



Terrasan

CHAIRMAN'S REPORT 2020



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DEAR STAKEHOLDERS

We were deeply saddened by the passing of our Executive Chairman, Prof Mohammad Karaan on 13 January 2021. Prof Karaan joined the Terrasan Group Ltd ("Terrasan or the Group") as a director during 2010 and was appointed as Executive Chairman on 23 July 2012. His immense contribution to the Group and the Board during this period as well as his vision for the future of the Group remain invaluable.

Subsequent to Prof Karaan's passing, my fellow Board members appointed me as Non-Executive Chairman, effectively 1 July 2021.

The year, 2020 was an extraordinarily challenging year having to deal with the myriad challenges presented by the Covid-19 pandemic. The pandemic has had a tremendous impact on our nation, both economically and socially. We extend our sincerest condolences to those who have lost loved ones or suffered any kind of personal loss or financial hardship during this difficult time.

2020 required significant changes in how we work and live. These major shifts were especially evident in our aquaculture's dominant foodservice sector shifting supply to the retail sector. Despite the impact of the COVID-19 pandemic, the Group demonstrated its resilience and agility in protecting our employees and sustaining our operations. We implemented stringent new safety, health, and hygiene measures across all our operations to keep our people safe, while protecting each stage of the food supply chain to ensure the continued availability of product so that livelihoods and food security are not compromised.

COVID-19 devastated economies worldwide, wreaking havoc to an already weakened South African economy which shrank by 7% in 2020 (Stats SA), its worst performance in a century. It is expected that the economy will rebound by around 4.6% depending on progress made in relieving electricity constraints as well as in implementing other structural and governance reforms. Despite these challenges, the Group delivered solid financial results for the year ended 2020, which include the following highlights:

- trading revenue exceeding R1.07 billion (increasing by 21% from R887.0 million during 2019);
- operating profit of R122.8 million compared to an operating loss of R52.7 million in the comparative period;
- industrial fish throughput to our processing facility of 86 702 tons, up from 46 485 tons during 2019;

- abalone sales volumes of 496.7 tons representing an increase of 86% compared to the 267.7 tons over the 2019 reporting period; and
- improved debt ratios.

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 during the 2018 and 2019 financial years 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 increased by 21% to R1 070.9m (2019: R887.0m) for the period under review. Adjusted EBITDA is 191% higher at R191.7m (2019: R64.5m), adjusted profit for the period under review increased by 89% to R112.3m (2019: R11.8m) while adjusted earnings attributable to the shareholders of the Group increased to R81.7m from R6.5m in 2019. Adjusted EPS was significantly higher at 510 cents from 40 cents in 2019.

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 R38.4m before tax (2019: R32.1m) and R27.6m after tax (2019: R23.1m);

- finance and other costs relating to the implementation of the B-BBEE and other transactions of R17.2m (2019: R24.6m);
- an IFRS adjustment in relation to the acquisition of the Saldanha Protein Group transaction of R9.1m before tax (2019: R15.6m) and R6.6m after tax (2019: R11.2m);
- an amount of R8.3m as a share-based payment expense for the subscription by La Vie Seafood Products (Pty) Ltd (an entity fully owned by the B-BBEE shareholders of the Group) in West Point Processors (Pty) Ltd (“WPP”) in terms of the requirements of IFRS;
- an amount of R3.5m as a share-based payment expense for long-term share incentive options granted to employees; and
- the costs relating to the product recall (as fully reported on in our 2019 Annual Report as well as our Interim Results for 30 June 2020) amounting to R3.8m (2019: R39.9m) before tax and R2.7m (2019: R28.7m) after tax as well as proceeds from product recall insurance amounting to R9.5m before tax and R6.8m after tax received during 2020.

Including the items above, a total comprehensive profit of R53.3m was earned for the period under review (2019: R89.9m loss) and EPS increased from a loss per share of 519c in 2019 to earnings per share of 150c earnings in 2020.

The Group’s adjusted EBITDA margin increased from 7% to 18%, mainly as a result of the excellent results within our fishmeal and fish oil operations, which substantially improved the profitability of the Saldanha Protein Group.

