

TRANSCRIPT

Grieg Seafood Q2 2022 Results

23 August 2022

Highlights

Andreas Kvame, CEO:

Welcome to the presentation of the second quarter of 2022 for Grieg Seafood. As usual it is Atle Harald Sandtorv, CFO in the company, and I, Andreas Kvame, who will hold this presentation. So let's get started.

We will go straight to the highlights of the quarter. We had a fantastic EBIT of NOK 986 million this quarter, which we are extremely pleased with. Prices have been exceptionally good which we have benefitted immensely from, but we have also had a very strong biological performance in the sea. Cooperation between production and the sales department has functioned well. We also decided to capitalize on the strong market in the second quarter by increasing our volumes. In addition, we released fish in Newfoundland which was a milestone for us. We released our first batch of fish in May, and by now we have been able to release pretty much everything we can there, which is about 2 million fish. Survival rates have been good for those fish, which we will come back to.

Our costs were NOK 48.60/kg in the quarter, somewhat lower than in Q2 2021, and we achieved NOK 42.70/kg for the Norwegian operations, even though we have faced significant inflationary pressures, which we will look more at later.

In the third quarter, we expect to harvest 21,400 tonnes and 87,000 tonnes for the entire year, slightly less than our previous guidance. I'll explain where and why a little later. We harvested 23,672 tonnes during the quarter and our sales were over NOK 2.3 billion, allowing us to achieve an EBIT of NOK 41.60/kg.

So over to the market, which has been exceptionally strong. This isn't a number that has changed since the last quarter, but minus 1 percent supply growth is still expected this year, mainly coming from the first half, with a small increase expected in market volumes in the second half. Looking at the totals for the first half, volumes fell 6.7% compared to last year. The drop in volumes has never been so high before. The biggest drop until now has been about 5% for six months compared to six months a year earlier. So that is a significant drop and goes a long way in explaining the strong prices, especially in the spot market.

The decline so far in harvest volumes is 4 percent for the half year, and we expect a 1% year-over-year increase in the second half. Most markets have naturally seen a decline in demand which is, of course, tied to a lack of supply. Another factor to be aware of is that there are basically no inventories of frozen fish out there. They have been emptied. So even if supply increases, you will normally see some of that going to replenish low frozen supplies, such as frozen portions and similar products.

What we have noticed is, even with record high prices for salmon, other proteins have also had substantial cost inflation, raising their prices in the same period. We still believe in a continued, strong

market, with strong demand for salmon. Even if inflation were to have a somewhat negative impact on demand, we are still expecting decent prices for salmon.

Prices have eased somewhat lately as a result of increased supplies, or due to demand easing below supplies in August, but we see the situation coming into balance during the year. The underlying demand for salmon is there, and we see that in all the markets we are operating in today but where prices will end up is not easy to say.

Then over to operations. We will take Rogaland first, where results were simply spectacular. There was a substantial decline in harvest volumes compared to the first quarter and with harvesting mostly taking place during the two last months of the quarter. Harvest volumes were 5,000 tonnes, revenues were NOK 480 million, operational EBIT was NOK 48.90/kg and farming costs were NOK 46.70/kg. This is the first time, at least for me, that EBIT/kg was higher than costs per kilo. That would be nice if it lasted! The average sales price was NOK 95.60/kg, sharply up vs. both a year ago and the previous quarter. So Rogaland supplied an EBIT of NOK 245 million this quarter.

Price achievement was also impacted by the size of the fish and our fish had the right sizes, with good average harvest weights. Much of our harvest was sold to good prices in the large fish segment, including the sushi market, which has become a sizeable market, and the Asian market.

The superior share was significantly up vs the year before, at 82%, which was also an improvement on the first quarter. This was better as both last year and the first quarter had winter ulcer impacts. Although this winter has had winter ulcers, things are moving in the right direction.

We have had good production in Rogaland, operations have been running very smoothly. Costs were stable in Q2, even though we had lower harvest volumes than in Q1. That's positive. We expect to harvest 7,100 tonnes in the third quarter, with most of that taking place late in the quarter. We are maintaining our production guidance of 30,000 tonnes for Rogaland.

