Terrasan

CHAIRMAN'S REPORT 2019

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INTRODUCTION

The year under review presented a difficult trading environment of insufficient growth to fully cover input costs causing a significant drop in earnings - a reflection of tough economic conditions experienced globally as well as locally. Dampened global economic growth because of a weaker demand, ongoing trade wars with increasing geopolitical risks and social unrest slowed down already lower growth economies. In SA, Gross Domestic Product ("GDP") grew by 0.2%, facing already severe challenges of depressed growth, high unemployment, power outages, the slow pace of reforms and policy progress, undermining growth prospects. These external factors heavily impacted the Group, requiring management to act swiftly in stabilising the business through decisive actions. The impact of these actions is clearly visible in our mid-year results for the 2020 financial year.

The release of the Terrasan Group Ltd ("the Group") Annual Report for 2019 was delayed as a direct result of the implications of the Product Recall (see below for more information), especially the completion of the National Regulator for Compulsory Specifications ("NRCS") investigation, to ensure that all identified issues could be considered and evaluated in the preparation of the Group's Consolidated Annual Financial Statements. The mid-year results for the 2020 financial year will be published shortly after the release of this Annual Report. Where appropriate, certain sections of this Annual Report will be replicated in the mid-year results to ensure that any gaps are bridged and that the Group's results and affairs are reported in its respective surrounding contexts.

CAPITAL RAISE AND B-BBEE SHAREHOLDING

The B-BBEE transaction that was concluded in 2019 improved the B-BBEE shareholding of the Group significantly.

Increasing our black ownership to 43% shows our continued commitment towards transformation which is in line with the future strategy of the Group.

GROUP OVERVIEW

Adjusted non-IFRS financial measures

The Group uses adjusted operating profit, adjusted earnings before interest, tax, depreciation and amortisation (adjusted EBITDA), adjusted profit for the period and adjusted earnings per share (adjusted EPS) as non-IFRS measures in evaluating performance and as a method to provide shareholders with clear and consistent reporting. These non-IFRS measures are defined as reportable operating profit, EBITDA, profit for the period and EPS in terms of accounting standards, excluding the unrealised profit in the fair value adjustment to biological assets, certain one-off and extraordinary items.

The salient features of the B-BBEE transaction that the Group implemented as well as the fact that the Group's annual financial statements has been prepared in accordance and in compliance with IFRS, significantly influenced some of the performance indicators.

Intergroup transactions

Intergroup transactions have not been eliminated for the purposes of reporting on the results of the individual businesses of the Group.

GROUP FINANCIAL RESULTS

Group revenue decreased by 14% to R887.0m (2018: R1 029.0m) for the period under review. Adjusted EBITDA is 65% lower at R64.5m (2018: R186.2m), adjusted profit for the period under review decreased by 86% to R11.8m (2018: R83.0m) while adjusted earnings attributable to the shareholders of the Group decreased by 90% to R6.5m (2018: R66.2m). Adjusted EPS was 88% lower at 40 cents (2018: 332 cents). The reported Group results include the unrealised IFRS adjustment in the fair value adjustment to biological assets, one-off and extraordinary items. These items are:

- the unrealised IFRS fair value adjustment to biological assets amounts to a negative adjustment of R32.1m before tax (2018: R55.5m positive adjustment) and R23.1m after tax (2018: R39.9m positive adjustment);

- an amount of R0.4m before tax and R0.2m after tax – the profit on the sale of the investment held in Ithuba Yethu Fishing (Pty) Ltd;
- finance and other costs relating to the implementation of the B-BBEE and other transactions of R24.6m (2018: R23.9m);
- an IFRS adjustment in relation to the Saldanha Protein transaction of R15.6m before tax (2018: R13.8m) and R11.2m after tax (2018: R9.9m);
- government incentives received in respect of developments amounting to R2.4m before tax (2018: R3.6m) and R1.7m after tax (2018: R2.6m);
- an amount of R16.0m before and after tax – mainly due to a credit loss allowance on the loan to Apco Investments (Pty) Ltd which arose from the sale of the investment held in Sea Pride Processors (Pty) Ltd and the interest in Oranjevis Joint Venture during the prior year; and
- the costs relating to the product recall (see below for more information) amounting to R39.9m before tax and R28.7m after tax.

