The Long Game

Letter to Shareholders

2018 was a great year for our company. Our sales were up by over $800 million or 38% reaching a record $3 billion and our EBITDA was up by more than $61 million or 32% reaching a record $251 million. It's hard to believe that it was just ten years ago that our annual sales and EBITDA were $450 million and $41 million, respectively, and that our five-year sales objective was less than $1.0 billion. Or that four years ago our sales and EBITDA were $1.2 billion and $76 million, respectively, and that our five-year sales objective was $2.0 billion. We have made incredible progress towards our goal of becoming North America's leading specialty foods company having consistently exceeded our long-term growth and profitability objectives.

During 2018 we also completed several strategic acquisitions that will make it one of the most transformational years in our history. Our Meat Snack, Seafood, Deli Meats, Cooked Protein and Sandwich platforms all made major strategic moves that have not only positioned them to succeed at the North American level, but will also play a key role in us achieving our objective of once again doubling the size of our business over the next five years.

While this past year has been a great one for our company it was not so great for our shareholders. For many years the growth in our share price has mirrored the growth in the intrinsic value of our company. 2018 was, however, the first time we saw a major deviation from this. This was all the more surprising given that we believe our company is in the best position it has ever been to accelerate growth in shareholder value. Looking back, we see many similarities between where we are today and where we were at the beginning of 2015, which was a key inflection point for an extended period of value creation, both in terms of our company's intrinsic value and our share price. In 2015, much like today, we had recently completed a variety of strategic initiatives and were just starting to realize the associated expected returns.

There are many possible reasons for the recent divergence between our share price and the intrinsic value of our company. These include everything from general market sentiment to concerns about the challenges being faced by large consumer packaged goods companies. I remain confident, however, that with time the situation will right itself, especially given that the potential of our company has grown exponentially over the last couple of years while our shares have been trading at levels not seen since 2016 when our free cash flow per share was only $4.22 versus $5.08 per share today. We have never been more excited and confident about our future and our ability to deliver shareholder value.

While I am clearly not pleased with the performance of our share price over the past year, I do take some solace in the fact that even at our current share price we have been able to generate over the last 15 years a compounded average annual return for our long term shareholders of more than 22%. This performance clearly trumps the short term volatility of our share price and is a much better indicator of the wisdom behind our unique business model. This is made even more evident when comparing our performance to that of many of the large mainstream food companies, or in our lingo, "Big Food." Over the last number of years most Big Food companies have at best seen their businesses remain flat and in many cases have experienced a steady deterioration. A major reason for our differing paths is the increasing awareness of consumers about what goes into the food they are eating, and corresponding with this a growing distrust of many of the products sold by Big Food. We recognized this trend many years ago and in response have been investing in and cultivating businesses that focus on producing high quality, authentic specialty foods. Big Food, on the other hand, has carried on with business as usual.

Given the deteriorating profiles of their businesses, the obvious question is why doesn't Big Food adapt? The answer quite simply is something I refer to as short-termism. By short-termism I mean managing for the short term, often the next quarter, at the expense of the long term. Too often the culture and infrastructure in Big Food forces managers to take short cuts in order to bolster quarterly results. This includes cheapening product formulations, not investing in infrastructure, not putting people first, not prioritizing social values and responsibilities, not investing in innovation, and ultimately sacrificing product quality in order to fatten short term profits.

Short-termism is completely inconsistent with producing the high quality, authentic specialty food products that an increasing number of consumers are switching to. In order to cater to this rapidly growing market a business must make decisions for the long term and can't be lulled into short-termism. This is a key reason why we have focused so hard on developing a decentralized corporate culture that is based on entrepreneurship, social responsibility, innovation, and operational excellence. All these characteristics are key to promoting the long-term mentality that is necessary to be a successful specialty foods company.

A great example of Big Food and the outcome of short-termism comes from a comment passed on to me by an individual who had previously led the cheese division of a large multi-national food company. When I asked him why he had left the company, his response was that he got tired of having to find new ways of taking the cheese out of the company's "cheese" products. Why does a successful company with a trusted, iconic brand "take the cheese out of the cheese"? What compels it to do so and why does it take such a risk given the dire consequences of alienating its long term and loyal consumers? The answer is very simple: short-termism.