Then over to Finnmark, where we harvested substantially higher volumes than in the first quarter or in Q2 2021. We had good harvest weights for our fish, even though prices were negatively impacted by contracts and some downgraded fish. Nevertheless, our superior share was 84%, up four percent versus Q1, and we were less impacted by winter ulcers than we were last year.

During the quarter, production and sales agreed that given the ongoing strong market, it was right to harvest higher volumes to capitalize on the strong market during the quarter. And this leads to the two reasons we are lowering our guidance for Finnmark. One is that by harvesting more, we are left with fewer fish in the sea, and the second reason is that in Finnmark we had significantly lower temperatures than we had anticipated. It has been cold, which you see in the feed sales figures. So we are lowering our volume guidance for this region by 2,000 tonnes.

Looking at the temperature profile we have had and the biomass that we have in the sea, Finnmark's production has actually been good. You just have to take in consideration the temperatures. Some of this could be recaptured in the autumn, it just depends on the weather.

Harvest costs per kilo were at NOK 40.60, which we are very, very satisfied with, and the operational EBIT of NOK 53/kg is nothing to scoff at. This was a very good quarter for Finnmark.

We also expect to harvest 7,100 tonnes in the third quarter there as well, with the lion's share of the harvest coming toward the end of the quarter in this region.

Then there's British Columbia, where we had a result in Canada of about NOK 31/kg, slightly down compared to the first quarter, and our operational EBIT was NOK 273 million, with farming costs of CAD 7.90/kg, modestly up compared to the first quarter. We also realized relatively good prices in the North American market, we had a superior share of 86%, up from 77% in the first quarter. This was mainly due to fewer issues with sexual maturation.

Production in British Columbia has gone well, satisfactory taking into account conditions. Production costs have been stable, and we have harvested from sites with relatively good biological performance. We expect BC production to be relatively similar to Rogaland and Finnmark, at 7,200 tonnes in Q3. And opposite of Norway the main part of this production will come early in the quarter. We will be harvesting a bit more fish for two reasons. One is to avoid sexual maturation, and on the other is make room to transfer new fish to sea during the autumn. This also means we will have somewhat lower average weights than otherwise desired in this area, but this is a choice we have made. In addition, with those lower average weights, we are reducing our production guidance for this region by 1,000 tonnes to 21,000 tonnes.

Newfoundland, a greenfield project, very, very exciting, but, of course, this is our first release of fish, so things could happen, but so far things are looking very good. The progression at our hatchery and smolt unit is good, the fish we have in the sea are growing well, with very low mortality, but we haven't had a winter yet, so we are cautious optimists about operations.

Freshwater production has gone well with good biology, and biology in the sea has also been good. We don't expect to harvest in this region until the end of 2023. The first fish released to sea in May should be close to 2 kg by Christmas, based on the growth we are seeing today.

In operations, our start-up costs were higher than we had hoped for, although we knew they could get that high, reaching NOK 37 million in the quarter, but this level will come down significantly during the next quarter.

Capex in this area is mainly sea production and, not least, things related to digitalization and the infrastructure around the Newfoundland operations which it supports.

Then we will look at the cost development for our regions. How are costs developing? Everyone is aware that there is a certain amount of inflation, we have seen it in fish feed prices. We have a war in Europe, and we have made a decision in Grieg Seafood that we don't want to use feed ingredients from Belarus or from Russia. We do not wish to contribute to Putin's war machinery in any way. We would like to praise Biomar, leading the way as a feed producer, taking a very clear standpoint about this at an early stage. We have taken our standpoint and aren't using any of those ingredients in our feed starting in the third quarter.

We are working very much on continuous improvement throughout our whole organization, which we have demonstrated well in recent quarters. We don't take any breaks from this work; it is extremely important that we work on productivity and efficiency in the whole organization. At the same time, you meet a wall when it comes to the external impact on costs, whether it be energy costs in all forms – fuel, electricity, etc. That means that even the cost of the box you put salmon in rises NOK 0.70-0.80 per kilo

guttled weight due to these costs, feed costs have risen substantially, and so on. This is like fighting windmills, it adds up, and we are fighting a battle to keep costs down, as we explained thoroughly at our capital markets day in June. There is a link in our report showing the measures we have taken, which you can look closer at, but the key thing is that we are continuing our programme with post-smolt and see that has an impact, a positive impact.