Including the items above, a comprehensive loss of R89.9m was incurred for the period under review (2018: R135.5m profit) and EPS decreased from earnings of 561c per share in 2018 to a loss per share of 519c in 2019.

The Group's adjusted EBITDA margin decreased from 18% to 7%, mainly as a result of the lower production of fishmeal and fish oil. This was attributed to the decrease in the by-catch allocation resulting in lower catches and ultimately to a substantial decline in the profitability in the Saldanha Protein Group.

CASH FLOW AND FINANCIAL POSITION

Cash generated from operations was R74.9m (2018: R102.5m). Working capital decreased by R44m from 31 December 2018 to 31 December 2019. The Group invested R31.4m in property, plant and equipment compared to R44.7m in the previous reporting period. Dividends of R35.5m were paid to shareholders of the Company (including the B-BBEE entities) during the period under review (2018: R9.0m). The above resulted in cash and cash equivalents decreasing by R53.4m (2018: decrease of R5.6m) from R55.4m at 31 December 2018 to R2.1m at 31 December 2019.

Borrowings, including preference share funding, increased from R433.6m at 31 December 2018 to R450.9m at 31 December 2019. The Group's debt : equity ratio increased from 55% to 71%, while the net debt: equity ratio increased from 48% to 71% from 31 December 2018 to 31 December 2019.

The equity attributable to shareholders of the Group amounts to R484.3m (2018: R635.6m), including an amount of about R82.8m (2018: R105.9m) which is the cumulative unrealised after-tax profit from the valuation of the Group's biological abalone assets of R189.6m (2018: R215.4m).

OVERVIEW OF THE GROUP'S OPERATIONS

Canned fish

Canned pilchard produce is sold on the domestic market. The Saldanha brand holds an estimated 8% of the current market share.

No pilchards were produced from local fish (2018: 393 950 shrinks). 2 716 872 (2018: 3 052 275) shrinks were produced from imported cutlets.

Revenue increased by 14% to R426.7m (2018: R374.8m) for the period under review. Gross profit margins were substantially lower at 15% (2018: 20%). Due to the sluggish South African consumer market, management was forced to lower prices which impacted negatively on profit margins. This effect is observed throughout the industry.

The allocation of the Total Allowable Catch ("TAC") for our fishing rights holding company, West Point Fishing Corporation (Pty) Ltd ("WPFC") was substantially reduced to 423 tons (2018: 2 245 tons) for the 2019 year. At this volume it was not financially viable to send a vessel to sea in search of pilchard. WPFC thus sold 50% of this quota on an upfront payment basis to a company fishing in the Port Elizabeth area. Industry catches were at 58% of much reduced TAC, indicating that the resource is under severe pressure.

To mitigate the steady reduction in the pilchard TAC over the past years and to obtain sufficient stocks to supply the market, the division successfully sources quality frozen pilchard cutlets from Morocco. This supply has enabled us to continue operations and sales but at some margin contraction.

Product Recall

During late January 2020, West Point Processors (Pty) Ltd ("WPP") received isolated customer complaints relating to bloating and leaking cans. WPP immediately launched an investigation and proceeded with an inspection of the canned product held in the WPP warehouse. Additional cans with a similar defect were noted. It appeared that the problematic cans had been manufactured on production line 2. WPP then immediately secured the services of an external food safety consultant to advise and assist in the investigation.

In consultation with the NRCS, the Group proceeded with a voluntary isolation of the products produced on production line 2. This was done as a precautionary measure whilst further investigation into the root cause continued. On 24 February 2020, WPP released a press statement where all products produced during 2019 on production line 2 were recalled.

Related costs (product recall) incurred by Saldanha Sales and Marketing (Pty) Ltd and WPP amounted to R3.0m and R36.9m respectively.

WPP was fortunate to have product recall insurance cover, albeit only to a maximum of R10 million. In terms of IFRS, proceeds received from the insurer may only be accounted for in the year in which the funds are received. Therefore, insurance payments will be reflected in the 2020 annual financial results. Funds received thus far amounted to R5.2m with the balance expected towards the end of the financial year.

