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PROFITABILITY IMPACTED BY FALL IN PRODUCTION VOLUMES

Huon Aquaculture Group Limited (ASX: HUO) has delivered a net profit after tax (NPAT) of $26.4 million for the six months to 31 December 2018 ($27.6 million in 1H2018). Performance was impacted by a 29% fall in harvest tonnage to 9,019 tonnes which is consistent with guidance provided at the time of the full year results for volumes of 20,000 tonnes for FY2019. Huon confirms this guidance and as a result anticipates that harvest volumes will be weighted to the second half with revenue for FY2019 slightly below the result of FY2018 and Operating EBITDA down 5-10%.

SUMMARY OF BUSINESS PERFORMANCE FOR 1H2019

- Revenue of $136.3 million representing a 20% decline on pcp and 29% reduction in harvest tonnage
- Statutory NPAT fell 4% on pcp to $26.4m, supported by a 35% increase in the Fair Value of Biological Assets compared to 30 June 2018
- Operating NPAT declined 53% due to the reduced volumes and a 23% increase in production costs/kg from the higher ongoing costs from the prior period and recent jellyfish bloom
- Average harvest weights improved in the half to 4.78kg compared to 4.27kg in 2H2018 when fish growth was seriously impacted by elevated water temperatures from the long, hot summer in 2017/18
- The 45% decrease in Operating EBITDA to $21.6 million combined with increased working capital requirements as the biomass was rebuilt, lower production volumes and higher costs, resulted in negative cash flow from operations of $1.6 million (1H2018: positive $23.2 million)
- Capex of $41.4 million during the half was largely debt funded, contributing to a $48 million increase in net debt to $129.4 million. Gearing has risen to 38.8%, a level which is not expected to be exceeded in FY2019
- Directors have declared an interim dividend of 3 cents per share, franked at 50% and payable on 11 April 2019

FINANCIAL SUMMARY

	Six months ended		31 December 2018	30 June 2018	31 December 2017	% Change Dec on Dec
	Tonnage	t	9,019	10,275	12,693	-29%
1	Revenue	$M	136.3	147.4	170.5	-20%
	Revenue per HOG kg	$/kg	15.11	14.35	13.43	13%
2	EBITDA	$M	46.6	7.4	51.5	-10%
	NPAT	$M	26.4	(1.2)	27.6	-4%
3	Operating EBITDA	$M	21.6	32.6	39.2	-45%
4	Operating NPAT	$M	8.9	16.4	19.0	-53%
	Fair value adjustment of Biological Assets	$M	25.0	(25.2)	12.3	103%
	Biological Assets	$M	228.5	169.4	195.3	17%
	Cash Flow from Operations	$M	(1.6)	34.8	23.2	-107%
	Net debt	$M	129.4	81.3	67.3	92%
5	Total gearing ratio	%	38.8%	26.1%	21.3%	83%
	Earnings per share	cents	30.17	(1.38)	31.59	-4%
	Dividend per share	cents	3.00	5.00	5.00	-40%

1 Revenue from the sale of goods.
2 EBITDA is earnings before interest, tax, depreciation and amortisation.
3 Operating EBITDA excludes the impact of the Fair Value Adjustment of Biological Assets.
4 Operating NPAT excludes the impact of the Fair Value Adjustment of Biological Assets and related tax impact.
5 Total Gearing Ratio is measured as debt (net of cash)/net assets.

RESULTS COMMENTARY

Performance for the half year to 31 December 2018 has been affected by the deterioration in operating conditions in the second half of FY2018 which saw a significant reduction in the biomass. This development had been well anticipated with guidance provided in August 2018, and confirmed at the AGM in October, for a 3,000 tonne reduction in harvest volumes for FY2019 to 20,000 tonnes.

Huon Aquaculture CEO and Managing Director Peter Bender noted that the decline in both sales and profitability in the current half reflected the impact of the extremely challenging operating conditions in the 2017/18 summer. This not only reduced the tonnages available for harvest but also the average weight of fish harvested in the first half of FY2019.

"Huon Aquaculture's disappointing financial performance in the current half highlights the challenges we face every day when working with nature. Our job is all about preparing for those events that are beyond our control and managing risk. All the decisions we have taken in recent years are about building both capacity and resilience within the company. This ensures we are able to manage through the difficult periods, recover momentum and quickly return the business to where it would have been on our planned growth path."

As consequence of reduced production volumes, sales revenue fell 20% to $136.3 million, mitigated by the sustained strength of the salmon price locally and internationally. The majority (94%) of Huon's harvest went to the domestic market in order to maintain sales in a market labouring under supply shortages and struggling to meet the continued growth in demand. The overall average price received during the half increased 13% to $15.11/kg on the previous corresponding period (pcp).

Huon's key focus during the half was to continue with its expansion in Storm Bay and to complete construction of the Whale Point Salmon Nursery. Both of these represent investments in our capacity to increase production, a process which commenced during the half with a major rebuild of our biological assets. This is reflected in the 17% increase in value of Biological Assets on pcp as well as a doubling in the gain in FVA on pcp to $25.0 million – also reversing the $25.2 million loss in the previous half.

