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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Village Farms International's First Quarter 2018 Financial Results Conference Call. Yesterday, Village Farms issued a news release reporting its financial results for the first quarter ended March 31, 2018. That news release, along with the company's financial statements, are available on SEDAR and on the company's website at villagefarms.com, under the Investors heading.

Please note that today's call is being broadcast live over the Internet and will be archived for replay both by the telephone and via the Internet beginning approximately 1 hour following completion of the call. Details of how to access the replays are available in yesterday's news release.

Before we begin, let me remind you that forward-looking statements may be made today, during or after the formal part of this conference call. Certain material assumptions were applied in providing these statements, many of which are beyond our control. These statements are subject to a number of risks and uncertainties that could cause actual results to differ materially from those expressed or implied in forward-looking statements. A summary of these underlying assumptions, risks and uncertainties is contained in our various securities filings, including Village Farms' current annual information form the year ended December 31, 2017, and MD&A for the quarter ended March 31, 2018, as well as the press release issued by Village Farms and Emerald Health Therapeutics announcing their joint venture in June 2017, all of which are available on SEDAR. These forward-looking statements are made as of today's date. And except as required by applicable securities laws, we undertake no obligation to publicly update or revise any such statements.

I would now like to turn the call over to Michael DeGiglio, Chief Executive Officer of Village Farms International. Please go ahead.

Michael A. DeGiglio - *Village Farms International, Inc. - CEO, President & Director*

Thank you, Denise, and thank you to everyone for joining us by telephone and Internet today. With me for today's call is Village Farms' Chief Financial Officer, Stephen Ruffini.

In terms of the agenda for today's call, I'll be somewhat brief, but I'll begin with an update on the significant progress at Pure Sunfarms, our joint venture for large-scale, high-quality, low-cost cannabis production in Canada. Steve will then do a brief review of first quarter financial results, and I'll return for some concluding comments before Steve and I take your questions.

Beginning with Pure Sunfarms. It's only been a little more than 1 month since our last quarterly call, but there is, nonetheless, a great deal of additional progress across the business to report on. Just this past Friday, Pure Sunfarms received an amendment to the cultivation license for the Delta 3 greenhouse for an additional 110,000 square feet, which now permits it to begin commercial-scale growing on a total of 133,000 square feet. And we're anticipating approval for the balance of the 250,000 square feet of the first quadrant of the 1.1 million square feet within the next month. We are planning out this first section this week and are targeting the entire first quadrant of 250,000 square feet to be fully planted out by the end of July, pending one final amendment to the cultivation license.

And another milestone on schedule, and we're very excited to start our production ramp-up at Delta 3. This milestone is very important for the company, and we expect to begin planning out the second 250,000-square-foot quadrant in August. Since that, we anticipate having 0.5 million square feet in commercial production in September and remain on track to have the entire 1.1 million square feet in production by year-end.

As I've discussed previously, the senior growing, financial, human resources and operational personnel, including the established team transferred from Village farms, as well as additional management hires we recently made are all in place at the Delta 3 greenhouse, and the search for the Pure Sunfarms CEO is underway.

On our last call, we announced our intention to accelerate the production ramp-up of Delta 3, pending the availability of requisite generating equipment to run through the coming winter to power supplemental lighting during the shorter days of the year. As a reminder, we have secured 24 megawatts of power from the local utility for supplemental lighting, and we have approximately 6 megawatts now, with the balance available mid next year. As a reminder, we have also secured an additional 24 megawatts should the option on Delta 2 won't be exercised.

I am now pleased to report that we have finalized the rental contract for all the generation -- generators required. This will enable Pure Sunfarms to increase production through the 2018/'19 winter months such that we are now projecting production of approximately 7,000 to 8,000 kilograms in 2018 and 46,000 to 52,000 kilograms in 2019. That is a total of approximately 53,000 to 60,000 kilograms through the end of 2019 on this existing single facility. I will note that the 2018 projection assumes recreational market legalization on or before September 1 of this year. The generators will be in place in August of this year.

Conversion of the remaining 1.1 million square feet of the Delta 3 greenhouse is progressing steadily and remains on track to be fully operational by the year -- by the end of this year. And we continue to expect to achieve our conservative full production target of 75,000 kilograms annually in 2020.