Fishmeal and Fish oil

Weaker fish landings resulted in a lower production of fishmeal and fish oil which led to a substantial decline in the profitability of this segment for the year under review.

The TAC allocation for anchovy was 30 800 tons (2018: 27 741 tons). Industry catches were at 47% of the TAC (2018: 80%), with WPFC being considerably higher at 65% i.e. 19 998 tons (2018: 32 274 tons). These low catches were mainly the result of the low by-catch allocation. Since 30 June, poor weather conditions and vessel maintenance challenges further hampered fishing activities.

The total industrial fish throughput to the processing facility equated to 46 485 tons (2018: 64 846 tons). Sales of 12 406 tons (2018: 20 576 tons) of fishmeal and 604 tons (2018: 1 122 tons) of fish oil were achieved. Fishmeal sales were supplemented by buying in fishmeal of 352 tons (2018: 4 647 tons), which historically substantially increased the profitability of this division.

During 2019, this buy-in fishmeal became very scarce at profitable margins, hence this, together with the substantial decrease in volume of fish catches were the major reasons for the decline in profits in this division. The fluctuation in the Rand weakening from an average rate of R13.44/USD in 2018 to R14.59/USD in 2019 contributed positively towards profitability. This was however negated by a decrease in the USD selling prices of fishmeal and fish oil. Further to this, changes in EU regulations on Food and Feed Safety contributed to additional costs to our manufacturing process.

Revenue decreased by 40% to R246.5m (2018: R414.2m) for the period under review. Gross profit margin was substantially lower at 13% (2018: 21%).

Horse Mackerel

TPF acquired a long-term right to catch 1.96% of the horse mackerel TAC. The current horse mackerel TAC decreased to 27 670 tons for the 2019 year (2018: 31 477 tons). A contract was negotiated with a third party to catch the horse mackerel but unfortunately no catching took place during the period under review.

Combined Operational Results - Canned Fish, Fishmeal & Fish Oil and Horse Mackerel

Revenue decreased by 15% to R674.4m (2018: R789.0m) for the year under review. EBITDA was 97% lower at R3.7m (2018: R121.0m) and a loss after tax of R9.0m was incurred (2018: profit after tax of R76.6m).

Abalone division

Aqunion

Market demand in our main market, Hong Kong (accounts for more than 60% of our sales), was negatively impacted by:

- pro-democracy protests;
- the ongoing USA - China trade war; and
- the growth in supply of small abalone from South Africa and China.

The Hong Kong economy contracted by 1.2% Year-on-Year, the first contraction in a decade, and by year-end the consumer-confidence index had fallen to its lowest level since 2009. The pro-democracy protests severely impacted the hotel, restaurant, and catering sector (HORECA) that constitutes the largest share of Aqunion's revenue stream. A drop on the demand side drove selling prices and sales volume downwards.

The above factors have resulted in total revenue decreasing by 18% to R144.5m (2018: R176.3m) for the period under review.

The reportable results of the abalone segment included the unrealised loss component of the IFRS fair value adjustment to biological assets which amounted to R32.1m (2018: R55.5m profit) before tax and R23.1m (2018: R39.9m profit) after tax. Taking the above-mentioned into consideration, together with intergroup finance cost of R24.7m (2018: R23.7m) before tax and R17.8m (2018: R17.1m) after tax, resulted in a loss of R27.9m (2018: R59.7m profit). Our contemporaries are all facing similar challenges.

Aqunion sold 281 tons (2018: 309 tons) of abalone, a decrease of 9% over the previous reporting period. The abalone biomass increased by 163 tons, from 383 tons at 31 December 2018 to 546 tons as at 31 December 2019, net of sales. The valuation of biological assets however decreased from R215.4m on 31 December

2018 to R189.6m as at 31 December 2019. It represents a devaluation of R25.8m (2018: R65m increase) that is mainly attributable to lower USD market prices for abalone and a stronger ZAR/USD exchange rate.

