ASX/Media Release

Huon Aquaculture Group Limited (ASX: HUO)

Issued: 23 October 2019

<u>2019 Annual General Meeting</u>

Attached are copies of the Chairman's Address and Chief Executive Officer's Review of Operations to be presented at today's Annual General Meeting, Wednesday 23 October 2019, The Stables, RACV/RACT Hobart Apartment Hotel, 154-156 Collins St, Hobart commencing at 10.30am.

Yours faithfully,

Thomas Haselgrove

Company Secretary

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CHAIRMAN'S ADDRESS
HUON AQUACULTURE GROUP LIMITED ANNUAL GENERAL MEETING
10.30am, Wednesday 23 October 2019
The Stables, RACV/RACT Hobart Apartment Hotel
154-156 Collins St, Hobart

The Year in Review

I will now move to my report for the year ended 30 June 2019.

Performance

An inescapable truth of farming, whether on land or sea, is that the environment has a considerable impact on how any business performs. In FY2019 a combination of warm water temperatures, that extended through to April, and the secondary impacts on the health and growth rates of our fish that came into contact with a moon jellyfish bloom in late 2018 negatively affected our sales and earnings.

I would like to commend the people in our business for being well prepared; responding quickly and putting in the hard work to manage these negative environmental events, however, it was not possible for Huon to match last year's performance.

For FY2019 Huon delivered revenues of $282 million on harvest volumes of 18,849 tonnes. Our revenues were supported by an increase in salmon prices which were underpinned by a shortfall in supply. Operating EBITDA of $47.3 million was 34% below 2018, as a result of lower sales and the higher costs of managing the business arising from the challenging environmental conditions. Statutory net profit after tax (NPAT) fell 64% to $9.5 million.

Capital Management

In light of the environmental challenges that held back the financial performance of the business in FY2019, your Directors declared a final dividend of 3.0 cents per share, franked at 50%. This brings the total dividend payment for the year to 6.0 cents per share, down from the total dividend payment of 10 cents in the previous year.

Huon's dividend policy is to maintain an annual dividend pay-out ratio of up to 35 per cent of Operating NPAT. The total dividend for FY2019 represents a pay-out ratio of 33.1%.

We have continued to implement our strategy of expanding the business to take advantage of the long term trend of growth in domestic demand for salmon. Capital expenditure in FY2019 of $75 million represents the completion of a two-year program of investment in new infrastructure and innovation, including the new Whale Point salmon nursery.

Our capital expenditure requirements in FY2019 were funded entirely from cash flows and borrowings and, as a consequence, our net debt at the end of FY2019 was up 70% on the prior year, at $138.8 million. Huon's gearing at the end of FY2019 of 44%, while the highest since listing in 2014, is well supported by the new debt facilities that were put in place last year.

Capital expenditure in coming years is expected to moderate to around $40 million per annum as we move to consolidate the benefits of the past 5 years of significant investment in expanding our production capacity, delivering operational efficiencies and creating a larger scale, more resilient business.

People and safety

The safety of our people remains of paramount importance at Huon. We are continuously reviewing and improving our safety systems, programs and processes to, not only, reduce our risks but to improve the wellbeing of our people.

This approach to safety includes a focus on delivering our People & Capability strategy, which includes the successful Huon Leaders program that gives our people the skills and training to take responsibility for managing safety effectively. I'm pleased to report that in FY2019 we have seen an overall improvement in safety performance across our business.

Strategy

Huon's continued growth is built around our three strategic pillars, which are growing the market; growing production and enhancing operational efficiency; and doing so safely and sustainably. Our investment of over $350 million in the business over the past 5 years has supported these strategic goals and positions the business to almost double capacity in the next three to 5 years.

In FY2019 we completed our two-year, $150 million capital expenditure programme which saw us build and commence operations at our Whale Point salmon nursery and expand operations at our Storm Bay leases. Whale Point allows us to increase the capacity of our existing leases by transferring larger, more mature and resilient fish to sea resulting in a significant reduction in the time it takes for those fish to reach harvest weight. We have also commenced operations at our new East of Yellow Bluff lease in Storm Bay, representing a significant expansion in our high energy, off shore production capacity.