With production ramp-up firmly on track and the legalization of recreational use of cannabis in Canada around the corner, a top priority for Pure Sunfarms is now the sales and distribution of our near-term output. 2 weeks ago, we finalized the first supply agreement with our Pure Sunfarms partner, under which it will purchase 40% of the Pure Sunfarms production cumulatively in 2018 through the end of 2019. That's expected to be 21,000 to 24,000 kilograms using current production targets. I will note that this agreement is for a pre-determined price per gram, which we are not disclosing for competitive reasons.

The first supply agreement provides a strong initial revenue stream while allowing Pure Sunfarms the flexibility to pursue opportunities with provincial governments as well as addresses significant near-term demand that we are seeing from other licensed producers. We are in ongoing discussions with all the above as we speak.

Immediately upon Health Canada's issuance of the cultivation license for the Delta 3 facility, Pure Sunfarms initiated the sales license process. Last quarter, I reported that the 2 test cycles required by Health Canada for our sales license were underway, which I will note were being conducted concurrently.

Last week, Pure Sunfarms successfully completed its first harvest from these cycles, and we couldn't be more pleased with the results. A portion of the first harvest is being submitted for testing on the Health Canada sales licensing process.

Before I turn the call over to Steve, let me touch briefly on the incumbent produce business. The first quarter sales were USD 29.5 million, down 6% over -- year-to-year on lower yields in Texas and lower yields from our Mexican partners and, actually, slightly lower yields in our Delta BC operations as we have not fully replaced the capacity loss as a result of Delta 3 facility being transferred to Pure Sunfarms' cannabis production. This capacity will be fully replaced by the fall of this year. With lower volumes, all of our production was committed to contracted price to retail customers, and we weren't able to take advantage of a very solid spot market pricing in the first quarter. Our contract prices are very good prices with our retailers on an average annual basis. However, where we retain higher pricing in the summer months, those prices are lower than usually what the spot market is.

Our EBITDA of USD 1.8 million was down 34%. This was partially driven by a 25% increase in pound-for-pound freight costs due to the new U.S. regulations that required freight companies to install electronic logging devices. If you look at the news in January, February and March, every industry in the United States was affected severely by that. We are now working it down to single digits and getting more efficient every day to where we believe we can return almost to where our freight costs were, although we're projecting higher freight costs going forward. Again, this is a regulatory requirement that has impacted multiple industries.

So going forward, this is being -- it was also partially -- as far as EBITDA goes, it was also partially by the considerable work that Village Farms personnel across the organization continue to do to advance Pure Sunfarms business. I can tell you that I spent nearly 90% of my time on that business in the last quarter, Steve has and many of our folks here. And now as we ramp up management, that will be changing going forward.

I would like to turn the call over to Steve to walk through our financial results in detail. Steve?

Stephen C. Ruffini - *Village Farms International, Inc. - CFO, Executive VP, Company Secretary & Director*

Thanks, Mike. Welcome, everybody, to the call. As Mike said and our press release said, our sales were down 6% year-on-year. As Mike also mentioned, that was due to lower volumes. We also reported a lower net price year-on-year of 4%. Again, this is directly due to what Mike's already mentioned, the higher freight costs. So we report and analyze our sales always on a net basis. Actually, our gross selling price year-on-year was up \$0.03 a pound, but that was more than negated by the incremental freight costs to get it to our customers. And as Mike mentioned, it was a nationwide impact.

Those in Canada, you may not be aware, the Department of Transportation in the U.S. implemented electronic logs into all trucks, so they now monitor truck drivers who are not allowed to drive more than 10 hours. If they drive more than 10 hours, there's a fine. So needless to say, when that went into effect on January 1, it wreaked a bit of havoc in the U.S. trucking system. As Mike mentioned, it's since calmed down. We are forecasting, for the year, a \$0.02 to \$0.03 per pound increase in freight costs. And again, that -- whether it's shipping TVs or whether you're shipping from the Walmart distribution center to the Walmart store, everyone's incurring that incremental cost, unfortunately.

Our cost of goods were down 5%. Again, this was due to lower volumes year-on-year as well as our own facilities. Our SG&A was up 5% or \$174,000 due to various costs. The most part are due to our new cannabis initiatives such as full-scale IR, which we haven't had in the past, miscellaneous consultation and legal costs involved with that new business on the part of Village Farms.