CASH FLOW AND FINANCIAL POSITION

Cash generated from operations was R200.3m (2019: R74.9m). Working capital decreased by R66.4m from 31 December 2019 to 31 December 2020. The Group invested R26.1m in property, plant and equipment compared to R31.4m in the previous reporting period. Dividends of R13.2m were paid to shareholders of the Company (including the B-BBEE entities) during the period under review (2019: R35.5m). The above resulted in cash and cash equivalents increasing by R46.1m (2019: decrease of R53.4m) from R2.1m at 31 December 2019 to R48.2m at 31 December 2020.

Borrowings including preference share funding decreased from R450.9m at 31 December 2019 to R425.6m at 31 December 2020. The Group’s debt: equity ratio improved slightly from 71% to 69%, while the net debt: equity ratio improved from 71% to 62% from 31 December 2019 to 31 December 2020.

The equity attributable to shareholders of the Group amounts to R522.5m (2019: R484.3m), including an amount of about R55.1m (2019: R82.8m) which is the cumulative unrealised after-tax profit from the valuation of the Group’s biological abalone assets of R151.2m (2019: R189.6m).

OVERVIEW OF THE GROUP’S OPERATIONS

Canned fish

Canned pilchard produce is sold on the domestic market. Historically, the Saldanha brand held an estimated 8% of the market share.

The production of canned fish during the period under review, was significantly hampered as a result of the following:

- the product recall - during February 2020, WPP proceeded with the product recall which resulted in minimal production during the first quarter of the year as the root cause of the problem was being investigated;
- significant weakening of the Rand to the Euro - resulted in a substantial increase in the price of imported frozen cutlets; and
- severe shortage of frozen cutlets.

310,588 shrinks were produced from local fish (2019: nil) and 910,947 (2019: 2,716,872) shrinks were produced from imported cutlets.

As a result of the above the 2020 year saw a substantial decline in the sales of canned fish which severely impacted profitability. Revenue decreased by 33% to R286.5m (2019: R426.7m) for the period under review. Gross profit margins were substantially lower at 2% (2019: 5%).

The allocation of the Total Allowable Catch (“TAC”) for our fishing rights holding companies were increased to 1,642 tons (2019: 628 tons) for the 2020 year. At this volume it was not financially viable to send a vessel to sea in search of pilchard. Industry catches were at 46% of a relatively low TAC, indicating that the local resource is still under severe pressure.

Up to recently the division successfully sourced sufficient volumes of quality frozen pilchard cutlets from Morocco in order to mitigate the effect of the low local TAC. It is however critical for the division to diversify into more supply channels going forward and this is being expedited as a priority.

Product Recall

With reference to the product recall that we reported on extensively in our 2019 Annual Report, it is pleasing to report that the National Regulator for Compulsory Specifications’ (“NRCS”) technical committee approved the re-canning of recalled products following a report presented by NRCS Cape Town. WPP immediately commenced with the re-canning process and it is anticipated that all of the related products will be sold before the end of the 2021 financial year.

Fishmeal and Fish oil

During 2020, excellent fish landings, high processing yields and a weak rand were the main contributors to increased revenue from fish meal and fish oil, which led to a substantial increase in profitability. The group’s TAC allocation for anchovy was 41,486 tons (2019:

41,486 tons). Industry catches were at 81% of the TAC (2019: 47%), with Terrasan companies achieving a catch rate in line with that of the industry. WPP managed to secure 25% (2019: 21%) of the total industry landings to its factory. The additional 4% amounted to just more than 14,000 tons of fish.

The total industrial fish throughput to the processing facility equated to 86,702 tons (2019: 46,485 tons). Sales of 20,955 tons (2019: 12,406 tons) of fishmeal and 1,932 tons (2019: 604 tons) of fish oil were realised.

Revenue increased by 120% to R542.7m (2019: R246.5m) for the period under review. The gross profit margin was substantially higher at 34% (2019: 13%).

Horse Mackerel

The Group acquired a long-term right to catch 1.96% of the horse mackerel TAC. The horse mackerel TAC of 27 670 tons were in line with that of the prior year. During 2020 the full allocation was caught by a third-party vessel for which the group received R0.5m (2019: Nil).

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

Revenue increased by 24% to R835.4m (2019: R674.4m) for the year under review. EBITDA was exponentially higher at R164.5m (2019: R3.7m) and a profit after tax of R116.6m was achieved (2019: loss after tax of R76.6m).