This most recent capital expenditure program was preceded by our three-year, $200 million investment in our controlled growth strategy, where we re-engineered every step in our production processes to enable us to operate in high-energy sites offshore. This investment included building and commissioning industry leading systems, technology and infrastructure that underpins the sustainable growth and resilience of the business.

It is now time to consolidate the significant changes we have made to the business through this period of significant investment, so that we continue to deliver against our strategic pillars. The next few years will see a focus on maximising operating efficiencies, increases to production capacity and enhancements to our ability to absorb environmental impacts.

This means FY2020 will be the first year since 2014 that Huon has not been implementing significant changes to the way it operates. We will, however, continue to innovate. We are in the early stages of developing Yellowtail Kingfish operations in Western Australia and have initiated a 2-year environmental monitoring program to assess if our new lease site, off Geraldton, is suitable for this species. This follows the conclusion, in FY2019, of our successful Yellowtail Kingfish trail at Port Stephens in NSW.

Conclusion

We have a clear strategy for growth. We are delivering against that strategy. The business is positioned to almost double production capacity over the next 3 to 5 years. At the same time our development of industry leading facilities such as Whale Point - the largest on-land grow-out facility in the Southern Hemisphere - and technology, such as the Fortress pens, that allow safe, sustainable farming of high energy sites offshore means we are also creating a much more resilient business.

I am confident that Huon Aquaculture will deliver value for its shareholders and all its stakeholders in FY2020 and the years to come. On behalf of the Board I wish to thank our customers, suppliers, local communities, employees, and you, our shareholders, for your support.

I will now ask our Managing Director, Peter Bender, to present his review of operations and to comment on the outlook for the year ahead.

Thank you.

CHIEF EXECUTIVE OFFICER'S REVIEW OF OPERATIONS
HUON AQUACULTURE GROUP LIMITED ANNUAL GENERAL MEETING
10.30am, Wednesday 23 October 2019
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Thank you Neil, good morning everyone and may I also welcome you and thank you for your attendance at today's AGM.

Huon Aquaculture's disappointing financial performance in FY2019 is a reminder, not that we particularly need reminding, of the influence that natural events can have over our business. That no matter how hard we work to plan for and mitigate its effects, sometimes we are outplayed. Our results reflect the short term operational costs of managing such an event and the ongoing impact on fish growth through the remainder of the year.

Operational Challenges

In the closing weeks of 2018 Huon leases in the Huon River and D'Entrecasteaux Channel were struck by a moon jellyfish bloom, an infrequent event with the last occurrence in the summer of 2012/3. While quickly controlled, there were fish mortalities and there was an expectation that growth rates would be affected although it was hard to say to what extent. During January and February, however, a more serious secondary impact manifested as affected salmon also developed gill necrosis which was exacerbated by the persistently high warm water temperatures.

Water temperatures in Huon's southern Tasmania growing sites remained high beyond February through to April. Temperatures above 16˚C are not optimal for growth, nor are they conducive to recovery from gill necrosis. As a consequence, production volumes for the year fell further than anticipated due to higher than expected mortalities and lower fish weights. Although jellyfish blooms are an infrequent event, any future outbreak should have less of an impact as we plan to have much less fish stocked at these highest impacted sites as we implement the stocking of our new Yellow Bluff site.

The reduction in production volumes year on year was only partly due to the jellyfish. This time last year we flagged that the harvest would be down from 22,968 tonnes to an expected 20,000 tonnes due to the poor summer in 2018. In the end we harvested 18,849 tonnes with an average harvest fish weight of 4.4kg, well below the previous 5 year average of 4.6kg. The impact on fish growth from gill necrosis and warm water temperature was particularly evident in the second half of FY2019 when the average weight fell to 4.1kg. Further flow-on effects are anticipated in FY2020 until the 2018 Year Class fish weight recovers.