"While Huon is now past the worst of the damaging effects from the 2017/18 summer and Huon's improved performance in the second half will reflect that recovery, production costs remain under pressure due to the secondary impacts on fish health arising from a jellyfish bloom in November/December 2018. We have however completed implementation of the majority of our efficiency program which will deliver a sustainable reduction in costs over coming years." concluded Mr Bender.

RISK MANAGEMENT

Moon Jellyfish Bloom

During November 2018 Huon experienced a moon jellyfish bloom in the Huon River and D'Entrecasteaux Channel. These are infrequent events in the Huon Estuary, having been observed and studied for the past 40 years, but they are difficult to predict with the last occurrence in the summer of 2012/13.

The key mitigation strategy is to keep the jellyfish away from the fish, including towing the pens slowly through the water allowing the jellyfish to be pushed out through the net. This and other mitigation strategies were successfully undertaken from the date of the initial outbreak until the end of December, although not without labour and operational costs. The biological impact as a result of this episode comes from fish mortalities and lost growth. Some of those fish affected by the bloom are now suffering from gill necrosis, a secondary impact from the jellyfish encounter. This has the potential for some residual impact on the survival rates of those fish which will persist until the water temperature cools to c. 15 degrees, at which time gill health will recover.

At this point the estimated full year impact from the jellyfish bloom is expected to be between $8 million and $10 million.

Bushfires in Tasmania

From late December 2018, bushfires have burnt significant parts of Tasmania (over 200,000 hectares) including in the Huon Valley region where Huon Aquaculture has a number of operational sites.

While the fires were extremely challenging for staff, facilities and the entire community there was no disruption to the harvest schedule and no loss of assets or damage to infrastructure. Rains in the second week of February eased the situation, enabling operations to return to a more normal footing.

Huon sites including farm and hatchery locations were well-prepared with emergency plans enacted. Daily emergency management meetings occurred through late January/early February to ensure appropriate contingency plans were in place. All sites had generators, water sprinklers were installed on the hatchery roofs and there was access to freshwater which could be used by firefighters as a fill point. Road closures required sea transfer of staff to/from work and harvest trucks to the processing factory.

Yellowtail Kingfish – Trial Phase Complete

Huon is continuing to progress its strategy of diversifying into other high demand fish species through establishing sites for farming Yellowtail Kingfish on both the East and West Coasts of Australia.

In October 2018 Huon secured a licence to operate in a new aquaculture zone 60 km west of Geraldton in Western Australia. While the 2200 Ha site is fish farm ready following completion of an EIS by the Western Australian government, Huon will undertake additional detailed monitoring before committing capital.

In recent weeks Huon has decided to conclude the Yellowtail Kingfish research trial at Port Stephens in NSW which has been running for the past 2.5 years. The trial succeeded in demonstrating the viability of farming Kingfish commercially in a high energy, warm water environment off the east coast of Australia.

The medium term objective is to set up farming sites on both the East and West Coasts of Australia to supply locally grown Kingfish to the domestic and lucrative Asian markets

CAPITAL MANAGEMENT

During the half Huon spent $41 million of its $75 million capital expenditure budget for FY2019 on progressing its expansion program. The majority of funds came from recently renegotiated debt facilities, resulting in net debt almost doubling to $129.4 million on pcp and gearing rising to 38.8%.

Adjusted Cash Flow from Operations (Cash Flow from Operations plus interest and tax paid) fell during the half from $24.8 million (pcp) to $8.7 million as a result of the reduced production volumes, higher costs and the increased cash requirement associated with rebuilding the biomass. These pressures ease in the second half with the result that the remainder of the capital expenditure budget will be funded from cash flow.

Directors have declared an interim dividend of 3.0 cents per share, franked at 50% and payable on 11 April 2019. This is consistent with Huon's dividend policy to maintain an annual payout ratio of up to 35% of Net Operating Profit after Tax.

OUTLOOK

Huon's expectation of forecast production volumes for FY2019 remains unchanged at 20,000 tonnes with harvest volumes weighted towards the second half. As the biomass is rebuilt over 2019 we expect to see a return to production volumes in FY2020 of at least 25,000 tonnes and Huon currently have fish in production that will support a 30,000 tonne production in FY2021. This reflects where the business would have been if it had maintained its planned growth profile of 10% pa, prior to this setback in FY2019.

The strong pricing environment was expected to offset the fall in volumes, enabling Huon to deliver continued growth in revenue and Operating EBITDA. We did not anticipate the ongoing pressure on production volumes as a result of the jellyfish bloom. This is now expected to continue into the first few months of the second half as a result of the jellyfish event. A more likely outcome for FY2019 therefore is for a slight reduction in revenue and for Operating EBITDA to be 5-10% below the record result of Operating EBITDA $71.8m reported in FY2018.

The fundamentals of the business continue to be underpinned by a market environment in which growth in supply continues to fall short of the long term trend of growth in demand, both in Australia and globally.

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