Abalone (Aqunion)

By the end of 2019 Aqunion's biological stock had matured into its expanded production capacity, which was installed during 2015-2018. Thus, output increased by 45% to 479.5t (2019: 330.4t) for the period under review.

Unfortunately, the foodservice sector was of the hardest hit sectors by the pandemic because of lockdown levels imposed globally. Because this sector constitutes the larger share of Aqunion's revenue stream, the decline in economic activity impacted on the division's overall profitability.

In Hong Kong, travel restrictions to the city, shipping and flight limitations, as well as behavioural changes by consumers, affected the demand for abalone. In response to changing market conditions, Aqunion adjusted its market as well as its product mix by increasing its supply to the retail sector, shifting to a lower margin product mix.

Against this background total revenue increased by 22% to R176.8m (2019: R144.5m) for the period under review.

Sales volumes of 496.7 tons (2019: 267.7 tons) increased by 86% compared to the previous corresponding period. The abalone biomass increased by 50 tons, from 546 tons at 31 December 2019, to 596 tons at 31 December 2020, net of sales. The valuation of biological assets decreased from R189.6m as at

31 December 2019 to R151.2m as at 31 December 2020. It represents a decrease of R38.4m (2019: decrease R25.8m) that is attributable to a decrease in USD sales prices.

Despite 45% increased output and 86% higher sales volumes, total costs increased by only 3.9% to R126.4m (2019: 2.2% increase) due to a strategic focus on cost containment.

The reportable results of the abalone segment included the unrealised loss component of the IFRS fair value adjustment to biological assets which amounted to R38.4m before tax (2019: R32.1m) and R27.6m after tax (2019: R23.1m). Taking the above-mentioned into consideration, together with intergroup finance cost of R20.2m before tax (2019: R24.7m) and R14.6m after tax (2019: R17.8m) the loss for the reporting period decreased to R21.2m (2019: R27.9m).

The restrictions on travel and the depressed market conditions have made it more difficult to make progress on our long-term strategy of greater geographical market diversity and greater product diversity. However, we feel positive about the fact that in comparison to 2019, for the period under review, Aqunion has added another product to its offering, which now constitutes more than 10% of sales. Furthermore, sales into mainland China constituted greater than 10% of the total for the period under review (2019: 0%) and these sales were made up of three product types.

Given the current depressed market conditions we will continue to give more priority to reducing production cost than to high productivity, and we will continue to give priority to product and sales channel development.

Abalone feed (Marifeed)

Marifeed continued to maintain its strong position as the leading producer and supplier of abalone feed within the South African industry. However, due to cost-savings implemented by its customers, sales and revenue declined by 4%, compared to the previous corresponding period, to R42.6m (2019: 44.3m).

EBITDA decreased by 42% to R6.2m (2019: R10.7m) for the period under review.

Mussels (Blue Ocean Mussels)

Revenue decreased by 36% to R21.1m (2019: R32.7m).

Operating loss for the period under review was R7.3m (2019: R4.3m profit).

Operationally, Blue Ocean Mussels (Pty) Ltd ("BOM") sold 352 tons (2019: 685 tons) of mussels (fresh and processed combined), 49% lower than 2019. Further improvement in yields of 47% (2019: 46%) were obtained.

Sales volumes have not recovered towards the end of 2020 as was anticipated. This is as a result of sustained pressure from local competitors and most notably the economic retraction due to the COVID-19 pandemic.

Downward price adjustments are not being considered at this stage as it is unlikely to ensure stock movement.

The Blue Ocean brand is enjoying favourable feedback in our two export markets (USA and Singapore) and management is looking at diversifying exports to Australia as well to supplement our move away from local market reliance.

The BOM farm is currently operating at 87% capacity with 44 rafts and an average of 662 ropes per raft, a decrease from 2019 (96% capacity) as a result of storm damage during 2020. This puts the farm at a potential production capacity of 1500 - 1800 tons per year. However, this has not been realised as market conditions due to COVID-19 and environmental factors

such as red-tide closures and spawning 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 per share on 2 October 2020 for payment to shareholders registered on 30 November 2020. The dividend was paid on 15 December 2020.

On 2 September 2021, the directors declared a final dividend of 50 cents for the 2020 financial year for payment to shareholders registered on 16 November 2021. The dividend will be paid on 30 November 2021.