On a more positive note, we have already committed to rebuild the biomass back to production levels that would have been in place if not for the losses experienced over the past 18 months. I'll have more to say on that a bit later.

Financial Performance

The impact of the events, just outlined, on Huon's harvest and sales for FY2019 was significant. As the Chairman has already noted, revenue fell 11% for the year primarily due to lower volumes, with the impact lessened due to higher salmon prices. The average price per HOG kg rose 8% to a record $14.96 as the market adjusted to the shortage of supply.

At the AGM in late October last year we confidently predicted an improvement in profitability despite an anticipated fall in volumes, demonstrating how quickly things can change in this business. I talked earlier about how the hard to predict, negative environmental events of 2018 created a bigger than expected drop in production volumes. This impacted profitability, but we also had to absorb the higher costs of managing the jellyfish bloom together with disruptions caused by bushfires that threatened Huon facilities over the summer. As a result, the average cost of production per HOG kg for the year rose from $9.91 to $11.73. The net effect of both lower sales and higher costs was a 34% fall in Operating EBITDA to $47.3 million, with margins declining from 23% to 17%.

While there was an improvement in the average cost of production in the second half of FY2019 compared to the first half, it is expected that it will remain elevated in the first half of FY2020 as a result of the effects of lower growth from gill necrosis on the 2018 Year Class.

Market

The reduced volume of salmon available for sale in FY2019 necessitated a short term shift in Huon's marketing strategy with priority placed on meeting the domestic market. As a consequence, hard won contracts over the previous 18 months with retail clients in the international market, could not be fulfilled. 28% of sales last year went through the retail channel and 64% into the wholesale market.

With demand for salmon growing by 10% pa in Australia, Huon is focused on at least matching that rate of growth in supply. Maintaining supply through the retail channel is a key focus for Huon's strategy and the opening of a processing and distribution facility at Ingleburn in NSW in April this year will enable us to supply fresh salmon to outlets in Sydney and the rest of the eastern seaboard.

Huon's increase in production capacity puts it in a strong position to increase market share for Australian grown salmon. Early in FY2020 Huon was successful in securing contracts for the sale of six of its cured, cold and hot smoked branded product range within Coles supermarkets nationally, including two Ocean Trout products. This is a big step change for Huon in terms of the distribution of its branded products. Approximately half the adult Australian population shops at Coles and will now be exposed to the brand for the first time in more than five years. This increased profile, together with growing production volumes for sale in coming years, will drive greater investment in marketing the Huon brand. This is consistent with our focus on increasing per capita consumption of salmon in Australia together with raising Huon's premium brand positioning within the domestic market.

In terms of pricing, salmon prices in the domestic market were stable during the year following increases late in FY2018. They are expected to continue to trade at similar levels in FY2020 while the market rebuilds biomass to levels capable of meeting demand.

International salmon prices also remained robust during the year as the 7% per annum growth in global demand for salmon continued to outstrip the major producer countries' ability to increase supply. Both Norway and Chile are operating with supply constraints, including access to new leases, which is an issue for producing countries globally.

A better than expected season in other growing regions has lifted supply in the short term. This has been exacerbated by Norwegian farmers needing to harvest faster than anticipated due to higher levels of lice in their fish at present. Consequently, the average size of Norwegian harvest fish is only 4.1kgs HOG, the lowest it has been for many years. While this has resulted in recent reductions in international pricing, the long term outlook continues to be a position of demand exceeding supply.

Expanding Capacity

I mentioned earlier our commitment to rebuilding the biomass back to previously planned production levels for FY2020 and beyond. I want to take a few minutes to explain exactly what I mean by that and what has had to happen in the business over that past couple of years to make that a reality rather than an aspirational goal.