We have worked hard on prophylactic measures, for instance with salmon lice, sickness, etc., using digitalization to understand more of what is happening in the sea and make the right decisions. That is important for us, and integrating the operations in the whole value chain, having everyone in the organization interacting well with each other, and having transparency throughout the company, are extremely important. Not least, we have spare capacity, especially in Finnmark, and we need to utilize the MAB (*Maximum Allowed Biomass*) by 100% at all times. We aren't there, but that is a key area of focus for us.

I think I will leave it there, Atle Harald, and give the word to you to cover our financials.

Financial Review

Atle Harald Sandtorv, CFO:

Thank you, Andreas. Now we will look a little a little more closely at the financial figures, starting with the P&L. Our revenues were record high at NOK 2.3 billion this quarter, sharply higher than the same quarter last year, driven by higher market prices and higher volumes. Our operational EBIT was NOK 986 million, and below that we have three items not included in operational EBIT. First there is the production fee of NOK 6 million, followed by the negative fair value adjustment of the biomass of NOK 78 million, partly since spot prices fell during the quarter. Third, we have a separate cost item here of NOK 155 million. We have earlier informed about civil lawsuits in North America, including a stock exchange notification about this in the spring. What we have done here is to set aside a reserve of NOK 155 million for what we believe will be the total cost to end that case or process. That leads to an EBIT of NOK 747 million.

Net financial items were also positive this quarter, as lower net interest-bearing debt is lowering financial costs, but the big item this quarter was foreign exchange gains, especially related to the Norwegian krone Canadian dollar exchange rate, and the valuation of our assets in Canada which impact that item. So we had a positive NOK 117 million for net financial items. So that leads to profit before tax of NOK 864 million. After tax, profits were NOK 679 million.

Then we have analysed the development of EBIT/kg from Q1 2022 to Q2 2022, where we had an EBIT/kg in Q1 of NOK 26.80. Prices rose, making a positive contribution of NOK 18.10/kg, based on this analysis. Costs rose somewhat, with a negative contribution of NOK 5/kg, where Rogaland made the biggest contribution due to lower volumes, whereas farming costs in BC and Finnmark were relatively stable, rising slightly in BC, while declining slightly in Finnmark. Note that we are guiding for an increase in farming costs in Q3, as Andreas mentioned. Headquarter costs were slightly down in Q2, dropping by NOK 1.90/kg, so we ended up with an operational EBIT of NOK 41.60/kg in the quarter.

Then over to the development in net interest-bearing debt, which as I said is declining. We started the quarter with about NOK 1.7 billion in net-interest bearing debt, and we had a large positive contribution from EBITDA of NOK 1.1 billion while we have used NOK 45 million to increase biomass. Remember that

increased costs, especially from feed prices, impact the value of the biomass and increase the size of the working capital we have. We have invested NOK 168 million, we paid a dividend of NOK 337 million, and debt increased by NOK 309 million due to miscellaneous other balance sheet items. We thus ended the quarter with just below NOK 1.5 billion in net interest-bearing debt. That amounts to NOK 17/kg, well below our goal of NOK 30/kg.

A few more details about our debt. We have a green bond loan of roughly NOK 1.5 billion and a term loan of NOK 1.5 billion. That term loan is linked to sustainability indicators. Further, we have a revolving credit facility and an overdraft facility in the bank for a total of NOK 1.7 billion, which are both undrawn. We have leasing including IFRS 16 liabilities totalling NOK 909 million, and some other interest-bearing debt of NOK 115 million, giving total interest-bearing debt of NOK 4 billion.

If we subtract cash of NOK 2 billion, we get net interest-bearing debt including IFRS 16 debt of NOK 2 billion. Taking out the IFRS 16 leasing liabilities brings us to NOK 1.5 billion in net interest-bearing debt which we use in the overview here (*Slide 17*). Of our NOK 4 billion in debt, 75% is linked to sustainability. Our free liquidity consists of our cash and undrawn credit facilities, or NOK 2 billion and 1.7 billion for a total of NOK 3.7 billion.