Aqunion's biological stock continues to fill its expanded production capacity, with biomass gain ahead of target at 525 tons, 18% higher vs a budgeted 445 tons. The growth in biological stock is a result of the expansion of production capacity, from 2015 to 2018. The full year harvest of 330 tons was 3% higher than for the same period in 2018 (319 tons) and 8% down, relative to budget (359 tons). Total costs increased to R125.6m, an increase of 2% relative to 2018, predominantly due to the higher biomass gain. Because of improvements and advancements in the production system, actual costs were 12% below budgeted costs.

The depressed market conditions, as alluded to above, coincided with the year in which our discrepancy between biomass gain (525 tons), which drives cost, and sales volume (281 tons), that generates revenue, is the greatest in our expansion. Aqunion responded by placing more focus on cost containment and developing sales channels outside of Hong Kong.

Aqunion started developing its sales channels in other markets prior to the beginning of 2019, already experiencing some short-term successes in terms of sales volumes. In particular, Aqunion relocated its Commercial Director to an office in Hong Kong in January, to be closer to our customers in the Asian region, and this marked a first for a South African abalone producer. While Hong Kong remained the sales destination for over 60% of our product, we sought alternative markets, achieving sales in the USA, China, Taiwan, Malaysia, Singapore, and Japan.

At the same time, we developed and launched a product for the dried abalone market which constituted roughly 6% of our annual sales volume by live-weight equivalent. We expect this product to make up a greater portion of our future sales, placing less reliance on our traditional canned and live abalone product lines. Finding its way into China, thereby also increasing our geographical sales diversity.

Given the depressed market conditions of 2019, improving our operational efficiencies remains priority as well as product and sales channel development to expand our global presence.

Abalone Feed (Marifeed)

Marifeed continued to maintain its strong position as the leading producer and supplier of abalone feed within the South African industry, achieving increased sales volume growth of 14% compared to 2018. Revenue decreased by 5% to R44.3m (2018: R46.8m), due to reductions in feed price given to support its customers in the abalone industry, pushing EBITDA 29% lower to R10.7m (2018: R15.0m).

Mussels (Blue Ocean Mussels)

Revenue increased by 23% to R32.7m (2018: R26.6m). Operating profit for the period under review was R4.3m (2018: R3.5m loss).

Operationally, Blue Ocean Mussels (Pty) Ltd ("BOM") sold 685 tons (2018: 570 tons) of mussels (fresh and processed combined), 20% higher than 2018. A substantial reduction in raw material wastage resulted in improved yields and efficiencies.

Because of sustained pressure amongst local competitors and the economic downturn, sales volume during the 2nd half of 2019 was significantly lower than expected. Downward price adjustments are not being considered at this stage as it is unlikely to ensure stock movement. However, the Blue Ocean brand is receiving favourable feedback from our two export markets. Management is pursuing exports into Japan, Vietnam, and Malaysia to supplement our move away from local market reliance.

The BOM farm is currently operating at 96% capacity with 44 rafts and an average of 735 ropes per raft. This puts the farm at a potential production capacity of 2,000 tons per year. At the time of the report this has not been realised since market conditions due to COVID-19 and environmental factors such as red-tide closures have hampered throughput and as a result the farm has not yet been necessitated to increase production to the required capacity.

DIVIDEND

Based on the Group's interim results, the directors declared an interim dividend of 50 cents (2018: total dividend of 85 cents) per share on 21 November 2019. The interim dividend was payable to shareholders registered in the records of the company on Monday 16 December 2019 and paid on Wednesday 18 December 2019.

On 2 October 2020, the directors declared an interim dividend of 50 cents for the 2020 financial year for payment to shareholders registered on 30 November 2020.

BOARD OF DIRECTORS

Mr BF Burger sadly passed away on 12 March 2020. We value his contribution to the Board and guidance and dedication to the Group during his tenure as director for nearly 27 years. Mr KA Sinclair resigned as director during the period under review and we thank him for his valuable contribution made to the Board. Mr I Strauss was appointed as a director on 1 July 2020.