Another example of Big Food and the outcome of short-termism was evident during a recent family holiday in Maui. I was asked by my daughter to buy everything for a hotdog dinner for her and her friends and was shocked when I could not find any wieners, buns or ketchup whose second or third ingredient was not high fructose corn syrup. With North Americans already consuming ten times more sugar per day than they should, why does Big Food consider it acceptable to use a short cut ingredient that is a major contributor to obesity and diabetes and is, in general, negatively impacting the health of their customers? Short-termism.

These examples of short-termism provide you with a glimpse of why we have been able to successfully compete with companies that are much larger and have significantly more resources. We will never compromise our values or the long-term success of our company in order to achieve short term results.

While our strategy of focusing on the long term – with many of our initiatives having returns that are measured in years, not quarters – has enabled us to create significant shareholder value over the last 15 years, ironically it is also one of the likely causes of the recent weakness in our share price. During the third quarter of 2018 we made some tough decisions to delay or not rush a number of major sales initiatives in order to ensure their long-term success. These decisions were based on a range of factors including making sure the right production solutions were in place given certain unexpected labor and trade challenges. What happened next surprised and disappointed us. While reporting record third quarter results, and maintaining our bullish view on the long term outlook for our company, our share price fell by almost 30%. We instantly went from market darling to market laggard despite our company never before being as well positioned to create shareholder value. Our 15 years of consistent execution of our business plan, the potential of several recently completed transformational acquisitions, our plethora of upcoming new product launches, our wide array of new sales opportunities in the U.S., and our robust pipeline of business acquisition opportunities were all completely ignored.

At times like these I often take guidance from the writings and comments of Mr. Warren Buffett, one of the greatest investors of all time. In particular, I appreciate one of his comments on the power of long-term investing, which I feel equally applies to running a business: “Successful investing takes time, discipline and patience. No matter how great the talent or effort, some things just take time: you can’t produce a baby in one month by getting nine women pregnant.”

While we have no regrets about the long-term decisions that were made in the third quarter, we are using this experience to reevaluate our position on providing guidance to the market. In general, I am not a big fan of quarterly or even annual guidance as I believe it can focus shareholders on the wrong metrics in evaluating a company, however, I also understand that a certain level of guidance brings some consistency in speaking to analysts and the street in general. It is a fine balance that we are still evaluating. Ultimately, however, my greatest affinity is for shareholders who are willing to take the time to understand our business model and the strategies we are executing to create long term shareholder value instead of just relying on published numbers.

The PB ecosystem

There is a video on YouTube that describes what happened to Yellowstone National Park when a pack of wolves was re-introduced to its ecosystem about 20 years ago. The initial reason for the re-introduction was that the wolves were needed to cull a too densely populated deer herd. The cull went according to plan, however, to the surprise of everyone the wolves also indirectly made significant contributions to the health of the park’s ecosystem in ways that no one expected. These included an improvement in the health of pasture land, increases in the numbers and diversity of other forms of wildlife including that of small animals and birds, and a general improvement in the firmness of riverbanks that lead to healthier river systems.

Every time we bring a new company into the PB ecosystem we improve our business in intended ways but, we also often benefit in unexpected ways, similar to what happened with the wolves in Yellowstone. We call this the 2+2=8 or PB algorithm. 2018 was our busiest year yet in terms of acquisitions and we are very excited by how the new best-in-class people and businesses we have added to our ecosystem will play out under the PB algorithm.

We are especially pleased that we were able to launch our Meat Snack and Seafood platforms into the U.S. through the investments in Oberto and Ready Seafood, respectively. Both of these businesses are led by incredibly talented management teams that have the potential to grow their companies into globally leading businesses. I have always said that we do not make acquisitions but rather we invest in people.

Seattle, WA based Oberto is an iconic 100-year-old brand that is synonymous with quality, innovation, community engagement, family values and old-world heritage and traditions. Brands and businesses like Oberto are not offered for sale very often so we were delighted to have had the opportunity to make this acquisition. Tom Hernquist, Oberto’s CEO, and his management team have been quick to leverage the PB ecosystem to fast track their product innovation pipeline and are in the process of launching a number of new exciting products in the U.S. as we speak.