Our interest expense was down in Q1 even as interest rates rise due to our ongoing principal payments as well as the \$4 million principal payment we made in December to Farm Credit of Canada to unencumber the Delta 2 greenhouse in the instance Pure Sunfarms exercise its call option to convert that greenhouse. Our long-term debt at 3/31/18 was \$38.5 million. As a comparison a year ago, on March 31, 2017, that number was \$44.7 million. So we continue to pay down our debt, and that continues to be a focus of management.

As Mike mentioned, our EBITDA was USD 1.1 million, CAD 2.3 million, so down a little over \$900,000. \$309,000 was due to freight. The JV loss, which, obviously, we didn't have in 2017, was \$237,000. Higher SG&A of \$174,000, and a very slight decrease in our product gross margin due to our lower yields in our Texas assets.

Our bio asset on March 31 was in line with our prior year. For those that understand, that's a leading indicator that tells the reader that as of April 30, which is essentially our measurement date for our bio asset, we have not had a negative impact on the loss of the Delta 3 assets. So our margins on our Canadian assets, Delta 1 and Delta 2, are in line, even without the Delta 3 asset this year versus last year. So that's a function of growing the right produce for the right customers at the right price.

And with that, I'll turn it over to Mike.

Michael A. DeGiglio - *Village Farms International, Inc. - CEO, President & Director*

Thanks, Steve. And I'll just comment off the cuff. I mean, we are moving forward. We can see the bogey of cash flow in Pure Sunfarms investment out on the horizon getting closer and closer. So taking a lot of the resources from Village Farms to ramp that partnership and that whole venture is going well. As you know, we haven't hired anyone in Village Farms. We're managing our GS&A across the board, so having some quarters on a rough -- again, half of the loss was tied to freight and the investment of time in Pure Sunfarms, but that will be changing going forward. We are profitable, and we have no burn rate, and we're pulling this off with internal resources, so I think it's a credit to the organization.

We previously described the Canadian cannabis opportunity as a transformational move for Village Farms, an opportunity to leverage our established, large-scale, low-cost operations and deep experience as a vertically integrated agricultural producer to a significantly more profitable product. That transformational opportunity is quickly becoming a reality.

In just 11 months, we have taken Pure Sunfarms from a joint venture agreement and a plant to a commercial-scale cannabis producer. Pure Sunfarms is on track to be one of the largest cannabis growing operations in Canada and a vertically integrated supplier. We have successfully executed on every milestone, and we are now poised to begin to realize the financial return from this investment.

We're also excited about the coming months. With the significant anticipated demand for cannabis product in the coming months as the Canadian market approaches legalized recreational use, the ability to both ramp up scale and operate efficiently will be critical. We know that it won't be without challenges. It's large-scale agriculture. The main asset is the biological entity. It's always challenging. But as I said last quarter, there's no group in the country with more experience and expertise, including master growers and well-established labor force and ramping up and operating a large-scale growing operation than Village Farms team that's now in place with the Pure Sunfarms greenhouse. I am very confident that the advantages of our 2 decades of operating history at the Delta facility will be proven out in the months and years to come.

We remain confident and are committed to our goal of a cost of production of \$1 or less per gram. As I've noted in the past, every agriculture product eventually commoditizes, and increasingly, it appears that, in the Canadian cannabis market, that may happen sooner than later. It goes without saying that to build a successful brand and reputation, you must have superior quality and a completely safe product, or you're not even in business. But from day 1, we have also built Pure Sunfarms to be a low-cost, all-in cost producer, from the use of existing greenhouse facilities to a conversion optimized for efficiency to an established operations team that has lived and breathed low-cost agricultural production on that site for nearly 2 decades. In fact, based on our extensive experience in agriculture markets, our initial decision to enter the Canadian cannabis market was predicated on being able to achieve superior profitability in a well commoditized environment. I think Warren Buffett would approve.

