# FINAL TRANSCRIPT

**IPL Plastics Inc.**

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## PRESENTATION

**Operator**

Good morning. My name is Pamela, and I will be your conference Operator today. At this time, I would like to welcome everyone to the IPL Plastics Inc. Third Quarter 2018 Financial Results Conference Call. All lines have been placed on mute to prevent any background noise.

After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time, please press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, please press *, then the number 2. Thank you.

Mr. Walsh, you may begin your conference.

**Alan Walsh** — Chief Executive Officer, IPL Plastics Inc.

Thank you, Pamela, and good morning, everyone. Welcome to IPL Plastics third quarter 2018 financial results conference call. I'm Alan Walsh, IPL's Chief Executive Officer. I'm joined by Pat Dalton, our Chief Financial Officer.

I'll begin by providing an overview of our third quarter, Pat will then discuss the financial results in greater detail, and I'll conclude with some comments about our business outlook. After that, we will be pleased to answer your questions.

Before we begin, I need to remind listeners that certain statements about future events made on this conference call are forward looking in nature and are based on certain assumptions and analyses made by the Company. Please refer to the cautionary statement on forward-looking information on Slide 2 for more information.

Also, please note that we will discuss several non-IFRS financial measures this morning. And that all dollar figures are in US dollars, unless we state otherwise.

Turning to Slide 3. We are pleased to generated continued organic growth in the third quarter despite significant transient input cost pressures.

Customer demand for our products was strong, and we grew volumes in all three operating divisions. Pat will take you through the details shortly. I would like to briefly summarize the results and discuss the cost pressures we are facing.

Revenue increased 7.4 percent from a year ago to 169.2 million in Q3 2018, driven by volume growth and price increase, primarily in the CPS and RPS divisions.

Adjusted EBITDA declined to 20.5 million compared to 25.5 million last year, due to changes in product mix and cost pressures, primarily from resin and labour.

Gross profit and adjusted EBITDA also declined due to these pressures.

Finance costs were reduced by 2.2 million, as we repaid debt from IPO proceeds.

The income tax charge was 2.6 million lower, driven by a reduction in our pretax profit and our reassessment of our corporation tax accrual.

Net income was 2.7 million in Q3 2018 compared to 4.8 million last year, and adjusted net income was 10.5 million, an increase of 1.8 million from 8.7 million in Q3 2017.

Obviously, input cost pressures continue to be a challenge for us. Resin costs have continued to escalate, and while we implemented price increases in the second and third quarters, the positive impact was eroded by further increases in resin prices.

Labour availability has also been a challenge, particularly in North America, which has led to increased costs. And while freight costs stabilized in the third quarter, they had escalated significantly in the first half of the year.

We have recently commenced enhanced measures to improve the Company's business margins and core profitability levels during 2019. This broad-based strategic initiative, which is in its early stages of formulation, is designed to drive margin enhancements and sustainable profit growth across all divisions, but with a specific focus on our Large Format division in North America.

On the operations side, we are continuing with our capital expenditure program to upgrade our facilities, increase automation, and expand our manufacturing capacity and capabilities. We spent 44.2 million in the first nine months of the year out of an estimated budget of 52.5 million for 2018.

In terms of the balance sheet, we have reduced net debt to 219.7 million at the end of the third quarter compared to 276.3 million at the end of 2017.

I also want to note that we have published our new sustainability strategy on our website this morning. Enhancing sustainability is a key initiative for the Company, and this document lays out our commitment to creating products for the circular economy. This 2019 to 2022 strategy outlines our key ambitions and focus areas for the coming years. I would encourage you to read it.

Overall, management and the board are excited about IPL's competitive position. We are maintaining strong growth despite challenging cost pressures.

I would like to remind you that IPL has a long history and we have faced these pressures before, and we know how to deal with them. I am confident that the measures we are putting in place will drive significantly stronger profitability in future quarters.

I'll now turn you over to Pat to discuss our financial results and balance sheet in greater detail.

**Pat Dalton** — Chief Financial Officer, IPL Plastics Inc.

Okay. Thanks, Alan. Turning first of all to Slide 4 of our presentation.

Revenue in the third quarter of 2018 was 169.2 million, an increase of 7.4 percent from last year. This was primarily attributable to volume growth and price increases in all three of our divisions, particularly in our Consumer Packaging division and also in our Returnable Packaging division. These increases were partly offset by negative foreign exchange movements.

Gross profit in Q3 was 28 million, or 16.6 percent of revenue compared to 32.6 million last year.

Adjusted EBITDA reduced by 5 million year over year to 20.5 million, or 12.1 percent of revenue. The decline in gross profit, adjusted EBITDA, and their respective margins were primarily due to cost pressures from resin and freight and changes in the product mix.

