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Tassal MD on FY15 results and evolution to Salmon and Seafood growth strategy

Interview with Mark Ryan (Managing Director & CEO)

In this Market Briefing interview, Mark Ryan, Tassal's Managing Director & CEO, discusses the company's full year 2015 [FY15] results and evolution to a Salmon and Seafood growth strategy, including:

- *Tassal's continued earnings growth driven by the company's domestic market growth strategy and majority of sales into the retail market segment*
- *operating efficiencies driving margin improvements that countered weaker domestic wholesale and export prices*
- *strong cash flows and balance sheet*
- *growing dividend*
- *positive outlook for the 2016 financial year following the implementation of the company's Salmon and Seafood growth strategy and acquisition of De Costi Seafoods.*

Over the 2015 financial year Tassal was again able to sustainably grow its revenue and earnings. What continues to underpin this growth?

Mark Ryan

Tassal's focus on successfully executing its domestic market growth strategy has again underpinned our earnings growth. Importantly, Tassal's growth is sustainable given it is not reliant on volatile wholesale and export prices, with over 70% of our sales into the domestic retail market.

Statutory revenue was up 16.3% to \$309.79 million while net profit after tax was up 21.8% to \$49.9 million. This growth reflected our growing and successful domestic market strategy. Central to this was continued growth in domestic market per capita consumption of Salmon given the sales and marketing initiatives implemented by Tassal, including our capabilities in category management and innovative new product development.



Over the past 12 months, we have also seen excellent operational performance right across our supply value chain from growing to processing to logistics and distribution. These savings have helped offset some of the lower pricing in the wholesale and export markets in the second half, while also strengthening our overall operating platform going forward. Our relentless focus is to ultimately achieve global best practice in cost of production.

We have also seen favourable growing conditions, improved feed conversion and fish survival. This drove operating cost efficiencies that allowed the offset of rising feed prices. Pleasingly, feed prices have reduced from 1 July 2015.

Contribution margin decreased from \$3.30 to \$3.14 per hog kg. Why did it decrease and is the margin sustainable going forward?

Mark Ryan

The contribution margin decreased in FY15 relative to FY14 primarily due to the lower prices in wholesale and export markets. With the majority of Tassal's sales into the domestic retail market, new retail contracts recently entered into, wholesale pricing recovering and operating efficiencies within our business continuing to gather momentum, we have a positive outlook on contribution margin going forward over the medium to long term.

With feed pricing reduced from 1 July 2015 and the performance of our Selective Breeding Program continuing to deliver a reduction in growing time and bathing required – i.e. delivering a cost of production decrease – these factors will support our contribution margin.

In terms of the operating efficiencies, efficiency projects were implemented across all of Tassal's processing sites this year, with a focus on yield and throughput initiatives. With improved performance across all sites, the full benefits of those projects will flow into the 2016 financial year and onwards.

As you know, we also acquired De Costi Seafoods at the end of July 2015 – with earnings from De Costi Seafoods being available from 1 July 2015. We expect substantial synergies and efficiencies to flow from this acquisition in the Salmon and Seafood categories. De Costi Seafoods is expected to deliver efficiencies across the Salmon and Seafood supply value chain for Tassal, and the larger combined business will deliver economies of scale from a cost perspective and be in a strong position to maximise domestic Seafood consumption in the same way as Tassal has done in Salmon.

Wholesale sales grew more strongly than retail sales for Tassal in FY15. Can you please comment on the reason behind the strong wholesale growth and what you are expecting for FY16 given the majority of domestic sales over the last few years has been in the retail category?

Mark Ryan

The year saw strong growth in Tassal's wholesale market sales, up 33.5%, as we moved back to volumes previously seen before the effect of the hot summer 2012/13. We are pleased at the rate at which we have been able to claw back this volume. However, wholesale prices disappointed in the second half of FY15, impacted by an oversupply of lower quality fish affecting the price Tassal could otherwise have received for its fish. This, combined with increasing cheaper imports, reduced

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the wholesale hog price by around \$2.00/kg during the second half of FY15. There has been some recovery to the wholesale price from May 2015, but it is still below the levels experienced in the first half of FY15.

However, you need to put the wholesale market into perspective versus our domestic retail market business. Over FY15, wholesale sales amounted to 6,426 hog tonnes and \$79.0 million. This compares to 15,832 hog tonnes in retail sales generating \$216.6 million of revenue.

Retail sales as a proportion of Tassal's overall business in FY15 accounted for 71% of volume and 73% of revenue, so wholesale price pressure was somewhat insulated by domestic retail sales through the year.

Do you expect wholesale prices to remain depressed going forward?

Mark Ryan

We believe wholesale prices bottomed in the second half of FY15 and in fact saw increases come into effect from the start of May. It is hard to say whether prices will continue to increase given inherent historic volatility, but we don't believe they will fall in the near term.

We expect the risk of future oversupply in the domestic wholesale market to lessen as supply flattens and domestic demand continues to increase given the success of Tassal's strategy to increase domestic market per capita consumption of the overall Seafood market. In addition, over supply due to fish imports should reduce as the Australian Dollar weakens and Salmon products become less profitable to import.

