VERITAS INVESTMENT RESEARCH

Maple Leaf Foods
BUY – C$29.00

Ticker	Current Price
TSX-MFI	C$23.52

NEED-TO-KNOW Q3-F20

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Counting Chickens Before They Hatch

Maple Leaf's third quarter was a mixed bag especially as investors continue to rely on the relatively small and unproven plant-protein division for growth while underweighting the potential upside from the London poultry plant – a project similar to MFI's past pork plant consolidation. As a result, we think spending at the plant-based protein division is questionable given the uninspiring ~9% top-line growth and stubbornly high operating costs. MFI chalked up the lackluster results to supply chain issues. In turn, MFI's core meat division showed very positive trends, with revenue growing another 6% and Adjusted EBITDA margins reaching ~11% even after adjusting for IFRS 16.

Even though the company showed very positive results in its core business, we think the company's execution of its plant-based protein strategy has so far, fallen short. During Q3, the plant-based protein division's lack of growth coupled with COGS and SG&A costs totaling 180% of revenues washed away any gains investors saw from the meat division. **We remain less enthusiastic about MFI's plant-based protein efforts given the lack of material progress. For the sake of investment returns, we continue to look towards the poultry plant consolidation as the key to MFI's future growth.**

In our view, the current environment remains favourable for MFI given its position as staple good. With tempered expectations for plant-based protein, we maintain a BUY recommendation on MFI with an updated intrinsic value estimate of $29 per share.

Need-to-Knows from Q3-F20:

- **Meat division posted strong top-line growth of ~6% and Adj. EBITDA margins of ~11% after the full impacts of IFRS 16:** We keep our focus on the core meat division given its importance in the overall strategy. Though still early, the company has kept its commitment to improving its Adj. EBITDA margin to 14% to 16%. With margins now consistently above 10%, even after IFRS 16 impacts, we are more confident in MFI's progress on its most important growth lever. We also expect top-line growth to stay healthy, but slow slightly for the remainder of the year as the company waits for its Chinese exports to resume.

- **We question the plant-based protein growth strategy:** We think management must re-evaluate whether the continued, elevated spend on this division is worthwhile. MFI spent $200M in the last twelve months while only adding $43M to revenues. Even though gross margins and SG&A might eventually revert to pre-acquisition levels (i.e. 20% to 25%), there is still a significant amount of work for MFI to do.

- **Chinese pork demand continues to influence the market:** During the quarter, hog prices increased 62% due to increased demand from China. However, average prices throughout the quarter were still below 2019 levels. Though African Swine Flu continues to impact Chinese markets, we think prices will trend at the historical average, stabilizing MFI's margins.

- **Construction capital deployment continues, however, costs increased due to COVID:** The company continues to progress on the project with the bulk of the development occurring in the coming two years – in line with our original estimates. In addition, management now expects cost overruns, with project expenditures reaching $720M. This is also in line with our original estimate made during our analysis of MFI's pork plant consolidation precedent.

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