Net income was 4.8 million compared to 7.5 million last year. And adjusted net income in Q3 2018 was 10.5 million, an increase of 1.8 million from the 8.7 million last year.

Diluted earnings per share were $0.09 in Q3 2018 compared to $0.22 in Q3 2017, while pro forma adjusted diluted earnings per share were $0.19 compared to $0.16 last year.

In the nine-month period ended September 30, 2018, we have revenue growth of 23.2 percent compared to the same period last year. This revenue growth was primarily attributable to the acquisition of Macro Plastics in June 2017, but also to the significant organic volume growth of 8.1 percent, and also the price increases that we put through the revenue line.

Moving to Slide 5, you can see that the revenue and adjusted EBITDA bridges for both the third quarter and year-to-date periods on a pro forma and on a like-for-like basis. As you can see, the bulk of the revenue came from volume rather than price in the third quarter, as we continued to drive organic growth in our business.

The price movement of 5.1 million covers both resin pass-through and other pricing adjustments.

With respect to EBITDA, input cost pressure eroded our volume and price growth in both the third quarter and in year to date.

Turning over to Slide 6. Slide 6 illustrates the year-over-year change in quarterly gross profit margin and adjusted EBITDA margin. You can see the impact of input cost pressures and product mix changes within the cost of sales component of the bridges on the left of the slide.

We estimate that the continued increases in resin prices reduced IPL's gross profit margin by 3 percent and the adjusted EBITDA margin by 2.9 percent in the third quarter.

During the second and third quarters, we implemented a number of measures in response to cost increases. And while these have had some positive impacts, these have largely been offset by continued resin price pressures, though as Alan mentioned earlier, freight costs have stabilized in Q3.

Moving to Slide 7, where we would now demonstrate some of the very significant increases of the resin prices over the last 18 months. As you can see on the graph, the index prices for polypropylene and polyethylene were up 31 percent and 12 percent, respectively, in North America in Q3 2018 compared to Q3 2017.

Resin prices in Europe were also higher in Q3 2018 compared to Q3 2017, though the increase was not as significant as in North America.

As our RPS business uses almost exclusively polypropylene resin, the results of this division in Q3 2018 were materially impacted by the significant consecutive increases of 9 percent in polypropylene prices in May and in June of 2018.

Looking ahead, the near-term outlook for resin pricing is for polyethylene to remain relatively stable, with perhaps some downward movement in polypropylene input prices.

Slide 8. Here I'd like to talk some more about the performance of each of our three divisions, and I'll begin with a brief overview of each division.

We had solid organic growth in the CPS division due to the rollout of our new dairy business in North America, volume growth in our existing business, and also through price increases. We also experienced very strong demand from our largest customer in Europe.

Revenue in the Large Format & Environmental division was in line with Q3 2017, as the extent of the organic volume growth in that division was reduced by the inclusion in Q3 of 2017 of two significant contracts: one in the Environmental division and one of the other in the material handling product areas of that division. We also generated very strong sales in Europe in that division, as we secured new tenders for environmental containers in Q3 2018.

In the RPS division, revenue increased due to strong organic growth, as bin sales in units increased by 25.4 percent year to date. This significant increase was driven primarily by the introduction of new specialty bins and technology for the automotive markets, further penetration of the apple market, partially offset by lower sales to the citrus market due to poor weather.

As shown on this slide, margins in every division were impacted by input cost pressures and changes in the product and customer mix. However, we were pleased to see very solid organic growth across all three divisions.

Moving on to Slide 9. The Consumer Packaging Solutions division had revenue of 46.2 million in the third quarter, an increase of 14.3 percent from the 40.4 million last year. This was driven primarily by the rollout of the new dairy business in North America and the additional demand from our largest customer in Europe.

Gross profit was 8 million compared to 8.4 million last year. And adjusted EBITDA in this division held steady at 7.8 million.

Margins declined due to product mix, resin prices increases, labour market challenges, and some incremental logistics and packaging costs in 2018.

Moving to Slide 10. In the Large Format & Environmental division, revenue was 84.8 million in Q3 2018, a slight increase of 84.1 million last year.

Gross profit of 12 million and adjusted EBITDA of 8.8 million were both lower compared to Q3 2017, as were the margins. This was primarily due to changes in product and customer mix and resin price increases. Labour and freight cost pressures across our North American business also impacted margins here.

Moving to Slide 11. Revenue in the RPS division increased 20 percent to 32.5 million in Q3 2018 compared to 27.1 million last year. As I noted earlier, demand for the new specialty bin technology was strong. However, gross profit of 6.4 million and adjusted EBITDA of 4.7 million were lower than Q3 last year.