It is important to remember that Tassal is not reliant on the wholesale and export markets for its growth. As I mentioned before, retail sales as a proportion of Tassal's overall domestic market accounted for 73% of revenue and 71% of volume over the last 12 months, and so Tassal was able to mitigate the effect of the pricing weakness in wholesale and export markets during the second half of FY15.

Tassal continues to have a strong balance sheet. How does this place you in terms of your growth strategy?

Mark Ryan

We have been very focused on strengthening our balance sheet over the past four years, both in terms of reducing the level of debt and increasing the value of our assets, primarily the value of live fish given it is an indicator of future earnings growth.

Biological assets continued to grow over the 2015 financial year with the value of live fish up 18.1% to \$222.9 million. At the same time we have built up our inventory, with finished goods stock up 12.7% to \$60.2 million reflecting the anticipated sales growth over the 2016 financial year.

Gearing and funding ratios are at comfortable levels. Gearing stands at 17.6% - a slight increase over FY14 as Tassal focussed on using its debt facilities to grow its live Salmon biomass for FY16 and onwards.

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Tassal has again demonstrated continued strong cash flows, but operating cash flows of \$42.7 million were lower than the year before even though earnings have continued to increase. What is the reason for this?

Mark Ryan

Sustainable contribution margins generated from our domestic market strategy continue to drive Tassal's strong cash flows. Operating cash flows of \$42.7 million were lower than FY14's \$50.6 million as we took advantage of good growing conditions to invest in both live fish and inventory to support future sales growth initiatives. An additional \$19.5 million was invested in fish supply to ensure Tassal can meet anticipated future demand.

Having successfully executed your growth strategy in Salmon, you recently announced the evolution of that growth strategy into Salmon and Seafood. Can you please discuss this new strategy?

Mark Ryan

We are very excited about our Salmon and Seafood Strategy and our strategic evolution to Seafood. We previously sold highly recognised, ethical, valued Salmon brands and products to Australian consumers and retailers, and given this success are well placed to expand our focus to the Seafood category.

The acquisition of De Costi Seafoods underpins our strategic move into Salmon and Seafood, and expands our total addressable market from \$700m annually in Salmon to \$4.3 billion annually in Seafood. We will also be able to improve our customer value proposition with a wider sustainable product range, improved product development and innovation opportunities, provide national and multi-state offerings for Salmon and Seafood, and improve category management in Seafood.

Meanwhile we will continue to leverage our domestic market focus, building on this and our retail relationships. Off the back of this we should be able to unlock access to significant foodservice opportunities.

Why did you decide to acquire De Costi Seafoods?

Mark Ryan

In expanding our growth strategy to Salmon and Seafood, the De Costi Seafoods acquisition made a lot of strategic sense. Not only was it a much better proposition than building up a "greenfield" operation that would have taken several years to generate any earnings with significant upfront capital costs and limited procurement capability, this acquisition brought together two market leaders in the Seafood industry.

The acquisition provided Tassal with the ability to accelerate its Seafood Strategy and deliver a number of revenue and cost synergies. We expect to further optimise the Salmon and Seafood supply value chain, while also generating economies of scale from a cost perspective and maximising domestic per capita consumption of Seafood like we have successfully done with Salmon.

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While Tassal is already a vertically integrated Salmon company, the acquisition of De Costi Seafoods will enhance this. De Costi Seafoods is a supplier to Tassal's major customers and has been a significant Tassal customer for many years. De Costi Seafoods is located in the optimal location – New South Wales – for Seafood. There is strategic alignment in retail capability and similar overall channel mix.

Capabilities will be leveraged under the tie up. De Costi Seafoods' procurement relationships and capabilities have significant intellectual property value to Tassal. In addition, its location and processing diversification will allow Tassal to leverage its existing category management, new product development, marketing and distribution capabilities.

Finally, the acquisition will drive economies of scale that are expected to lower operating costs. There will be sufficient volume to deliver processing efficiencies in Tasmania and New South Wales. We have developed a Seafood hub in New South Wales utilising Tassal's Salmon scale and national distribution capabilities. Returns will improve as we benefit from shorter capital and working capital cycles as well as earnings from the "Seafood basket".

In closing, what is the outlook for Tassal in FY16?

Mark Ryan

We continue to focus on growing domestic market consumption and are not seeing underlying market growth slow. While our focus in the past has been on Salmon, our growth strategy has broadened to Salmon and Seafood and we believe we are well placed to replicate our success in Salmon into the wider Seafood category following the acquisition of De Costi Seafoods.

Our Salmon fish size continues to grow given the breeding and feeding strategies put in place, and we have the volume coming through to underpin continued growth in domestic market per capita consumption. At the same time as growing volumes which will drive higher revenues, we are also further optimising our supply value chain to drive additional operational efficiencies.

We are very excited about the opportunity for growth in Seafood following the acquisition of De Costi Seafoods, and our ability to maximise domestic market per capita consumption of Seafood to drive sustainable long term growth, just as we have done in the Salmon category. Our clear understanding is that growing Seafood will grow Salmon and growing Salmon will grow Seafood.

Thank you, Mark.

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



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