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Lodgement of Market Briefing**

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Market Briefing

Tassal MD & CEO on 1H18 results and 2H18 growth outlook

Interview with Mark Ryan (Managing Director & CEO)

In this Market Briefing interview, Mark Ryan, Tassal's Managing Director & CEO, gives an update on the company's 1H18 result and 2H18 growth outlook, including:

- *Record half-year results achieved across all metrics*
- *Successful execution of the Company's sustainable long-term growth strategy*
- *Step change in biomass and volumes harvested*
- *Summer water temperatures as expected – summer water temperatures always challenging*
- *Proactively addressing climate change*
- *Positive outlook for 2H18 and a record FY18 result expected.*

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1H18 was a record half-year result, highlighting the strength of Tassal's business model. What were the key drivers for this result?

Mark Ryan

We are extremely pleased to deliver a record half-year result, where operating earnings grew in line with revenue. This was supported by improving dynamics in the domestic salmon market, optimising sales mix and pricing returns, efficiency benefits, and favourable domestic returns.

Our strategic focus is to grow salmon per capita consumption in the domestic market, currently targeting 10% pa, whilst optimising salmon returns. This is demonstrated through the more than 11% growth in salmon volumes for the domestic market in 1H18 and the increase in operating EBITDA by 23.4% to \$53.2 million.

Optimising EBITDA is not just driven from a 'cost out' focus; it is fundamentally about optimising both sales mix and pricing returns, while also generating productivity gains from biomass and size. Targeting an ideal salmon size of 5.0kg HOG ensures Tassal the best chance of optimising salmon sales mix, as well as delivering 'cost out' and efficiency initiatives.

In terms of salmon sales mix, we were able to drive the right balance from the salmon harvested, not only from a domestic market vs export market perspective, but also wholesale vs retail, and the individual products supporting these markets. Wholesale fresh whole salmon pricing was maintained from FY17 levels and significant growth was experienced in retail modified air fresh packaged [MAP] products – a product where we maintain strong capability and distribution advantages.

In addition to the more than 23% growth in revenue and operational earnings, operating cashflows saw exceptional growth of 69.2% to \$40.6 million. The higher cashflows, together with the capital raising in 2H17, generated a substantial reduction in gearing to 13% net debt to equity, providing greater flexibility to invest for the long term. We have significantly de-risked and strengthened Tassal's balance sheet.

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How has Tassal been able to deliver a step change in salmon biomass and volumes, and how do you ensure you can sell the increased volume?

Mark Ryan

Over the past 18 months, we have strategically focussed on optimising our fish size and biomass to allow greater efficiencies and to optimise salmon earnings returns. The drivers of this strategy have been optimising both domestic vs. export sales mix and in turn the domestic sales mix [lower retail / higher wholesale market reliance], successful selective breeding program, implementing best practice infrastructure and farming practices, improving feed diets and implementing proactive risk mitigation techniques.

Targeting a salmon size of an average of 5.0kg Hog on an annualised basis allows us to optimise both sales mix and returns [domestic vs export], plus achieve scale and operational efficiencies.

Over 1H18, Tassal's total salmon sales volumes were up 43.8% to 16,908 Hog tonnes. Breaking this down, domestic salmon volume grew 11.6% reflecting strong growth in domestic consumption per capita – with wholesale salmon volume up 23.2% and retail volume up 3.1%, resulting in an optimal wholesale vs retail sales mix of 47.0% [1H17: 42.6%]. Pleasingly, wholesale fresh hog market pricing was maintained from FY17 levels, despite significant softening of pricing in the international salmon market.

The export market grew 315%, demonstrating how quickly this market can be 'turned on' to sell increased volume. The export market supports optimising fish size – it cannot be judged just from a sales pricing \$/kg perspective. Our growing and processing efficiencies prosper from scale benefits from fish size being on average 5.0kg hog, which means in any pen of fish, there will be a percentage of fish smaller than 6.0kg [which the domestic market prefers] and a percentage of fish larger than 6.0kg [which the export market prefers].

So with supply chain efficiencies that include lowering costs of growing per kg, achieved through growing bigger fish [and bigger fish are more suited to the demand dynamics of the Asian export market], the export market is an important contributor to the overall returns achieved, and it is not just the returns achieved from pricing alone in the export market.

Therefore, we continue to see export sales providing Tassal the ability to generate growing efficiencies needed to optimise contribution margins and operational returns. While export salmon sales comprised 30% of total sales in 1H18, with volume up 315% to 5,167 HOG tonnes, we expect to see this level normalise back to around 20% for FY18 overall. Moving forward, export sales will be targeted at around 10% to 15%.