Margins here were impacted by lower sales in the Californian citrus market due to poor weather. And in addition, higher resin prices and temporary outsourcing costs in the automotive business also impacted margins.

To put this in perspective, had polypropylene pricing remained flat year over year, our adjusted EBITDA margin in this division would have been 3.3 million higher.

Turning to Slide 12, where I now want to talk about the balance sheet. Working capital as at September 30, 2018, was 94.1 million compared to 64.4 million at the end of December 2017. This increase in working capital reflects our strong organic growth and also the seasonality of our business, whereby our investment in working capital typically peaks during the first half of year and unwinds over the remainder of year.

Total assets as at September 30 were 789.9 million and shareholders' sums was 348.5 million. Both numbers improved from December 2017, primarily to the settlement of the deferred contingent consideration balance, and also the completion of the IPO together with the proceeds raised therefrom.

Net debt declined to 219.7 million at the end of September from 276.3 million at the end of December 2017. During the third quarter, we repaid a net amount of approximately 70 million of our revolving credit facility, and we also repaid C$45 million of unsecured subordinated debentures. This had the effect of reducing our finance costs to 2.6 million, a reduction of 2.2 million compared to the 4.8 million recorded in Q3 2017.

Our net debt to equity ratio declined to 0.63 from 1.14 at the end of 2017, and our net debt to adjusted EBITDA ratio declined to 2.76 times from 3.45 times previously.

Our interest coverage ratio was 4.84 times compared to 5.97 at the end of 2017.

Turning to Slide 13. Here you can see a reconciliation of our adjusted free cash flow. I won't go through every number on this slide, but you can see that the net cash flows from operating activities were 16.6 million in Q3 2018, a decline of 6.7 million compared to last year. This was due primarily to amounts paid in respect of the IPO and the scheme of arrangement which was completed earlier this year.

Adjusted free cash flow in Q3 in 2018 was 18.4 million compared with 19.8 million in Q3 2017. It increased relative to the end of Q2 2018, due to the seasonality of our investments and working capital that I previously mentioned.

Turing to Slide 14. I just want to provide some context on the CapEx Program. We spent 44.2 million in the first nine months of the year out of an expected 28 in total of approximately 52.5 million. Of that total, 37.2 million was strategic and developing CapEx expenditures and 7 million was maintenance capital expenditure.

I'll now turn it back to Alan to discuss our business outlook and strategy.

**Alan Walsh**

Thanks, Pat. Turning to Slide 15. Looking ahead, we continue to see strong demand for our products across all three of our operating segments. That gives us confidence in continued organic revenue growth.

The results for year-to-date 2018 were adversely impacted by a number of factors, including changes in the product mix and increases in resin prices, logistics, and labour costs.

During Q3 2018, polyethylene prices increased by 3.5 percent, polypropylene pricing has remained flat, and freight costs have stabilized when compared to the prior quarter.

We responded to the increases in resin costs in 2018 by passing on those costs where contractual pass-through arrangements are in place with customers and by seeking to negotiate general price adjustments with other customers.

General price increases were implemented in quarter two and quarter three this year; however, the positive impact of these price increases has been eroded by further increases in the price of resin during these periods.

The near-term outlook for resin prices is for polyethylene to remain relatively stable, with perhaps some movement downwards in polypropylene input prices into year-end.

In line with our strategic plan, we have recently commenced enhanced initiatives under our business optimization program called Fitter for Continued Growth. Over the last number of years, the Company has experienced very significant levels of organic growth, completed a number of acquisitions, completed a complex corporate restructuring in preparation for the initial public offering, realigned its operation divisions, and significantly advanced a large-scale capital investment program which is nearing completion.

These measures are designed to improve our business margins and core profitability levels during 2019 and beyond.

This broad-based strategic initiative, which is in early stages of formulation, is designed to drive margin enhancement and sustainable profit growth across all divisions, but with a specific focus on our LF&E division in North America.

Our CapEx budget of 52.5 million for 2018 is unchanged from last quarter. Our current CapEx program, which began during fiscal 2016, is underpinned by commitments from select customers, and it is essential to the long-term prosperity of our business.

Finally, we are continuing to evaluate external growth opportunities in our industry. We can't predict the timing of any potential acquisition, but I can say that we are evaluating a number of complementary transactions that make strategic sense and would be accretive to shareholder value, subject to meeting our disciplined acquisition parameters.

So to conclude, I'll note we're optimistic that we can continue to generate solid organic growth as we adjust our business model to manage input cost pressures and boost margins. We have a strong platform and competitive position in our industry.