FIVE YEAR REVIEW	2019	2018	2017	2016	2015
	R'000	R'000	R'000	R'000	R'000
Ordinary shareholders' interest	484,296	635,567	616,924	475,379	457,342
Minority interest	161,014	147,970	92,244	28,783	21,601
Total assets	1,326,262	1,455,073	1,315,285	662,121	630,331
Cash generated from operations	74,892	102,483	22,282	101,422	85,106
Net asset value per share (cents)[1]	3,093	3,569	3,071	2,836	2,753
Adjusted net asset value per share (cents) [1]	2,657	2,982	2,662	2,380	2,120
Revenue	886,985	1,028,519	493,344	476,554	351,626
Adjusted EBITDA for the year	64,488	186,196	66,746	108,562	100,818
Adjusted profit for the year	11,807	83,047	39,667	73,672	67,526
Total comprehensive (loss)/income attributed to ordinary shareholders	(83,955)	111,665	19,568	34,451	115,222
Adjusted profit attributed to ordinary shareholders	6,503	66,191	37,837	64,166	60,884
Group (loss)/earnings per share (cents) [2]	(519)	561	112	206	907
Adjusted group earnings per share (cents) [2]	40	332	216	384	479
Dividend declared i.r.o. of the year (cents)	50	85	45	45	110
Dividend paid per share (cents)	135	45	0	100	115
Number of shares issued (million)	16,037	16,974	20,086	16,763	16,613
Weighted number of shares issued (million)	16,177	19,920	17,534	16,710	12,698
Share price[3]					
- closing (cents)	3,750	3,750	3,200	2,400	1,493
- highest (cents)	3,760	3,750	3,200	2,400	1,600
- lowest (cents)	2,750	2,700	2,600	1,650	1,450

1. Based on net assets excluding IFRS adjustment for treasury shares. Denominator is the issued shares at the end of the year: 26,336,124 (2018: 25,022,524).
2. Denominator is the weighted average number of shares issued during the year: 16,176,663 (2018: 19,919,533).
3. Excludes estate, other transfers and new shares issued.

TRADING SUBSEQUENT TO THE 2019 REPORTING PERIOD

Despite the significant challenges we faced during the 2019 financial year as well as the impact of the Product Recall and the severity of COVID-19, the Group delivered a sound operational performance during the first half of the 2020 financial year.

STRATEGIC OUTLOOK

The Saldanha Protein Group currently exports fish meal to Turkey, Spain, and Denmark which is in line with our growth strategy. Management has successfully satisfied all the necessary requirements which enabled us to export to China. The first shipments to China were shipped during May 2020.

A team is being formed to investigate new technology and fishing methods in the Pelagic fishing sector. This information will guide management in the replacement of the ageing fleet of vessels. Offers to sell at least two vessels are currently being considered.

Management is currently in the process of employing a suitably qualified Food Technologist who will assist in food quality and new product development.

A committee has been formed to prepare for the 2021 rights allocation process as it is imperative that the Group reviews its overall commitment to transformation and job creation in order to ensure a successful application. The implementation of the B-BBEE transaction is part of the Group's strategy of transformation and positioning of the Group for the upcoming FRAP 2021.

We remain committed to advancing sustainability in our business by containing waste and consumption of water energy and carbon. Monitoring systems are being introduced to this effect. Management has outsourced the boiler and steam supply at the fish processing factory from 2019. Plans are currently underway to switch from coal to wood biomass as the main energy source in an effort to reduce greenhouse gas emissions (GHG).

The headwinds we face only strengthen our resolve to continue driving for growth and excellence and actively looking for opportunities in the crises. We will continue to de-risk from our reliance in Hong Kong and expand to new markets in Japan, Taiwan, Singapore, the USA, etc. We are driving hard at efficiency gains and cost containment everywhere and will investigate every opportunity to unlock the benefits of scale effects in all our activities and with our contemporaries. The short-run downturn does not deter us from our longer-term goal of creating value for all our shareholders. We are investigating several expansion opportunities in this regard.

VOTE OF THANKS

Firstly, I am incredibly grateful for the hard work and determination of our employees and senior management in striving to deliver value across the Group during these challenging times. I would also like to thank my colleagues on the board for their valuable contribution, support and insight that plays a vital role in our growth and the Group's long-term strategy. I deeply appreciate the loyalty and trust of our stakeholders and clients and their confidence in our business. Finally, on behalf of the Board, I extend our appreciation to all our employees and their families across the Group.

Prof ASM Karaan

Executive Chairman of the Board

27 October 2020