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Global salmon export pricing decreased over 1H18. Does Tassal's operational strategy leave the company at risk of generating lower returns going forward?

Mark Ryan

No. Even with global export pricing falling over the past six months, we have been able to generate operating earnings growing in line with revenue. Pleasingly, wholesale fresh hog market pricing was maintained from FY17 levels, despite significant softening of pricing in the international salmon market.

Ultimately, for Tassal it is all about balanced, responsible growth with our focus to grow domestic salmon per capita consumption at around 10% per annum, acknowledging the export market plays an important role in sustainable growth for Tassal.

Overall, our strategy of growing bigger fish to a target size of 5kg Hog acts as a natural hedge to volatility in global salmon pricing. Due to the high capital and fixed overhead component of salmon farming, the more biomass and more optimal fish size, the better the cost of growing across a salmon harvest for a financial year.

In addition, we see export market volumes fluctuating depending on domestic market demand and supply, and in line with this expect export market volumes for Tassal to reduce to around 20% of sales for FY18, down from 30% in 1H18. Moving forward, export sales will be targeted at around 10% to 15%.

We are very focused on increasing Tassal's operating returns, something we have done successfully over 1H18. Operating returns are not just generated from a focus on 'cost out' as it also involves managing sales mix [both markets and ultimately products] too. By continuing to grow domestic per capita consumption and optimising sales mix, we have improved top line returns, and we believe we are able to grow both top and bottom line in synch with each other on a sustainable basis.

We believe if we just look one dimensionally at pricing alone, short term returns will give way to longer term sustainable, responsible growing earnings and ultimately optimising shareholder value. Our focus on ensuring we optimise domestic per capita salmon consumption will continue to ensure we maximise shareholder value.

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We understand that recent summer water temperatures have been warm. How is Tassal proactively addressing this?

Mark Ryan

We took advantage of supply conditions in 1H18 to ensure we responsibly harvested salmon before summer. These fish were either sold or will be used for value added production in 2H18, which allows us to avoid carrying too much risk over the key summer period.

Water temperatures are always concerning for the salmon industry globally and for us, particularly summer water temperatures. Summer water temperatures are within the expected range for this summer between last year, which was cool, and two years ago, which was extremely warm. Summer water temperatures are always challenging.

We actively manage our farming through the periods of high water temperatures, with most of our harvest undertaken before the start of the summer season, and harvest fish for summer being stocked in our coolest sites. Even in a 'cool' year – last year – water temperatures were as high as 19 degrees during the peak months of (January to March).

November was a challenging time for the Tasmanian Salmon Industry. Unseasonably warm weather resulted in increased bathing for our salmon and subsequently a decrease in our fish performance for fish to be harvested in 2H18. Importantly, through flexing our sales, this will allow fish to stay in the water longer and capture growth. In turn this will allow us to target an appropriate sales mix and returns for 2H18.

Cost of growing salmon globally has been increasing, as have water temperatures. Warmer water generally equates to increasing farming costs, with more operational tasks required over the summer period from a farming perspective [e.g. bathing, diving, cleaning etc] so there is some correlation with warming waters and summer specifically – but growing costs have also increased due to higher capital costs [e.g. nets, pens, feed barges etc], together with operational costs [feed and labour] and biosecurity and environmental management.

Tassal has not been immune to warming water temperatures and increasing costs, nor do we accept we cannot proactively do something about this. Through ensuring we focus on growing domestic per capita consumption and optimising sales mix, together with scale and fish size efficiencies – we believe we can continue to grow operational earnings in a responsible, sustainable manner.

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Following on from the above, where does Tassal sit in proactively addressing climate change?

Mark Ryan

Climate plays an important role in Tassal's operations. Tassal recognises climate change is likely to present a range of challenges to the aquaculture industry. Without proactive adaptation, salmon farming may become more vulnerable to disease and/or changes in environmental conditions.

In response to the changing climate, in particular rising sea temperatures, Tassal has developed considerable options for adaptation including selective breeding, modification of farming technologies and practices, and geographic diversification of its marine farm portfolio. Tassal has also engaged scientists to identify emerging climate trends and system responses, and to undertake comprehensive broad scale environmental monitoring. We maintain a comprehensive risk management system to manage the long-term risks, issues and opportunities presented by climate change and respond accordingly.