That concludes our remarks this morning. Pat and I would now be pleased to answer any questions you have.

So, Pamela, please open the line for questions.

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## Q&A

**Operator**

Thank you. Ladies and gentlemen, we will now begin our question-and-answer session. Should you have a question, please press *, followed by 1 on your touch-tone phone. You will hear a three-tone prompt acknowledging your request, and your questions will be polled in the order they are received. Should you wish to decline from the polling process, please press *, followed by 2.

If you're using a speakerphone, please lift your handset before pressing any key. One moment for your first question.

Your first question comes from Anojja Shah at BMO. Please go ahead.

**Anojja Shah** — BMO Capital Markets

Hi. Good morning.

**Alan Walsh**

Morning, Anojja.

**Anojja Shah**

I just wanted to know—morning—I just wanted to know if you could give any more detail on those potential acquisitions that you just mentioned? I mean, not specifics, but just maybe your target areas of interest or geographical regions, product areas, that sort of thing?

**Alan Walsh**

Obviously, there was some market speculation around things at the back end of last week, which we're not going to comment on for obvious reasons. We are exploring opportunities in both North America and Europe across all three divisions.

And I think what I would say on the acquisition side of things, we are certainly seeing a lot more of a pipeline emerging over the last three months of potential opportunities that fit strategically in terms of our focus areas, so two key geographies are North America and Europe.

**Anojja Shah**

Great. Thank you. And then are there any specifics you can give on the optimization plan that you announced today, either on timing or any savings targets? And then why the focus on large Format North America specifically? What exactly are you trying to address there?

**Alan Walsh**

Yeah. I suppose just one point I would like to point out to you and whoever's on the call, and it's a refresher. There's nothing necessarily new about what we announced this morning. If you cast your mind back to our IPO presentation, our prospectus, this is lined out pretty clearly in the prospectus whereby our growth strategy is built around four key pillars. One of those pillars is improving our EBITDA margins and optimizing our business operations.

So we're … and we would've always said to people as well during the IPO process that the optimization of this business will really come in the second half of 2019 and into 2020, as we complete our capital investment program. So we're … as we come to the end of that capital investment program, as I mentioned earlier, we are now focused on generating the operational efficiencies across the business.

The reason for the particular focus on LF&E, it's our biggest division. The margins have been, probably, most impacted in that division, and you can see that in our MD&A where the margins are called out specifically.

So we see, I suppose, the biggest bang for our buck in focusing on the LF&E division initially. But there are operational improvements across all three divisions that we're focused on.

**Anojja Shah**

All right. Thank you very much.

**Operator**

Your next question comes from Walter Spracklin, RBC. Please go ahead.

**Walter Spracklin** — RBC Capital Markets

Yeah. Thanks very much. Good morning, everyone. I guess my first question is going to be on your price increases that you're passing on to customer—or the cost increases you're passing on to customers through your price increase program. I know some of that is contractually driven and others it's more on a general price increase. Two questions there. One, what is the response that you're getting from your customer? And what are you seeing in terms of your competition? Are they following? And therefore, if not, are you at risk of losing any share? Or—and just a general acceptance of your price increases in your various markets—or segments?

**Pat Dalton**

Walter, thank you for that question. First and foremost, yes, we're certainly seeing our competitors beginning to put some price increases through to their customers at this point in time. There is a general acceptance, I would say, from all customers that the input prices of resin has increased.

With respect to the reaction from customers, I would say it's somewhat mixed. Customers have certain choices around whether to continue—for instance, if they've got a polypropylene container—whether they would continue having that container manufactured with polypropylene, or whether they would switch to polyethylene. And certainly, some customers are, I would say, beginning to evaluate the alternatives, given where polypropylene has priced to at this point in time.

So we're seeing all the way and certainly even also in terms of the pass-throughs certain customers obviously, in general, it's been fairly well accepted. Where we've gotten to, I think, with polypropylene is just the absolute scale of the significant increase in polypropylene. I think it's certainly now beginning to cause customers with existing pass-throughs to rethink the polypropylene input into their products and obviously to consider whether a switch to polyethylene makes sense for them at this point in time.

**Walter Spracklin**

And if that switch occurs, how flexible are—is that just an outright loss for you? Or do you have any flexibility to switch as well?

**Pat Dalton**

We have complete and utter flexibility to switch.

**Walter Spracklin**

Okay. Okay. If pricing does start to come down, is it an automatic reduction in price that you have in your contracts? Or is there any stickiness that you can hold onto some of the price increases you achieved, even if resin prices come down?