Our equity ratio is 50%, or 52% measured according to bank covenants, so the situation is solid.

A little about our investments, where we invested NOK 168 million in Q2 and NOK 291 million so far this year. For the year our guidance is NOK 850 million, a little bit up from our prediction one quarter ago. That means that we will be investing a little more in the second half of the year than in the first half. Of that NOK 850 million, what we call maintenance investments are about NOK 300 million, which are pure replacements of existing investments, and there are NOK 550 million in growth investments.

Growth capex in Norway is largely new localities, while BC involves our new smolt facility which we have talked about earlier, and investments in semi-closed technology to reduce biological risk in BC. In Newfoundland, those investments are for new localities and infrastructure as Andreas highlighted.

We have guidance for working capital for the rest of the year, which relates to biomass, and we see the need for NOK 350 million in investment, and that must be seen in connection with the increased costs we see, especially for feed. That guidance is up slightly vs. our guidance last quarter.

To summarize the financials, net interest-bearing debt has declined significantly from the end of 2020, from over NOK 3.5 billion to NOK 1.5 billion now. This is old news, of course, because it has been driven by the sale of Shetland, but we have also been able to exploit a very strong market, and, not least, we have benefitted from a good and stable biology in this development.

We also paid a dividend of NOK 3/share the last quarter, and we are maintaining our policy of paying out 30-40% of the Group's net profit after tax. Otherwise I will repeat that our costs are rising due to inflation, making it very important for us to maintain focus on measures that can offset that impact. It is important for our daily operations and for our balance sheet. That remains our number one focus.

Then I give the word back to Andreas.

Outlook

Andreas Kvame, CEO:

Thanks, Atle Harald. Then we will look into the future. As we said earlier, we expect that for the second half, and into 2023, the market will remain very strong. We have come out of a Covid-19 situation, recruited new consumers to our market, the retail sector has gotten a real boost from this situation, and in addition, a lift from the HoReCa (*hotel, restaurant, catering*) segment recovering. Even with inflation or even recession in some markets, we believe that salmon is here to stay in many households.

There isn't a lot of supply out there, maximum one percent growth in the second half compared to last year, depending on feeding and the pace of harvesting. If the harvest is higher than that, it just means less salmon available in the first half next year.

We expect that 5-10% of our volume this year will go as VAP (*Value-added processing*), as we move along that path. The development has especially been positive in North America, but also in Norway. We are putting a lot of effort into this.

For this quarter, we expect contract coverage of 37%. We have some increase of volumes on contracts, but at the same time, volumes will decline some in the third quarter, which will increase the percentage on contract. We have done this intentionally, and we know that the third quarter has always been a challenge for Grieg Seafood to achieve stability.

When it comes to biology, things are looking very good so far. We did struggle some with temperatures in Finnmark in the second quarter, but now feeding is at the levels it ought to be and shall be at, given the fish we have in the sea there.

Our volume guidance for the year is 87,000 tonnes, with Rogaland supplying 30,000, Finnmark 36,000 and British Columbia producing 21,000 tonnes, which adds up to those 87,000 tonnes. At the same time, we try to be as agile as possible relative to the situation in the sea at any given time, and relative to the situation in the market, so if the opportunity presents itself, we will take advantage of a strong market in the third quarter, the fourth quarter, or in the first quarter. We will just have to see how things develop.

To summarize, we have had a record strong quarter we are pleased with, driven by very strong prices and a very good biological production in the company. We capitalized some on the strong market by harvesting some extra fish, and also reduced our risks in a region like BC, but we also harvested more in Finnmark, and that in retrospect was a sensible thing to do. We have also had good biological production in Newfoundland, and survival rates are very, very good. So, it remains to be seen how we do during the winter, but so far, we are optimistic about what we see in Newfoundland.

Cost inflation is something we have talked about for two to three quarters, but we see that it is there, and we are working hard at keeping it at as low a level as possible, but when it comes to this, it is a bit like fighting windmills, as I said earlier.

The way the market looks now is solid, and also going forward, even if there are a few bumps in the road, like now in August and September, when there is some vacation time in Europe while harvesting is increasing, but we will get back to that.