Pure Sunfarms' mission is to set the standard for repeatedly delivering expected quantities and consistent quality with full regulatory compliance to our customers. We also recognize the value in Pure Sunfarms being a vertically integrated cannabis business and again, building on decades of experience Village Farms has as an integrated supplier to the largest grocery chains in North America in cannabis product development. And soon Pure Sunfarms will add an extremely [sought] executive team with the addition of industry and leadership expertise to drive Pure Sunfarms' product development, branding and distribution strategies to fully capitalize on this opportunity. As a reminder, Pure Sunfarms has options on 2 additional greenhouse facilities, the 1.1 million square foot Delta 2 and the 2.6 million square foot Delta 1 facilities immediately adjacent to Delta 3.

The receipt of the cultivation license for Delta 3 in March enables Pure Sunfarms, at any time, to exercise the option on either of those properties. The addition of Delta 2 would double Pure Sunfarms' annual output production to a concert of 150,000 kilos -- kilograms annually in 2020, and the addition of Delta 1 would double that again to 300,000 kilograms annually. The combined facility would be, by far, the largest single-site cannabis production operation in existence and benefit from the unique economies of scale that such a massive operation would yield.

The board of Pure Sunfarms continue to regularly evaluate the decision to exercise these options. Additionally, we are becoming much more confident each month on the future of cannabis in the U.S.A. and other countries, but especially the U.S.A., where we have nearly 6 million square feet of assets. After spending more and more time exploring these future options, we see great potential for our company going in that direction. And again, I'll remind everyone that we will not activate any plans in the U.S.A. till it's federally legal. That said, we are investigating significant time each month and increasing. And as a reminder, Village Farms has no partnership agreements with anyone in pursuing anything in the U.S. or any other opportunities outside of Canada.



So thank you for that. And with that, Steve and I are available for any questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Andrew Semple with Echelon Wealth Partners.

Andrew Semple

First question was just more on the sales channels. You're speaking to both -- looking at both provincial and other licensed producers. Where do you see more opportunity? And which channel would you prefer to sell to? And then finally, would there be any sort of preliminary guidance as to a split between the 2 that you could provide at this point?

Stephen C. Ruffini - Village Farms International, Inc. - CFO, Executive VP, Company Secretary & Director

So the strategy for Pure Sunfarms at this stage, without an executive in place, essentially is to flip-flop what Village Farms does today. So Village Farms today sells roughly 75% to 80% of all its produce direct. In this case, that means a retailer. Frankly, we don't sell to provincial produce stores. But at any rate, at the onset, obviously, it's going to -- the roll out schedule is going to be a challenge for the provincial boards that have to implement the federal law. So we are in discussions with LPs because we'd like to essentially flip that. So we'd like to sell 75% of the product, let's call it, to LPs, some on a contract, some at a spot. We believe the spot pricing will be higher than the contract price. And roughly 25% at the onset. So call it, late '18, early '19 to provincial government. And then over the course of the 18 months, as we get to full ramp-up stage, get to the other way by the -- sometime in early 2020, 75% to provincial governments, 25% to other LPs. Even today, after 30 years, Village Farms does sell product and buy product from other growers in the U.S. The biggest challenge in the ag space is matching demand and supply. Cannabis will be a little bit easier since you can store the product. But ultimately, you can get imbalances. You have people ordering when you have product, or maybe people are ordering when you don't have product, in which case it's helpful to have strategic partners with other, in this instance, LPs that you can help one another to keep the provincial buyers happy.

Andrew Semple

Great. That's great color there. Just another question. Just for clarification. Is the Delta 2 facility fully unencumbered as of now? And what about Delta 1?

Michael A. DeGiglio - Village Farms International, Inc. - CEO, President & Director

Delta 2 is fully unencumbered. Just to remind you that we paid off the debt on Delta 2 last December, so it's fully unencumbered. And there is a remaining -- Delta 1 still is in the collateral pool with Farm Credit of Canada at this point.

Andrew Semple

Okay. And what sort of conditions would you look for in the market before you would consider exercising the option at the joint venture level? I'm sure there would need to be an executive in place as well, but you can comment on the market conditions that would make exercise of the option accretive.