**Pat Dalton**

It's both, Walter. So if you look at our polypro and polyethylene, so in terms of our business, polypro makes up about 52 percent of our sales; polyethylene makes up about 47, 48 percent of our sales, so. And within each of those categories, there are various pass-through arrangements.

So for instance, in polypro, I think we have a pass-through of around 60—about 70 percent of that into polypro. Polyethylene is much more like 50–50 in terms of the pass-through arrangements. So clearly where there is no pass-through in place, that is much more within our capability to hold onto those price adjustments that we would have put through at this point in time.

**Walter Spracklin**

Right. So you could've gotten a price adjustment on the other 50 percent that's not covered. It's just that it's not a pass-through calculated cost and, therefore, able to retain it?

**Pat Dalton**

Correct.

**Walter Spracklin**

Yeah. Okay. A bit of your revenue streams can be a little lumpy, particularly on the municipality side with enviro bins and automotive. Can you talk about any discussions or advances you're getting with customers in either one of those divisions? And any prospect for some larger wins with either kind of your major automotive customer, but now coming into North America? Or are you seeing any other further penetration US or Canada into some of the municipalities on the enviro-bin side?

**Alan Walsh**

I'll take that, Walter. If we look at the automotive side of things first—and I think I've said this in previous calls—we have sufficient production capacity within that segment for probably the next 18 to 24 months under the initial phase of the contract that we won with our customer. So we're not anticipating seeing any lumpiness on the automotive side of our RPS segment over the next number of quarters.

In addition to that, we're also exploring the possibility of providing that product to other OEMs, et cetera, and looking at other opportunities for that product in the marketplace as well. So it's a two-pronged approach. Our challenge, again, comes back to production capacity and particularly European production capacity to maximize the rollout of that product. So that's consistent, I think, with what we've been saying all along on that.

On the municipal side of things, if I split that into two parts, in our European segment we've had a very strong year on the municipal side this year. We've probably manufactured more bins in the European market this year than we've ever made. Unfortunately, our margins have been impacted with where resin prices have gone.

In the North American market, I would say it's been a pretty steady performance, but we are getting traction in the North American market in particular products for more of what I would call specialized products around split carts, for example, and other innovative recycling containers. And we anticipate that giving us some significant traction during 2019 and beyond.

**Walter Spracklin**

Okay. And just on the automotive, you mentioned 18 months. What is the typical lead time that you'll see a customer come in that as you approach your—that 18-month—the end of that 18-month period how early would you expect or would you like to have a contract in place for when that contract ends?

**Alan Walsh**

Yeah. I think what's different where we are now, Walter, versus where we were is obviously the products on the automotive side of things took probably over three years to develop. And there was a lot of testing that went on, et cetera with the customer, with the pooling company to make sure it matched a number of their specified requirements.

So we've been through all that. The product is in the market. It's performing very well. It's very well accepted. So we won't have as long a lead time in terms of obviously we now have an actual finalized product that we can go and show all of the other players in the market as well. It literally comes back to that issue around production capacity again.

I don’t want to keep harping on about that, but there’s two key marketplaces for this: the North American market and the European market. We’ve put the investment into our facility in Shelbyville, which has come onstream during quarter three and is performing probably ahead of expectations in terms of cycle times and unit production. And our challenge here comes back to production capacity in continental Europe in particular, and that is something that goes hand-in-hand with our acquisition strategy.

**Walter Spracklin**

Okay. That’s all my questions. Thanks very much for the time.

**Alan Walsh**

Thank you.

**Operator**

Your next question comes from Scott Fromson, CIBC. Please go ahead.

**Scott Fromson** — CIBC

Gentlemen, just a couple of questions on in-mould labelling. How is it performing in terms of new customers, new products, new sales regions, et cetera?

**Alan Walsh**

So if I take IML in the context of our dairy segment in the Canadian market, that is now fully rolled out. We've probably moved onto the business optimization phase of that, Scott. It's performing well. You can see the volume growth in our presentation and MD&A, et cetera.

We are now seeing, I would say, more traction around IML in other segments of the market in the US, particularly around premium-end ice cream, which again is something that we would have spoken about before as a target area, given our experience of the European market and the lack of IML prevalence in the North American market and the US market in particular in certain product categories.

So we are starting to see some traction, and we have a number of development projects underway with some potentially significant customers in that space.

**Scott Fromson**

That's great. And are you seeing customer resistance to any pricing increases? Or are you able to retain premium pricing for what is a premium product?

**Alan Walsh**

We are. In our CPS segment, we effectively have 100 percent pass-throughs in that segment. So it is—and you're typically dealing with the bigger multiples, so it's a very formulaic approach. When prices go up, you pass them on, and obviously if prices come down there's a corresponding adjustment. So we're not seeing any pushback on that side.