The story of Ready Seafood is a demonstration of what passion, persistence, innovation and entrepreneurship can achieve. Brothers John and Brendan Ready started the business when they were teenagers, laying lobster traps in the morning and harvesting them when they got home from school. After college they parlayed their knowledge of the lobster industry into one of the largest lobster businesses in the U.S. by constantly disrupting the status quo. We were fortunate to come across John and Brendan just as they were looking for a partner to help them take their business to the next level. Our decision to team up with them was an easy one and has already resulted in a number of positive impacts on what is now our North American Seafood platform.

Another key addition to the PB ecosystem in 2018 was Concord Premium Meats. No company in our portfolio better captures the essence and values of entrepreneurship than Concord. Its founders, Irv Teper and Joe Mannara, built one of the most impressive food companies in Canada through constant innovation, putting customers first and always doing what they said they were going to do. We are excited that they chose us to be their partner in helping them expand their highly successful business model and product lines across Canada and into the U.S.

Over the past three years we have invested a great deal of capital and effort into building our fully cooked, minimally processed protein platform and in 2018 we were happy to bring TMF into our portfolio. Its market leading brand, *Lou's Barbeque*, is well known in Canada for its best-in-class, sous-vide cooked ribs, roasts and corn meal bacon, all of which exemplify the passion and commitment to tradition of its founder Lou Albanese. While Lou retired with the sale of his business, we are excited to be working with the talented management team, led by CEO Dan Davies, that Lou put into place over the last several years.

In 2018 we also made our biggest move yet into the organic protein space with our investment in Yorkshire Valley Farms, which has the leading organic poultry brand in Canada. Yorkshire is led by James Sculthorpe, a passionate and talented young executive who, along with his equally talented management team, is going to accelerate our initiatives in this exciting area of the food space. We are big believers in the future of organic products. Not only are they right in line with the trend I mentioned earlier of increasing awareness by consumers about what goes into the food they are eating, but they also support the drive towards a greener, more transparent food supply chain. Yorkshire is not only very well positioned to benefit from these trends but is helping other businesses in the PB ecosystem to accelerate their organic product initiatives – the PB algorithm.

There were several other exciting acquisitions we completed in 2018, however, the final one I want to highlight is Country Prime Meats as our history with CPM perfectly exemplifies the ethos and spirit of Premium Brands. CPM was founded by Reinhard Springmann in 1996 and today is operated by his two sons Markus and Peter. The company actually indirectly joined our ecosystem when we acquired Freybe in 2013. The Freybe and Springmann families shared many common values, including an unwavering commitment to quality, so it was not surprising that CPM was an important co-packing partner to Freybe. Similarly, it was not surprising that shortly after we announced our purchase of Freybe that Reinhard requested a meeting with me to discuss the future of our relationship. He was concerned that we would bring the products they were producing for Freybe in-house resulting in the loss of almost 95% of CPM's volume. At that time, we could have easily transferred production of these products into one of our plants, which would have resulted in immediate cost savings, i.e. a short term earnings bump, however, based on our long term vision for the meat snacks category, and our interest in further developing our relationship with the Springmann family, I assured him that not only was our business with them secure, but we would work with them to continue growing their production volumes. Furthermore, I told him that instead of thinking about reducing their capacity they should be considering possible future plant expansions.

Fast forward five years and CPM is not only an even more important supplier to Freybe, but is also co-packing meat snacks for other PB businesses and is an integral part of our Canadian meat snack strategic supply chain. So when it came time for the Springmann family to do some estate planning it was an easy decision by all parties on what the next steps should be and you may think that is the end of the story, but it isn't. The PB algorithm component of having CPM, Markus and Peter formally become part of Premium Brands is the incredible innovation that they had built into their plant and that they are now helping to develop in some of our other facilities. The CPM plant is located in Lac La Hache, about a six-hour drive north of Vancouver. When driving there for the first time you might begin to wonder whether you got the directions wrong or made a wrong turn since you appear to be in the middle of nowhere, surrounded by trees, lakes and wildlife. Then you see the CPM sign. As you drive up the long driveway to the plant you wonder about the sanity of the Springmann family investing in a facility in a location this remote until you enter the plant. It is truly spectacular and one of the best facilities of its kind in North America. It is clean and modern and features some of the best technology available including leading edge robotics and automation. It is an engineering marvel and a celebration of the entrepreneurial spirit and what can be accomplished by fostering a culture of innovation and excellence.