Michael A. DeGiglio - *Village Farms International, Inc. - CEO, President & Director*

Well, I think the executive in place was always -- we always looked at that from day 1, but we -- the way we operate, I guess we take a more prudent approach, so we wanted to make sure that the joint venture, which is almost a year old next month, was continuing strong, that we were hitting on our milestones, that we will receive our cultivation license. And now the construction, the systems have all been evaluated. All those decisions were the right decisions. So the confidence level of the company has raised tremendously that we can execute going forward. And an option to increase capacity is not based on the executive coming in because if we trigger an option now, that conversion would probably start at the end of a current cycle of one of the current (inaudible) we have, so maybe year-end. And the focus of our executive team is really going to be downstream initially. There's enough talent on site there for the operational side and the conversion side. So that said, I think the market side, it's just too premature to understand where it's going to go. Our decision on the conversion would not be based that great on understanding where the market's going to go because the issue is the execution of all the other LPs, will they, in fact, be able to execute on their currently being built, converted or funded capacity and how long will that take. And we have confidence we can have very quick speed to market on additional conversions. So I think there's just too many unknowns on the market, so we would -- that would not be a huge part of the evaluation at this point going forward, at least for the next conversion. Maybe the third one, it would be.

Operator

(Operator Instructions) Your next question comes from Vahan Ajamian with Beacon Securities.

Vahan Ajamian - *Beacon Securities Limited, Research Division - Research Analyst of Special Situations*

A couple of questions. First off, I know you haven't disclosed the price that Emerald obtained the joint venture. But is it safe to assume that it's at the price -- at the wholesale price that's prevailing in the market right now?

Michael A. DeGiglio - *Village Farms International, Inc. - CEO, President & Director*

Yes. I think that's safe to assume because we announced that transaction. So we negotiated that on behalf of Pure Sunfarms as Village Farms will keep it arm's-length. So we felt comfortable at this point with that. And based on the percentage that we allocated, even though they're our partner, we've treated it in a very professional manner. So that's safe to assume.

Vahan Ajamian - *Beacon Securities Limited, Research Division - Research Analyst of Special Situations*

And is it a constant price over the, I guess, 1.5 years or slides up or down?

Michael A. DeGiglio - *Village Farms International, Inc. - CEO, President & Director*

Yes, it's a constant price. It's a constant price. But if you look at it from this point for the 7,000 to 8,000 kilograms that, really, are going to come into production at the end of this year -- so it's through the end of '19. So basically, on any significant capacity, it's really for 2019, and it's a fixed price.

Vahan Ajamian - *Beacon Securities Limited, Research Division - Research Analyst of Special Situations*

Right, okay. And you gave some good color on the potential other offtake agreements for the next 2 years, I guess the 60% that's still to allocate. Any sense of quantifying how many seriously interested parties you have or how many end customers you'd like to have at the end of the day for the next couple of years from a customer diversification point of view?

Michael A. DeGiglio - Village Farms International, Inc. - CEO, President & Director

Well, Vahan, I can tell you there's no shortage of phone calls or meetings with other LPs. No shortage of that. So I think one of the things that's important is we know, in 30 years of operating on the produce side, that where we've made very strong relationships years ago with other competitors, other growers, that those relationships have been accretive in many different ways over the years. So I think what we're looking for are companies that, one, we can trust; and two, will be here in the future, especially when you look at the future, the M&A environment. Those agreements, we may not want agreements which stand an M&A, an acquisition, for example. Where their location is, is very important for us. If they have an advantage in a certain area, where being a local producer gives them a certain advantage over someone else, that we think can yield them a slight premium in the marketplace, thus, giving us a better pricing, that will come into play. So it's not just looking for the first guy out there who wants to buy capacity. They have to be willing to take or pay. We're not going to -- even if a province is going to not necessarily secure or do a consignment type of promotion, we're not interested in that if we make an arrangement because there's plenty of other opportunity. So I think we're evaluating that right now, but there's no shortage of LPs out there that would like to work with us. As Steve articulated, clearly, BC (inaudible) being in BC, in one of the predominant growers in BC, we're very interested in working in that region specifically. So I think that's our first foray with the government is on the West Coast and then working with some LPs across the board.

Vahan Ajamian - Beacon Securities Limited, Research Division - Research Analyst of Special Situations

And in terms of number of customers, I guess, (inaudible) is already taking 40%. Is it safe to say you want to select, say, less than a handful of overall customers that you can kind of grow with as an accretive partnership in the future? Is that the right way to visualize it?