And in terms of the premium pricing around IML, we continue to see the trend in the marketplace of IML displacing offset printed technology and thermoforming in certain situations as well.

**Scott Fromson**

Okay. That's great. Thanks. And can you comment on cost-cutting initiatives at the corporate level? SG&A costs were lower than we would've expected, which is obviously good.

**Alan Walsh**

Yeah. I can say at the corporate level our SG&A costs have not gone down. They've increased in the quarter. You won't probably really see the effect of this until going forward.

We've hired a number of additional people into the organization over the last quarter to focus around operations, corporate development, acquisitions, et cetera. So to boost the team in terms of the key focus areas we have around business optimization on one hand and acquisition and growth on the other hand.

**Scott Fromson**

Okay. I guess I'm talking on a percentage of sales basis, so that's good.

**Alan Walsh**

Yeah. I think you're probably seeing an operating leverage effect in sales as well—

**Scott Fromson**

Yeah.

**Alan Walsh**

—in terms of the growth, the organic growth in the business.

**Scott Fromson**

Final question. Are you turning then away any orders? And could you repurpose any Large Format packaging capacity for higher-margin product?

**Alan Walsh**

I mean, I suppose as a generic point you can always repurpose certain machines, et cetera, obviously depending on the product type. Are we turning away any customers? I think that's obviously part and parcel of our day jobs in terms of trying to manage capacity, et cetera.

But we could—if I come back to some of the comments I made earlier—we could certainly have additional organic volume growth in certain of our divisions if we had the production capacity to do it.

But in terms of the LF&E division in particular, we have no intention of repurposing any machines in there. There is a very healthy pipeline of business opportunities and organic growth potential in that division. It is a question of getting the operating efficiencies up to a level that we would be happy with.

**Scott Fromson**

Okay. Wonderful. Thank you very much.

**Alan Walsh**

Thanks, Scott.

**Operator**

Your next question comes from Elizabeth Johnston, Laurentian Bank Securities. Please go ahead.

**Elizabeth Johnston** — Laurentian Bank Securities

Hi. Good morning.

**Alan Walsh**

Hi, Elizabeth.

**Elizabeth Johnston**

I just wanted to go back to your comments about the business optimization within LF&E briefly. Are you able to give any more specific details of what that could include, thinking along the lines of evaluating the existing business, potentially considering the customer mix, any large changes like that? Is that something that could be included in this?

**Alan Walsh**

Yeah. I think it'll be including some of those factors that you mentioned. I suppose it's our biggest division, as I mentioned earlier. It's also been the biggest recipient of the CapEx program. We've made a number of significant investments into the production sites within that segment. Now I think it's a question about getting those investments fully bedded in, running efficiently, and getting that operational leverage effect that I referred to earlier.

I think if you look at the margins in our LF&E segment for the quarter—and it's in our MD&A—but our margins are up 10.4 percent. I think we would've always said the margins in that segment should be operating at somewhere between 14 to 15 percent, and that is something that we're very focused on achieving over the next 12 to 18 months.

**Elizabeth Johnston**

Okay. So it sounds like it is a lot—there could be some integration work as well in order to—

**Alan Walsh**

Correct.

**Elizabeth Johnston**

—do better—okay. Okay. That's good.

**Alan Walsh**

Correct.

**Elizabeth Johnston**

No. That's good. Thanks. So just turning it back over to RPS a bit, and you mentioned the … in the quarter specifically temporary outsourcing costs for the new automotive specialty bin technology contract. Given the investments in Shelbyville, now that you said that's up running, should we therefore expect at least that portion of those temporary costs that was laying on margin to dissipate through Q4 and 2019?

**Alan Walsh**

Absolutely. Yeah. And if I can just shed a little bit of colour on that, perhaps this is one of these classic situations where this project was in development; we knew the potential was significance. And you're sort of waiting and waiting and waiting to get the PO. And then the PO arrives and the customer wants a significant number of units yesterday, so to be able to manage that we had to outsource and subcontract and the manufacture of a number of the smaller components for that product.

That will not be a recurring feature in 2019.

**Elizabeth Johnston**

Okay. So when it comes to the backlog you mentioned, that in part was related to the timing of the beginning of that contract being quicker than you would … you had capacity for. But as it levels off you do have the sufficient capacity in place to meet that demand?

**Alan Walsh**

No. The backlog, the backlog, Elizabeth, we would have referred to previously was around our agriculture business, not on the automotive side.

