1.5 Operational Resources

Our organic growth plans can be achieved without significant operational expansion.

Our existing operational resources include:

Plant Capacity

As explained in Section 3.3 of this MD&A, the Company will cease operations at its leased production facility in Malden, MA in the second quarter of 2015 to reduce excess capacity across its manufacturing facilities in the U.S. Following cessation of operations at the Malden facility, the Company’s manufacturing footprint in North America will consist of four owned and operated plants, three in the U.S. and one in Canada, and combined these facilities have ample production capacity to meet forecasted demands. In addition, we have plans that can be implemented with minimal additional capital expenditures to increase the capacity of our plants through shift changes should further production capacity be required and we also expect additional capacity to be created at each of our production facilities as a result of the Supply Chain Optimization Project, described in Section 1.2 of this MD&A. Our ability to source new products is not limited to our own production. We purchase significant quantities of frozen fillets as finished goods, and some of our value-added products are purchased as finished goods.

Distribution Centers

Our Lunenburg, Portsmouth, Newport News and New Bedford facilities include large distribution centers. In March 2014, we purchased a previously-leased distribution center in Peabody, MA. We also utilize third-party cold storage/distribution centers to supplement our facilities when needed. We have Directors of Logistics in Canada and the U.S. to ensure that the warehousing and transportation of our products is handled in a cost-effective and customer service-oriented manner.

Technology

Technology supports our growth strategy and our centralized computer systems enable us to make timely decisions. Our business is simplified through an enterprise-wide business management system and specifications management system. We have also developed a proprietary internet-enabled procurement system that allows us to manage procurement in real time. Business intelligence software allows us to manage our information on a real-time basis to help us make business decisions quickly, manage inventory and accounts receivable and provide more informative financial disclosure. We have ensured that we are equipped to respond to customer demands for electronic transmission of business documents, including invoices, purchase orders, and payment confirmations. In 2014, we completed the installation of a document management system to simplify and expedite supplier payments. We continue to budget significant capital dollars to ensure we continue to have state-of-the-art systems to manage our Company and respond to customer requests. In 2015, we are implementing improved supply chain planning processes and software that will help to optimally allocate raw material and production capacity to better satisfy customer demand.

2. PERFORMANCE MEASURES

Our performance against key metrics will tell us whether we are achieving our strategic objectives. We made considerable progress in 2014 by focusing on these metrics.

2.1 Our Brands

Market Share

The market shares of our retail brands are significant, particularly in Canada. Foodservice market shares are hard to measure, as there is no independent source that tracks foodservice sales in a manner comparable to the retail channel. However, based on our information and knowledge of the market, we are clearly the market leader in Canada and including private-label, are the largest value-added frozen seafood supplier in the U.S.

We track retail market share information by purchasing syndicated data. We measure share on a rolling four-week, twelve- or thirteen-week, and fifty-two week basis, and have good insight as to whether consumers are responding to our new product ideas and promotions. In Canada, we are the leader in the retail channel with a market share more than four times the size of our nearest competitor. In the U.S., our Fisher Boy brand has a strong presence in certain regions and Sea Cuisine has a growing importance in the “prepared seafood” category.

Retail Availability

An important measure for retail availability is ACV. This is a measure of the volume of the traditional grocery stores as a percentage of total stores in a market (Canada or the U.S.) in which our products are sold. An increase in ACV generally means that our products are in more stores, and therefore, available to more consumers in more markets, which should translate into increased sales.

- In Canada, our ACV approaches 100% as our branded products can be found in virtually all stores where frozen seafood is sold.
- In the U.S., our brands, which include Fisher Boy, High Liner and Sea Cuisine, have a smaller share of the “total frozen seafood” category than in Canada. ACV for all our branded products (excluding the C. Wirthy & Co. brand acquired as part of the Atlantic Trading Acquisition) was 84% at the end of 2014 compared to 82% at the end of 2013. This increase is due to a concerted effort on our part to increase distribution for our products, especially Sea Cuisine. In some regions in the U.S., this is substantially higher.
• In Mexico, although we do not track ACV, we are confident in our position as a leading breaded and battered seafood supplier in major centers.

In Canada, we use Nielsen® to track market share and ACV of our retail brands in grocery, mass merchandising, general merchandising, club stores, and distributors. In the U.S., we use Information Resources Inc. (“IRI”) to track market share and ACV of our retail brands, where it tracks all grocery stores, super-centers (including Walmart) and club stores (excluding Costco). Since we are well represented at Costco, we believe our actual ACV is higher than that as presented by IRI.