Michael A. DeGiglio - Village Farms International, Inc. - CEO, President & Director

Yes, I would say a handful is good. But at this point, it's not all based on the price only, but that is a big part of it, that and the relationship. But to manage it effectively and be able to -- we don't want to make commitments we can't deliver, and we don't want them to make commitments they can't deliver on. So managing a handful would be prudent. And we probably wouldn't look at any type of arrangements going beyond the end of '19 because I think there's going to be -- once we see what the governments do, those contracts that they issued to LPs who -- they may only be 6 months in them or a year at most.

Vahan Ajamian - Beacon Securities Limited, Research Division - Research Analyst of Special Situations

Okay. And going back to the Emerald, I guess, offtake agreement. That's only for dry flowers, is that correct? Or is there extracts kind of contemplated in the offtake agreement?

Michael A. DeGiglio - Village Farms International, Inc. - CEO, President & Director

It's only for dry flower. And Pure Sunfarms will be doing its own extraction very soon. So as its first -- I mean, we look at extraction to oil as really more of a post-harvest process that you have to do and have to have before you actually get to downstream products. So the agreement is only for pure flower, but what they do with it in their product line is up to them. But we will be extracting at Pure Sunfarms in '19.

Vahan Ajamian - Beacon Securities Limited, Research Division - Research Analyst of Special Situations

Okay. And I know there was some discussion about your extraction strategy, how to best do it, what type of equipment to get. Has that been ironed out yet or still kind of looking into it?

Michael A. DeGiglio - *Village Farms International, Inc. - CEO, President & Director*

Well, we're working on a lot of different strategies. I don't probably want to articulate that because I think the extraction process is a proprietary strategy and should be for many different companies. It's still a nascent industry in the conversion, and we're talking to multiple companies. And actually, I think we have some exciting things down the road that we can be looking at. So I'll limit it to that (inaudible).

Vahan Ajamian - *Beacon Securities Limited, Research Division - Research Analyst of Special Situations*

Okay. And finally, on branding. I think when we spoke last month on the call, you mentioned that the rule (inaudible) out yet in BC, and you're kind of waiting for that to decide if developing your own brand would be a worthwhile investment or not. And I think we've seen some of the preliminary rule out of British Columbia. Is that -- any update on that you can share?

Michael A. DeGiglio - *Village Farms International, Inc. - CEO, President & Director*

Well, we're always going to be -- as we said, Pure Sunfarms will be a vertically integrated producer, and it will compete with anyone in the market. So branding is going to be a big part of what we do, even if it's just a name to start with. But I think it's going to take years to develop a brand. I mean, it's taken our experience -- it takes years and years, especially when you're dealing with a product that's coming from a biological asset as opposed to a processed product. And we hear people talking about, "We're going to build iconic brands out of the box." And you don't build iconic brands in a year or 2. I just don't see that. I mean, it's almost comical to me how companies talk. But I can tell you, at the end of the day, if you listen to Warren Buffett on his very recent shareholder speech, he talked about the companies he looks for have very strong brands but are the low-cost producers. And that's always been our strategy from day 1, is fundamentally make sure that our cost of production is low, so we can be the survivor or a survivor in the marketplace and then build the brand on it. And we've spent the last 11 months in this ramp-up focused on systems in order to make us a low-cost producer with high quality and now bringing in the team that will do product development and, ultimately, branding because I think putting a brand on just a strain of cannabis where everyone says they have the best strains is going to be very difficult to differentiate yourself in the marketplace. I think it's going to come through product development and differentiation of products for the adult use market. And that doesn't happen overnight. But it's clearly the strategy that we will pursue. But again, short term, we're not here blowing millions of dollars out of the gate. As Steve articulated, our strategy is to start working with LPs, keeping our cost down as we develop product and develop branding strategies, generate positive cash flow and reinvest that cash flow in further expansions. So that is the sort of short-term horizon that we're looking at.

Operator

There are no further questions queued up at this time. I'll turn the call back over to the presenters. Sorry, no. There's no more questions. Sorry.

Michael A. DeGiglio - *Village Farms International, Inc. - CEO, President & Director*

Okay. Well, thank you, everyone, for listening. Appreciate it, and we look forward to our next call shortly in a couple of months. Have a good day.

Operator

This concludes today's conference call. You may now disconnect.



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