**Elizabeth Johnston**

Okay. Okay. And then since you mentioned agriculture and given your comments about the lower business from California citrus, you still have a backlog in place even with the lower sales out of that segment?

**Alan Walsh**

Yeah. We do. We have a very healthy backlog there. I think just to give maybe a little bit of additional colour on the two factors there which have been the biggest factors in terms of the profitability impact in that division. First of all, in the citrus market that's a mix issue. Citrus bins are our highest-margin bins. It was purely weather-related during 2018, where the sales of our citrus bins were significantly lower than we would've anticipated.

And then secondly on the agriculture side, linking into resin, how—just if I can take a minute to explain how the business cycle works in this segment—we're typically taking orders currently, so from October, November, December, for the subsequent year. So if you look at where PP pricing was 12 months ago versus where PP pricing is today, it's been a pretty substantial increase. And we've had to absorb a lot of that increase as we've washed our way through—If I put it that way—the historical backlog and order book in that segment.

So Pat called out earlier that has an EBITDA impact of 3.3 million in the quarter. You can probably do the sums in terms of what the full year impact is on that. We've called out the EBITDA margin impact of that in the MD&A. So if … and it's all ifs, buts, and maybes, but if resin pricing had been stable, the performance in the RPS segment would've been significantly higher year to date.

Obviously, that's not the case, and we've tweaked our pricing strategies, et cetera, in terms of moving into 2019. And as I said earlier, we're also anticipating some reductions in PP pricing into the end of the year, which should all be pretty positive developments as we move into 2019.

**Elizabeth Johnston**

Okay. So and just if I could go back again briefly, sorry, on the citrus regarding the mix, so you had lower sales out of that higher-margin business. But that business, were the orders not placed well in advance of this quarter? I'm just trying to understand the timing of that.

**Pat Dalton**

Just to deal with that, yeah, the citrus market is a little different to the apple market. The apple market, the orders are placed well in advance. The citrus market is more like how do weather conditions emerge May, June—April, May, June, and then the orders are placed essentially at that point in time. So effectively, the real—the impact of the product mix really has just hit us in the third quarter in the citrus market.

And if you look at our net-net increase in terms of we called out the number of—we had a 25.4 percent increase in the overall number of bin sales in the RPS segment, in the actual agri-bin segment, so talking apples, citrus, other bins, the net increase or net volume increase year over year was 8 percent.

So notwithstanding the fact that the citrus market impacted our margins, our net volume increase in the agri-bin market was 8 percent.

**Elizabeth Johnston**

Okay. Great. Thank you for the extra colour; I appreciate it. And just maybe one final question for me. And it might be hard to do this, but excluding CPS, so maybe just referring to RPS and LF&E, are you able to broadly describe how far behind you are with respect to passing along the resin price increases? I don't know if you can broadly speak to that? I don't know if you're a quarter behind or half a year. Any sort of guidance there would be helpful.

**Pat Dalton**

Just as we said with CPS and as Alan said earlier, CPS is pretty much a straightforward pass-through. There is obviously some, I would say, mathematical issues. When you put in a pass-through into your cost of sales and the same number into your sales, you automatically get some dilution of your margin. So but at the CPS level, I think we're pretty happy with the pass-through.

On the RPS segment, just to give you the two things, there's two components—three components to the RPS segment.

Firstly with respect to the automotive, the automotive is pretty much 100 percent pass-through with a lag. And the lag really is from the timing of the placing of the PO, and can average somewhere between 30 to 45 days. So on the ag side—or in the automotive side of the RPS business.

On the agriculture bin side of RPS, as Alan explained earlier, it really is dependent on when the orders are placed. But once the orders are placed at the start of each year, or early in each year, by the time we get to year-end, that obviously has completely blown out. So effectively what we're doing right now is, as Alan said, we are resetting the pricing for 2019. And we're resetting that pricing on the basis of the current resin pricing. So effectively I would say some blowout left in the RPS segment in the fourth quarter.

And then with the LF&E division, if you take the LF&E division and you kind of take the two components of that. That division uses about 30 percent of polypro, and it's about 30 percent polyethylene. So in terms of the mix to date of the polypro, around 85 percent of that is a straight pass-through with lags. The polyethylene of that division, about 40 percent of that has pass-through and about 60 percent no pass-through in the polyethylene division.

So we would expect that there is some further pass-through to come through on the LF&E division.

**Elizabeth Johnston**

That's great—

**Pat Dalton**

I would say not material for the breakout.

**Elizabeth Johnston**

Okay. Understood. Thank you very much. That's it for me.

**Alan Walsh**

Thank you.

**Pat Dalton**

Thank you.

**Operator**

Your next question comes from Zachary Evershed, National Bank Financial. Please go ahead.