Percentage of Overall Sales From Our Brands
Our brands are one of our core strengths. Consequently, most of our sales are from our branded products. We measure the percentage of sales from our brands over a rolling twelve-month period, with a target of 80%. Excluding Atlantic Trading, the percentage of sales from branded products decreased in 2014 to 76% compared to 79% in 2013, reflecting a full year of American Pride’s operations. A higher percentage of American Pride’s sales come from non-branded products than the average for the rest of the Company due to its significant number of U.S. national chain restaurant customers.

2.2 Our Organization

Productivity
At the end of 2014, the Company’s manufacturing footprint consisted of five manufacturing plants, including four that are owned by the Company and one that is leased. Subsequent to the reporting period, the Company announced it will cease production at the leased facility in Malden, MA, in the second quarter of 2015 to reduce excess capacity across its U.S. manufacturing facilities (see Section 3.3 of this MD&A). The lease of this facility expires in December 2015 and this plant is currently the Company’s most underutilized facility with annual production of approximately 11.5 million pounds that is being transitioned to the Company’s New Bedford and Portsmouth facilities.

In late 2012 and early 2013, as part of achieving synergies related to the Icelandic USA Acquisition, the Company permanently closed two of its processing facilities located in Burin, Newfoundland (Canada) and Danvers, MA. However, subsequent to these closures, in the fourth quarter of 2013, the Company acquired manufacturing facilities as part of the American Pride Acquisition that were not operating at and continue to not operate at optimal capacity. The Company’s strategy to grow through acquisitions necessitates a continuous assessment of its manufacturing capabilities against its current and future production requirements to ensure its operations are being carried out in an efficient and cost-effective manner. Following the cessation of production at the leased Malden facility, we will continue to have adequate capacity for growth and will continue to invest in our manufacturing infrastructure.

Further examples of the continuous assessment following acquisitions were the decisions in the first quarter of 2013 to sell a primary processing operation that was acquired in December 2011 as part of the Icelandic USA Acquisition, and a joint venture, both of which were located in China. We continue to purchase products from these operations, however, our strategy in overseas procurement is to maximize our flexibility, which we believe will be better achieved by not owning or directly managing overseas production.

To assess productivity across the Company’s manufacturing facilities, we measure plant throughput, pounds produced per working hour and pounds of production on a rolling twelve-month basis. We are continually looking for opportunities to invest in projects at our manufacturing facilities that have a quick financial payback on capital invested with the goal of improving efficiency and reducing operating costs. As explained above, one of our current strategic goals is focused on supply chain optimization and as progress is made on this goal, we expect improvements in productivity measures across our manufacturing facilities.

Customer Service
Our strong customer relationships are a competitive strength. To preserve them, we must consistently strive to exceed customer expectations. To that end, we measure case-fill rates and strive to achieve at least 98.5% purchase order fulfillment, which is at the top of the industry. For 2014, excluding Atlantic Trading, our purchase order fulfillment, measured by number of cases of products shipped compared to what was ordered, was 97.6% (2013: 96.2%). This measure improved in 2014 reflecting that supply issues on certain species in 2013 did not continue to the same extent and resolution of distribution issues in the first quarter of 2013 related to the consolidation of our U.S. foodservice distribution. Also, higher average inventories throughout 2014 helped to improve this measure. Looking for opportunities to streamline operations at all of our facilities is a component of our current supply chain optimization goal and with the exception of any issues with supply, we would expect to hit our target in 2015.

People
We believe our greatest asset is our team of talented and passionate people and that investing in our people will help build a high-performance organization. We are focused on developing future leaders from within and on increasing individual capacity for leadership. We have learning and development plans for all employees that will continue to be a priority in 2015 and beyond, reflecting our ongoing commitment to employee development.