We were very honored to formally welcome the Springmann family into the PB family last year. I should also mention that when we had our closing dinner, Reinhard did not show any of the nervousness that was the case at our first meeting back in 2013 but instead was beaming with pride on what lies ahead for CPM and his sons as part of the PB ecosystem. All of this would not have been possible if we had succumbed to short-termism back in 2013.

Corporate governance is a hot topic these days and many institutional investors have come forward with positions on board diversity and board term limits. While we are fully supportive of improving board diversity, and appreciate the value created by bringing different perspectives to the board room table, the concept of arbitrarily limiting board member terms is ill advised and naive. That an experienced, knowledgeable, and contributing director who understands the company and its unique strategies, and who is part of a high functioning, successful board, should be forced to step down due only to the passage of a fixed amount of time is nonsensical. I am very disappointed that this is the direction the discussion has gone and feel that if this is followed through on it will destroy, not create, shareholder value. I also suspect that this will be an additional reason for why more good companies will choose to go private, thereby further reducing the pool of available public investment choices in Canada.

I appreciate that the logic of limiting the term of board members is to help prevent directors from losing their independence, however, in trying to achieve this we should be taking a more holistic approach and not looking for a simple magic bullet. A range of factors need to be contemplated, including how much skin-in-the-game a director has and the company's past performance in creating shareholder value and providing for good governance. In today's complex and highly competitive world, the deep knowledge needed to provide valuable and unique insights, views and opinions only comes from meritocracy and experience, not from arbitrarily set term limits.

As someone who is keenly interested in nutrition and health, I would like to share a brief comment on the new Canadian Food Guide, particularly since some of its advice appears to be in conflict with strategies being pursued by our protein focused businesses. I view the new food guide as a step in the right direction with its focus on reducing the consumption of sugar and highly processed foods, but am disappointed that it fails to reflect the increasing body of evidence on the potential health benefits of a diet that is low in refined carbohydrates and high in protein and saturated fats. Such a diet has been shown to be effective in dealing with the obesity, inflammation, diabetes and heart disease epidemics that are plaguing western societies. On a personal level, I can attest to the effectiveness of such a diet. Instead the Food Guide has chosen to continue to wrongly demonize saturated fat, promoting the use of highly processed vegetable oils and, to a certain extent, challenge the legitimacy of consuming animal based proteins, including eggs and dairy products. This is very unfortunate as it is not consistent with current scientific evidence and has the potential to put us back on the catastrophic path we took 70 years ago when, on the basis of opinion rather than scientific evidence, we were told that for breakfast we should replace eggs, a perfect source of nutrition, with highly processed sugary cereals.

Despite my issues with the new Food Guide, I have little concern about its potential impact on our business since I believe that science is on our side. Furthermore, an increasing number of consumers are making their health and dietary decisions based on their own research and not on the Food Guide. Ultimately, at Premium Brands we will continue to produce foods that are part of a healthy diet and that I am very proud to serve to my family and friends.

I would like to personally thank our 9,250 associates for their dedication and hard work over the past year. Premium Brands is made up of individuals with all sorts of backgrounds including different races, genders, religions, ethnicities and sexual orientations. We fully embrace this diversity and believe that the combination of many different perspectives within our shared culture of respect, inclusiveness, openness, and commitment to family and community, is a major source of our strength. We cherish the value created from the debate of different views, perspectives and opinions. In fact, it is from these exchanges that some of our greatest ideas and innovations have evolved. We will, as a team, continue to succeed because we all understand that Premium Brands' biggest asset is its people.

George Paleologou
President and CEO