FIVE YEAR REVIEW	2020	2019	2018	2017	2016
	R'000	R'000	R'000	R'000	R'000
Ordinary shareholders' interest	522,545	484,296	635,567	616,924	475,379
Minority interest	120,232	161,014	147,970	92,244	28,783
Total assets	1,259,527	1,326,262	1,455,073	1,315,285	662,121
Cash generated from operations	200,340	74,892	102,483	22,282	101,422
Net asset value per share (cents) ¹	3,240	3,093	3,569	3,071	2,836
Adjusted net asset value per share (cents) ¹	2,949	2,657	2,982	2,662	2,380
Revenue	1,070,926	886,985	1,028,519	493,344	476,554
Adjusted EBITDA for the year	191,738	64,488	186,196	66,746	108,562
Adjusted profit for the year	112,347	11,807	83,047	39,667	73,672
Profit/(loss) attributed to ordinary shareholders	24,045	(83,955)	111,665	19,568	34,451
Adjusted profit attributed to ordinary shareholders	81,691	6,503	66,191	37,837	64,166
Group earnings/(loss) per share (cents) ²	150	(519)	561	112	206
Adjusted group earnings per share (cents) ²	510	40	332	216	384
Dividend declared i.r.o. of the year (cents)	100	50	85	45	45
Dividend paid per share (cents)	50	135	45	0	100
Number of shares issued (million)	16,023	16,037	16,974	20,086	16,763
Weighted number of shares issued (million)	16,030	16,177	19,920	17,534	16,710
Share price ³					
- closing (cents)	3,000	3,750	3,750	3,200	2,400
- highest (cents)	4,250	3,750	3,750	3,200	2,400
- lowest (cents)	3,000	2,750	2,700	2,600	1,650

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 (2020: 26,336,124).

2. Denominator is the weighted average number of shares issued during the year: 16 030 384 (2019: 16 176 663).

3. Excludes estate, other transfers and new shares issued.

BOARD OF DIRECTORS

There were no changes in the board of directors during the period under review.

NEW APPOINTMENTS

Mr Marthin Potgieter was appointed as General Manager for the Saldanha Protein Group with effect from 1 May 2021. Marthin, based in St Helena Bay, studied Mechanical Engineering and has 23 years collective experience in the pelagic fishing industry.

Effective 1 July 2021 Mr Danie du Toit was appointed as Group Chief Executive Officer. Danie holds a MCom in Business Management and served on a number of boards both locally and globally. He is a results-oriented top management executive with proven leadership and management skills in a number of sectors.

OUTLOOK

Notwithstanding a challenging year of significant change in the world in which we operate, we have taken decisive measures to ensure Terrasan's long term sustainability. We have seen good progress on Project Phoenix which will deleverage our balance sheet significantly alongside a step-up on operating cash flows.

A top priority of 2021 is the Fishing Rights Applications Process. We have set up a committee who are engaging in all the necessary efforts and resources to renew and expand our fishing rights. Pelagic fishing remains our mainstay and we will enhance our efforts to improve our strategy and operations.

In the spirit of post-pandemic recovery, renewal and refocusing we have conducted some deep reflections on our business with a view to make it more robust, resilient and future ready. In this context we have structured our objectives and focus-actions under Project *Re-imagined*. Looking longer term, with the Board's oversight, Terrasan's management has updated the strategy for the company. We have a credible pathway to realise Terrasan 2.0.

Key initiatives included a review and update of our corporate governance policies and procedures, improved risk management and a Group wide Environmental, Sustainability and Governance framework. We are also actively investigating the use of technology to improve our business performance that will create value sustainably for our stakeholders consistent with our business approach and strategy.

We continuously remain committed to the safety of our people and the communities where we operate, while maintaining the integrity of our operations.

ACKNOWLEDGEMENTS

To our clients and stakeholders we appreciate your continued support and confidence in our business. Thank you to my fellow Directors for their vision and support that played a vital role in our achievements to date and especially during the unprecedented challenges we faced over this period.

I would like to express my gratitude to our people across the Group, for their efforts and continued commitment and for the way they have risen to the challenges of the past year.

I would also like to express my appreciation to our shareholders for entrusting us with the leadership of this great Company and for your continued support.



Mr S Subramoney
Chairman of the Board
15 October 2021