Ultimately, if farmed salmon is managed effectively for the impacts of climate change, a positive financial benefit may be realised from the increased demand of farmed fish to the reduced availability of global wild stocks as a result of climate change impacts and over-fishing for wild stocks.

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Much has been said and written about the impact salmon farming has on the environment. What is Tassal doing to balance environmental, social and economic interests?

Mark Ryan

Tassal is delivering on its growth ambitions, generating responsible and sustainable biomass growth, while delivering increasing financial returns. We take our environmental and social responsibilities seriously.

Tassal has maintained its Aquaculture Stewardship Council [ASC] certification across all operations for harvest fish. This is not easy to do. Tassal was the first salmon producer globally to achieve ASC certification across its entire business and remains one of only two globally [the other being Petuna] that have achieved this.

We have also strengthened our partnership with World Wildlife Fund-Australia [WWF-Australia] through Marine Spatial Planning [MSP] principles. The MSP principles involve a 'deep' assessment of environmental, operational, shared user and social overlays in fish farming. This assists in a broader appreciation of shared marine values, minimising conflict, promoting better biosecurity and facilitating growth in socially accepted areas.

Macquarie Harbour remains in the spotlight. However, as predicted, our Franklin lease continues to recover, and Tassal has returned to compliance across all leases in Macquarie Harbour from an 'out of lease compliance' perspective, and in-fauna

abundance is returning. Macquarie Harbour environmental and salmon growing conditions are complex – but we firmly believe it is a sustainable place to grow salmon from an environmental perspective.

Our focus on sustainable farming is not something recent. We have been undertaking significant research & development over the past six years focused on supporting safe operations in some of the wildest conditions farmed globally to enable farming to move out of waterways into further off-shore, high energy environments.

We will soon commence a transitional process towards off-shore, high-energy farming. However, many inshore leases are environmentally sustainable and enjoy excellent environmental compliance. As such, we will continue to farm salmon on leases which demonstrate a balanced environmental, commercial and socially accepted position.

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How is De Costi Seafoods performing, and is it delivering the benefits you expected when you acquired it?

Mark Ryan

When Tassal acquired De Costi Seafoods, the strategy was clear. We wanted to expand from salmon, to salmon and seafood to ensure we drive category growth and increased sales and returns. De Costi Seafoods was a logical acquisition given its position within the seafood industry.

Our operational focus with De Costi Seafoods has been to pivot the business away from simple processing, to more innovative product and packaging formats – products where we maintain strong capability and category growth. We have successfully achieved the objective set. While seafood revenue is up slightly to \$42.5million, earnings have grown strongly through a combination of market growth and supply chain efficiencies.

Salmon and seafood MAP products, together with Eastern Seaboard distribution has allowed Tassal to continue to drive both foodservice and retail growth, as well as supply chain efficiencies through De Costi Seafoods.

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Would Tassal consider opportunities in the wider seafood industry?

Mark Ryan

Yes. With the successful acquisition of De Costi Seafoods and the focus of that business on Australian Eastern Seaboard seafood distribution, it is important we consider species diversification.

Such diversification would need to support the supply chain advantage we have achieved via De Costi Seafoods – together with the market dynamics Tassal has been able to implement with its salmon business.



To ensure success with a species diversification strategy, our core competencies are driven from aquaculture and vertical integration. With De Costi Seafoods, the processing and market facing end is already successfully in place.

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With the 1H18 result being a record half-year across all metrics, can Tassal keep up the momentum in 2H18?

Mark Ryan

Tassal is well positioned to deliver continued sustainable growth. Tassal believes it is in a strong position to execute on its long term sustainable growth strategy across both salmon and seafood.

We have successfully grown per capita consumption of salmon in Australia, and see this continuing given the health and farming benefits of salmon over other proteins. We have not yet fully optimised the sales mix with additional work being done to further optimise both mix and returns over 2H18.

The combination of an optimised sales mix and pricing returns, while delivering scale and operational cost efficiencies should underpin strong growth in earnings.

The substantial reduction in gearing achieved through the capital raising in 2H17, together with the strong operating cashflow and responsible capital spend in 1H18 has significantly de-risked our balance sheet. This provides added flexibility as we look to roll out our next period of growth investment in both the salmon and wider seafood industry.

Taking all of this into account, the company's Board expects Tassal to continue its strong operational performance in 2H18 and generate record results in FY2018.

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Thank you, Mark.

For further information, please contact Tassal on 1300 880 179, or visit www.tassal.com.au

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