High Liner Foods was selected as one of Nova Scotia’s and Atlantic Canada’s Top Employers for 2011, 2012, 2013 and 2015. These awards are annual regional competitions organized by the editors of the national “Canada’s Top 100 Employers” competition to recognize employers that lead their industries in offering exceptional places to work. In 2012, High Liner Foods was also selected as one of Canada’s Top 100 Employers.
2.3 Grow Through Innovation

Overall Sales Increases
Global procurement means that we can access any species that meets consumer tastes. In addition, we are experts in product development. The overall sales increases provide us with an indication on how successful our ideas are and we aim to achieve at least a 5.0% increase in sales year over year. The Company’s total sales in domestic dollars increased in 2014 over the prior year by 13.3% and total sales volume increased by 9.3%. Excluding the impact of the American Pride and Atlantic Trading acquisitions, sales in domestic dollars increased in 2014 over the prior year by 1.8% and sales volume decreased by 2.5%. The 1.8% increase in sales in domestic dollars primarily reflects increased selling prices in 2014 to recover cost increases experienced on several species in 2014 and the 2.5% decrease in volume primarily reflects lower sales from our U.S. foodservice operations, particularly in the casual dining segment.

Innovation efforts in 2014 focused increasingly on the changing dynamics of the U.S. foodservice industry, where more consumer dollars are migrating from full-service casual dining to fast-casual restaurants that feature fast, high-quality food with a compelling value proposition. We expect to introduce products to the marketplace throughout 2015 that will work in fast-casual environments, which if successful, should help to improve the year-over-year sales increase in 2015 and bring it closer to our target.

Overall, in the U.S., per capita consumption of seafood is not growing and to counteract that we are targeting differentiated products and creative promotions to grow consumption and take market share from competitors.

Sales From New Products
Maintaining our benchmark sales from new products tells us that we are renewing our product line in a sustainable way. We measure annual sales and profits from new products to provide us with information as to our success in reaching consumers with new and consistently reliable food choices.

3. PERFORMANCE HIGHLIGHTS

3.1 Overall Performance
Financial and operational highlights for the 2014 Fiscal year include (all comparisons are relative to fiscal year 2013, unless otherwise noted):

- Adjusted EBITDA decreased by $2.0 million, or 2.3%, to $83.3 million compared to $85.3 million;
- Adjusted EBITDA in domestic currency increased by $0.3 million, or 0.3%, to $86.6 million compared to $86.3 million;
- Reported net income decreased by $1.1 million, or 3.4%, to $30.3 million (diluted EPS of $0.97) compared to $31.4 million (diluted EPS of $1.01);
- Adjusted Net Income decreased by $2.5 million, or 6.1%, to $38.8 million (Adjusted Diluted EPS of $1.24) compared to $41.3 million (Adjusted Diluted EPS of $1.32);
- Atlantic Trading was acquired on October 7, 2014 and in combination with American Pride Seafoods (acquired October 1, 2013), added $150.8 million to sales compared to American Pride sales of $39.7 million in 2013; and
- Net interest-bearing debt to Adjusted EBITDA, calculated on a rolling twelve-month basis, increased to 4.4x at the end of Fiscal 2014, compared to 3.9x at the end of Fiscal 2013.

The Company reported sales in excess of a billion dollars for the first time in its history. However, notwithstanding the achievement of this milestone, the Company’s Adjusted EBITDA and Adjusted Net Income decreased in 2014 compared to 2013. Below is a summary of the events, trends and circumstances that impacted performance in 2014.

2014 is the first fiscal year to reflect a full year of operations from American Pride, which was acquired in October 2013. The Company acquired Atlantic Trading in October 2014 and in combination with American Pride, these acquisitions increased sales in 2014 by $111.1 million compared to 2013, and increased sales volume by 33.0 million pounds compared to 2013. However, sales volume from the remaining business decreased by 6.7 million pounds, principally reflecting declines in our foodservice business during the year.

In addition, the cost of certain key species increased significantly in 2014 and resulted in lower product margins being achieved on certain products in 2014, particularly in our Canadian retail business, where due to a highly competitive marketplace and the magnitude of the increase in costs, the Company was not able to fully pass on the increased costs to its customers through price increases. Lower product margins on certain products and continued challenges in our U.S. foodservice business, along with a weaker Canadian dollar in 2014 resulted in a year-over-year decrease of $2.0 million in Adjusted EBITDA.

Capital expenditures were higher in 2014 than in 2013 due to several non-routine capital expenditures which included: the purchase of a previously-leased cold storage distribution facility in Peabody, MA, for $8.6 million; a payment of $5.7 million to terminate obligations in connection with an operating lease acquired as part of the American Pride Acquisition; and $3.0 million in leasehold improvements associated with the Company’s new office facility in Portsmouth, NH.