mitch Pinheiro - *Imperial Capital - Analyst*

So, a couple of questions here. For Rob, if I add back -- so if we add back some of the discrete items you called out on the consumer product side, the $7 million decline, you're getting somewhere maybe an operating margin in that segment of 7% to 8%. Relative to your goals, the longer-term targets, and I know, I guess, Steve, you talked about your three drivers and things like that in terms of margins, is that -- can you get there -- can you get from 7% to 8% to 11% to 13% strictly on leveraged cost management? Is there anything else that needs to be done?

And then, I guess, also, how would you weight the leveraged cost management and product mix as far as pushing it higher to your targets?

Steve Bromley - *SunOpta Inc. - CEO*

So, Mitch, the way I would simply try and lay that out is to take a look at the overall business. When you add back the $1.2 million that Rob referred to in additional costs, that leaves us around 4%, and if you look further into businesses that are in transition and -- for example, San Bernardino, while we had those costs, we are not getting a lot of earnings out of that yet; it's just starting. We would be about 4.5% if those things were normalized.

So there is a 3.5% gap that needs to be closed to get us to 8%. When you go through our detailed plans and assimilate all the activities across those platforms, about half of the lift -- so half of the 3.5% -- comes from volume gains, product mix, the results of our innovation. It is really topline driven. The other half comes from cost and leverage, and about two-thirds of that is cost and about one-third of that is leverage.

So the most important thing is growth and new products and innovation. Now that's why we have made such a concerted effort over the past year to really expand our innovation resources. Rik talked about the new innovation hub opening up in the facility. We have got some really exciting innovations in our pipeline that are now, as Rik mentioned, are starting to come to market, but there is a lot more, and this is really being led under the leadership of Jim Gratzek and the team that has been put in place, so we are very excited by that.

That's the top half and then the rest comes from cost. Rik gave some specifics on cost. And then, of course, leverage comes.

And as we have said, and Rob commented on this a little bit, we have built out a platform over the last two years with operational expertise and R&D expertise, so we have been investing. Our SG&A line has grown. But we're at the place now where we really believe the plant and the people are in place and we can leverage this.

And so, when we sold the fiber and starch business, we didn't strip the organization because we wanted those resources to be there for future growth.

Mitch Pinheiro - *Imperial Capital - Analyst*

Okay. That's helpful. I appreciate that color.

What about getting back to your -- you talk -- you had a 5% decline, I guess, in domestic ingredients. You cited sunflower and the LA port issue. What would that have been, ex these one-time items, in the quarter?

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

So the decline of 5%, if we didn't have port delays and that sort of thing?

Mitch Pinheiro - *Imperial Capital - Analyst*

Yes, yes.

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

The port delays were about $3 million, so that would have left most of that -- in the domestic side, if you will, of global ingredients more or less on par with last year.

I think the main thing to take away here is that it is not -- I don't look at this as an indication of market. A lot of the decline that you see in global -- the domestic part of global ingredients is on purpose. In other words, we rationalize certain lines, certain facilities. We are not doing certain varieties of seeds that were low margin before, and that's why you see while revenues are down, gross profit is up. So it's more of a strategic shift there than something I think that we normalize and say what the growth could have been. This is where we expected it to be.

Mitch Pinheiro - *Imperial Capital - Analyst*

Okay. And then, what products globally are you seeing tightness in, sourcing tightness?

Rik Jacobs - *SunOpta Inc. - President, COO*

You know, I think as -- we are seeing tightness everywhere. There is obviously a reason why our internationally sourced raw materials are growing 48%.

The reason, I think, is because we have the supply chain while others don't. I don't think for one moment that those categories are growing 48%. We are growing 48% and that's a result of the tightness in the market and of the years of knowledge and investment that we have done in all these projects, whether you talk Latin America, whether you talk Asia, or whether you talk Africa or Eastern Europe or Turkey.

Steve Bromley - *SunOpta Inc. - CEO*

And we are continuing -- to Rik's point, we are continuing to add resources and capabilities to continue to grow to meet needs. It is one of our core strengths and something we feel we are very good at.

Mitch Pinheiro - *Imperial Capital - Analyst*

Is there any particular tightness in North America in any particular --

Rik Jacobs - *SunOpta Inc. - President, COO*

If you look at the California drought, we talked a little bit about almonds. I think there is concern on the peaches in California as well. You can name some of the other fruits that are all coming out of California, especially those that use a lot of water.

