

February 26, 2015

Maple Leaf's results disappointing, but big bet on meat could still pay off

By Claire Brownell



Canadian households just aren't bringing home the bacon at the rate they used to, a phenomenon that's hurting Maple Leaf Foods Inc.'s bottom line.

On Thursday, the major Canadian pork producer reported a fourth-quarter net loss from continuing operations of \$23 million, or 16 cents per share. That's an improvement on the company's \$47.9 million net loss during the same period a year ago, but fell short of analyst expectations that the company would post earnings of 1 cent per share.

In a conference call with analysts Thursday, president and chief executive Michael McCain said consumers have been buying less beef and pork since the company raised prices in the second quarter of 2014 in response to higher costs. Since then, sales volumes haven't picked up as fast as the company had hoped, he said.

Maple Leaf is nearing the end of a multi-year restructuring program, replacing old plants and focusing on meat by selling unrelated assets, such as its \$1.83 billion sale of Canada Bread Co. to Mexico's Grupo Bimbo last year. Despite the current high commodity prices and weak sales volumes, Mr. McCain said he's confident the bet on meat is a good one.

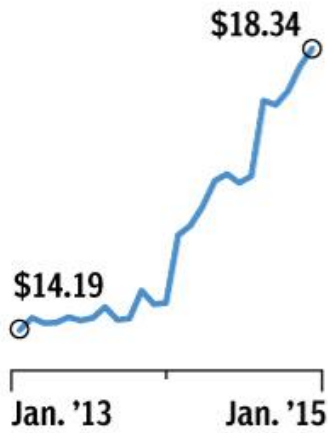
"The prospects for growth are pretty high," he said. "We offer a full range of proteins. There are many very healthy choices in our portfolio. We've focused on developing our natural product line. All of which are very attractive to consumers."

The price of pork has already started to fall again after rising dramatically during last year's epidemic of Porcine Epidemic Diarrhea. The price of beef, on the other hand, remains high with no end in sight, the result of years of drought and expensive feed costs.

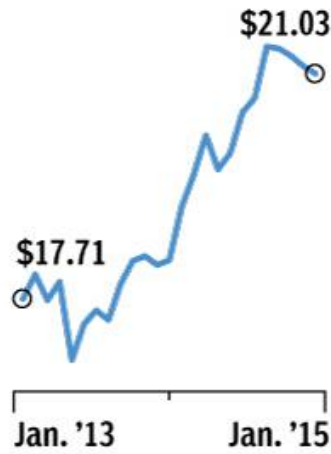
MEAT PRICES ON THE RISE

CONSUMER PRICE INDEX, AVERAGE RETAIL PRICES FOR SELECTED FOOD ITEMS, JAN., 2013 - JAN., 2015

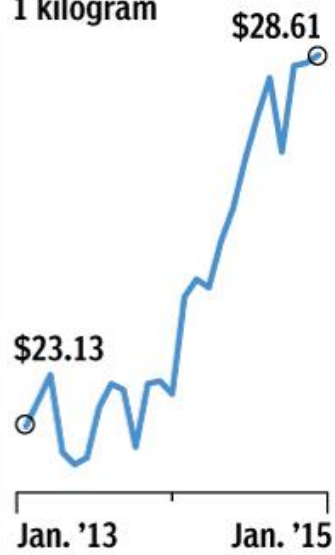
Round steak
1 kilogram



Sirloin steak
1 kilogram



Prime rib roast
1 kilogram



Blade roast
1 kilogram



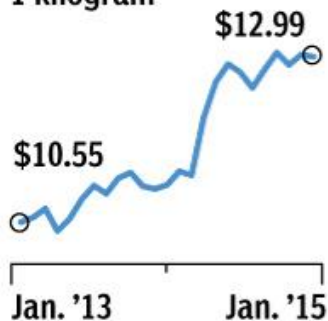
Stewing beef
1 kilogram



Ground beef, regular
1 kilogram



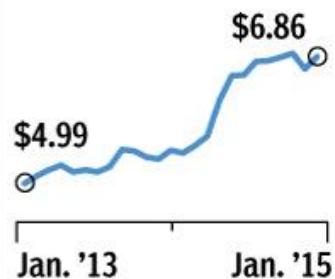
Pork chops
1 kilogram



Chicken
1 kilogram



Bacon
500 grams



Kevin Grier, an independent livestock market analyst, said the amount of meat Canadians are buying has dropped by 5% to 10% year over year. However, the amount of money they're spending on meat has actually increased because of the higher prices.

"We are consuming less, no question about it," he said. "But the dollars that we're spending is up significantly as well. Overall demand, I'd say, has been quite encouraging."

That phenomenon is reflected in Maple Leaf's sales figures. The company may have sold fewer kilograms of meat, but in dollars, it still managed to increase sales in its meat products group from \$744 million in the fourth quarter of 2013 to about \$790 million in the fourth quarter of 2014.

Sam La Bell, an analyst with **Veritas Investment Research Corp.**, said he's confident Maple Leaf's customers will eventually return to pork and beef. Maple Leaf also benefits from the low Canadian dollar, which will make it harder for U.S. competitors to undercut its products as the cost of beef and pork falls, he said.

"Generally people will come back," he said. "Culturally, we're still meat eaters."

Still, **Mr. La Bell** said he's not convinced the company can boost the sales volume as quickly as its management says it can. He said he's more interested in the stock because of the potential of its cost-cutting program to create value – Maple Leaf announced it will double its quarterly dividend Thursday, raising it to eight cents per share.

And if consumers are expecting the price of a package of bacon to fall soon, they may be disappointed. It may be more profitable for companies like Maple Leaf to keep prices where they are, he said.

"There's an incentive to keep prices higher than you otherwise would, because you already lost the volumes," **Mr. La Bell** said. "They would like to regain volumes without competing too hard on the price on the way down."