Construction of the new salmon nursery at Whale Point was completed in December 2018 and commissioned in February 2019 when the first intake of 300,000 juvenile salmon were transferred from Huon's Forest Home hatchery to Whale Point. The current season has seen just under 2 million smolt through the facility and has driven an overall increase in the average weight of smolt to sea from 210gm to 300gm. Whale Point production includes a population of fish that were put to sea at greater than 1.0kg - the biggest land-grown salmon ever recorded in the southern hemisphere. They will remain at sea for 9-10 months until harvest in March/April 2020.

In May 2019 Huon was granted an Environmental Licence for a new lease at Storm Bay in the area known as East of Yellow Bluff. The new lease site is 1.5kms from Bruny Island and will not only allow an expansion of capacity in Storm Bay but also enable Huon to deliver improved biosecurity by including a greater distance in separation of Year Classes of fish as well as providing some protection from the impacts of warm water temperatures and jellyfish blooms. The 2018 and 2019 salmon Year Class will see the full utilisation of two of the four Storm Bay lease sites together with commencement of stocking at the new Yellow Bluff lease.

Finally, I should mention our progress with Yellowtail Kingfish trials. During the year we successfully concluded our trial at Port Stephens in NSW and subsequently moved our focus to Western Australia. In October 2018 Huon was granted a lease site off the coast of Geraldton by the State government to undertake a two year investigation into the suitability of this location for farming Yellowtail Kingfish.

People and Safety

Huon continues to review and improve its safety systems, programs and processes. This includes an ongoing focus on the development and implementation of structured health and safety programs. These are aimed at not only reducing our risks but also improving the wellbeing of our workforce and supporting the ability of our people and leaders to manage safety effectively.

Overall safety performance continued to improve, particularly the Average Lost Time Injury Rate which fell from 14 hours lost per employee the previous year to 10 hours.

We also have a very strong focus on developing our workforce and building capability. Huon's People & Capability strategy continues to be rolled out, including the successful Huon Leaders program which has supported 42 participants in activities designed to strengthen their leadership capacity. The program has also laid the groundwork for a future program that will harness the skill sets of Huon's Emerging Leaders in FY2020.

Finally, I want to mention a new, whole of business Innovation Program that we are introducing this year to foster the development of innovation as a core skill set. This will build on the culture of innovation and employee idea generation that is a part of Huon's DNA and something we are very proud of.

Outlook

The challenges experienced over the past year warrant some caution in being too definitive about the outlook for sales and profitability. There are however some things we can be confident about.

Huon currently has fish in production that will support a 30,000 tonne production in FY2021 which is where the business would have been if it had maintained its planned growth profile of 10% pa, prior to the setback experienced in FY2019. We currently have record biomass in the water which is expected to translate into a harvest of at least 25,000 tonnes in FY2020.

It is also true that while we remain focused on driving operating efficiencies through the business, the residual impact of the fish losses and growth impacts from the 2018 Year Class will slow the rate at which the cost of production can come down.

Huon has experienced a challenging trading environment in the first quarter of FY2020, in part as a result of a better than expected season in other growing regions that lifted supply. This short term aberration should wash through over coming months but will make our first half more challenging than first thought due to us exporting more fish this half than the prior corresponding period.

Domestic demand continues to grow at around 10% pa whilst the supply dynamics both domestically and globally continue to be tight, underpinning long term revenue growth.

FY2020 will also be the first year since 2014 in which Huon is not investing aggressively in the business, providing the opportunity for a period in which the recent expansion in capacity can be fully consolidated. So there is good reason to be optimistic that both operating and statutory earnings will recover strongly this year on those reported in FY2019, assuming there are no abnormal weather or biological events.

Conclusion

So in conclusion, the fundamentals of the salmon industry support our strategy of expanding capacity to service growing domestic demand.

Having completed the second of two major efficiency and expansion programs we now have in place a platform that will deliver a sustainable reduction in costs beyond FY2020.

We are very conscious of maintaining our social licence to operate safely, sustainably and profitably with the broad support of the local communities where we work and the wider public.

I look forward to another successful year and extend my thanks to our local communities and suppliers and to you, our shareholders for your support.