So, there are some concerns there, but again -- let's take strawberries as an example. So you're going to have tightness in California. We've got sources in Morocco where they happen to plant exactly the same varieties, as they do in Serbia, as they do in Turkey, so we have other sources where we can get our strawberries from. Maybe not at the same cost, but we can get them, where others can't anymore.

Mitch Pinheiro - *Imperial Capital - Analyst*

Right. Okay, that's all I had. Thank you very much.

Operator

Christine Healy, Scotiabank.

Christine Healy - *Scotiabank - Analyst*

I guess I just want a little bit more clarity on global ingredients and the products that you rationalized there. Was it largely on the sunflower side, like just sourcing sunflower seeds, or was there also anything on the soybean side?

Steve Bromley - *SunOpta Inc. - CEO*

No, it's primarily sunflower driven and a little bit in soy, but the major part, Christine, was on sunflower.

And you will recall that last year, we disposed of a couple of operations in the Midwest that were growing varieties -- we were processing varieties of sunflower seed that you will recall we had yield issues with, and anyways, we just decided that the risk of some of those varieties in those growing regions wasn't worth the reward. So we sold the facilities and exited those lines.

There has been some rationalization in soy, but the largest part would be sunflower driven.

Christine Healy - *Scotiabank - Analyst*

Okay, that's helpful. And then, I guess, for annual revenue impact, is it fairly small or is it something that we should keep in mind? Is there a number that you can approximate for us?

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

Annually, it would be about $10 million.

Christine Healy - *Scotiabank - Analyst*

Okay, $10 million. Okay, that's helpful.

And then on the San Bernardino upgrade, so we saw some more costs here in Q1, but I just wanted to confirm that's the end of the costs, right? Q1 is the last of the upgrade costs?

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

I'm going to let Rik comment on it. It is the last of the heavy expansion-related costs. Now it has to ramp up. It's not going to -- we're not going to go from zero to (multiple speakers)

Rik Jacobs - *SunOpta Inc. - President, COO*

It's the end of the costs and hopefully on our way to profitability there, because recognize that on -- from an operating-income perspective, we are still burning cash over there, but [on one off], we are still negative margin, but that will solve itself as we fill that facility up now.

Christine Healy - *Scotiabank - Analyst*

Okay, Rik. How do you expect to see utilization ramp up over the next few quarters?

Rik Jacobs - *SunOpta Inc. - President, COO*

Well, if you just look at the organic orange juice that we sell and the organic orange juice that Citrusource sells, and also some of the conventional orange juice that Citrusource sells, that pretty much fills up the bottling side of it.

And then when you talk about the extraction side of it, some of that we're going to start selling inside of our global ingredients platform in bulk, bulk tankers to customers that need that on the West Coast, and all of that extraction, obviously, we're going to utilize for our own bottling, so that's how we are going to take care of that.

Christine Healy - *Scotiabank - Analyst*

Okay, so you expect to see pretty healthy utilization by the end of this year?

Steve Bromley - *SunOpta Inc. - CEO*

Yes.

Rik Jacobs - *SunOpta Inc. - President, COO*

Yes.

Christine Healy - *Scotiabank - Analyst*

Okay, okay, I just wanted to clarify that. Okay.

And then, Steve, Opta Minerals, your favorite thing to talk about, some pretty weak results here this quarter. And I read through the release this morning. It seemed like they are pretty -- they are in a state where they're hunkering down. They are prioritizing and reducing costs and simplifying the business and trying to improve their cash flow. So I guess I'm just wondering from your perspective, does this change at all your strategic process and your potential sale of your stake?

Steve Bromley - *SunOpta Inc. - CEO*

Look, it doesn't change our view on exiting that business at the right time, so there is no change. Look, it's certainly caused some twists and turns in the process that is ongoing, given the results and what it does to potential buyers and those sort of things, but we remain committed.

Christine Healy - *Scotiabank - Analyst*

Okay, thanks very much.

Operator

I am showing no further questions from the phone lines at this time. I would like to turn the call back to Steve Bromley for closing remarks.

Steve Bromley - *SunOpta Inc. - CEO*

Great, thanks very much. I'd like to thank everyone for joining the call today. We really appreciate your time and we look forward to speaking to everyone in the near future. So, thanks very much and have a great day.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program and you may now disconnect. Everyone, have a great day.