**Zachary Evershed** — National Bank Financial

Morning, gentlemen.

**Alan Walsh**

Morning.

**Zachary Evershed**

So you're resetting the RPS agri-bin pricing based on current resin pricing, which means that it'll be quite a bit more expensive than last year. Are you seeing a reduction in the number of orders that are coming in?

**Alan Walsh**

Nothing material, but yes, that is obviously a consideration because we're typically, as you know, Zach, competing with wooden equivalents here. So there is—

**Zachary Evershed**

Mm-hmm.

**Alan Walsh**

—that competitive dynamic, plus we have obviously increased our prices and tweaked our sales strategy to reflect current resin pricing. And while we may see some small impact from that, it's nothing that's concerning us.

**Zachary Evershed**

Okay. Wonderful. And then assuming that resin costs do stay level-flat at their current level, how quickly—this is essentially asking Elizabeth's question a different way—how quickly would each segment recoup its margin? I'm thinking that CPS has the standard 60-day lag in the pass-through. But then for LF&E for negotiations, how long would that go on average?

**Pat Dalton**

I think, Zachary, you can take it that pretty much in Q1 '19, everything will have gone through.

**Zachary Evershed**

Thank you very much—

**Pat Dalton**

Given our pricing strategy with the RPS division in particular.

**Zachary Evershed**

Okay. That's perfect. Thank you.

**Operator**

Your next question comes from Sean Blaney, Goodbody. Go ahead, please.

**Sean Blaney** — Goodbody

Hi, Alan and Pat. I think most of my answers—most of my questions have already been answered so far. So just have one very short question. Just on the freight costs, you've said that they've stabilized in Q3. Is that as a result of your refining freight procurement processes? Or is that just a reduction in the—or a stabilization in the market?

**Pat Dalton**

Sean, yeah, I think it's both. I think first of all in terms of the actions we've taken, we did appoint a new freight and logistics manager in Q2 of … early Q2 of 2018. And certainly I think we relooked at the way we were acquiring freight and that we were templating (phon) for freight and the logistics and arrangements in terms that were in place.

And the second thing, I guess, we're starting beginning to see more availability of logistics providers in the marketplace. Now whether that's an availability of the fact that we've got better skill set on the ground, or whether it's the fact that the market generally has geared up, I'm not sure what the answer is.

But certainly I would say overall what we're seeing is if you look at our Q3 costs versus our Q2 costs—or actually Q3 costs relative to the percentage of sales have come down.

**Sean Blaney**

Okay. Thanks very much.

**Operator**

Your next question comes from Ben Jekic, GMP. Please go ahead.

**Ben Jekic** — GMP Securities

Yeah. Good morning. Just one question for me and be as descriptive, kind of, as you can. If you provide a little detail, I'll understand. But with regards to potential for acquisitions in the future, and when you think about whether it's North America versus Europe, what is—and again, I stress big picture—what is driving whether one option will prevail or not, assuming that the prices are attractive? Is it are you sort of driven by global customers that are saying you're selling to us in North America; we want to see it in Europe? Or do you want to in case of Europe maybe win a new set of customers? Or get some innovation going? Or if you can maybe elaborate on that a little?

**Alan Walsh**

Yeah. Okay. I'll give you a little bit more colour, Ben, to the extent I can. So it's probably fair to say the primary focus of our acquisitions at the moment is in Europe. And just going back to what I said earlier around the requirement to have production capacity in continental Europe to maximize the rollout of a number of the products that we have developed ourselves. And that is particularly relevant for the RPS segment in particular. But those types of businesses would also obviously give us the opportunity to expand our product range within the LF&E division into continental Europe as well. So that is a key focus for us is how I'll put it.

Also, on the CPS side of things, if you look at our position in the market in North America and some of the customers that we have and some of the dynamics at play within those customers where they're going through supplier consolidation exercises, et cetera. And the fact that we are precleared to provide products to those customers because we have been providing them with good products for a number of years and we're on their approved vendor lists, et cetera, a lot of those customers are actually European-headquartered, there's a lot more opportunities that we could be exploiting with those customers if we had continental European production capacity.

**Ben Jekic**

Oh, fantastic. Thank you so much.

**Alan Walsh**

Okay.

**Operator**

Mr. Walsh, there are no further questions at this time. Please proceed.

**Alan Walsh**

Okay. So that concludes our call for this morning, and thank you all for your interest in IPL Plastics. And we look forward to speaking to you again next March.

Thank you.

**Operator**

Ladies and gentlemen, this concludes your conference for today. We thank you for participating, and ask that you please disconnect your lines.

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