That was our summary, so then we will open for Q&A.

Q&A

Atle Harald Sandtorv, CFO:

We will start with one question from the internet, to take care of that, and that has to do with farming costs in BC.

Question from analyst:

Are farming costs in BC directly comparable to Norway, or do they contain other elements, such as freight? If not, why do they differ so much from Norway?

Andreas Kvame, CEO:

No, they are not directly comparable. First of all, we use a completely different recipe in this area. Smolt feed costs are somewhat higher there, and the freight component is different, even if most of the raw materials come from North and South America. Freight costs, due to infrastructure in BC, are somewhat more expensive.

Atle Harald Sandtorv, CFO:

And I would like to add to that foreign exchange rates are a factor if we measure costs in Norwegian kroner. If the Canadian dollar goes from 7 to 7.5 versus NOK, obviously that raises our Canadian costs when we measure them in NOK. So keep that in mind. Our next question comes from the room.

Wilhelm Røe, Danske Bank:

A little question about Newfoundland. You say that the biological results are very good, and mortality is low, but how does this compare to other operations that are in a start-up phase?

Andreas Kvame, CEO:

It is fully at their level or even better in Newfoundland, but this is an early phase of the first release. We can't reach too many conclusions yet, but as of today it looks very good.

Wilhelm Røe, Danske Bank:

Does that apply to both growth and mortality?

Andreas Kvame, CEO:

Yes.

Alexander Aukner, DNB:

We have recently seen that some of the input materials for feed have calmed down, especially on the land side. You are guiding for a rather dramatic cost increase in Q3, could you say that with today's prices for inputs to feed that Q4 will be on par with Q3, or do you see further risks for cost increases based on your costs in inventories?

Andreas Kvame, CEO:

Well with feed, things happen gradually, and we will see a significant increase in Q3, which is also tied to somewhat lower volumes involved, but looking forward to the fourth quarter, when it comes to feed costs, we expect a stabilization.

Alexander Aukner, DNB:

I am a little surprised. It looks like you are expecting the same cost increase in feed in Finnmark and Rogaland in Q3 compared to Q2, despite volumes increasing in Rogaland. Are there any special reasons, such as biological challenges or other things? Or could we expect that with higher volumes you get some cost dilution?

Andreas Kvame, CEO:

No it is more like it happened first in Rogaland because of post-smolt. But there aren't any other reasons other than volumes being the same in Finnmark and Rogaland in the third quarter. In general, you can say that the same cost increases show up everywhere, whether it is fuel or energy in the form of electricity, in the form of feed, and so on.

Alexander Aukner, DNB:

The last question regarding demand. You say that you see strong demand in all markets. Could you expand on what you mean by that?

Andreas Kvame, CEO:

Yes, because of what occurred during the pandemic and afterwards, especially in the retail sector, the retail sector for salmon is larger than it was before the pandemic. We have seen that happen before during other crises over the years. The same thing happened during the financial crisis, and now it has happened again. Even if demand were to ease a bit from HoReCa, you have a large customer base that will contribute to holding demand up, given that salmon doesn't become very much more expensive than alternative proteins. But there we also see inflation.

Carl-Emil Johannessen, Pareto:

A follow-up question on demand. You also write in your press release that you are worried that "... current inflation reducing household purchasing power, might impact demand from both the HoReCa and the retail segment." Is this something you have seen examples of, or is it something you write to be on the conservative side?

Andreas Kvame, CEO:

Well, well, we do like to be conservative, but there is, of course, a lot of talk in the market, there always is, whether the price is NOK 50 or NOK 70, that it is always too expensive, so that kind of talk has always been present, so you have to see through this a bit. We don't know how things will develop in Europe, with interest rate increases and general cost inflation. What will households do, which proteins will they choose? I do believe it is important that we are competitive against other proteins. And I don't expect another Q2 2022 result right away.

Carl-Emil Johannessen, Pareto:

A quick question about contract prices. Has anything happened to contract prices for the second half relative to the first half? I know it is a bit early to ask about next year, but are there expectations of achieving a substantial increase in prices for next year compared to this year?

Andreas Kvame, CEO:

Well maybe you are referring to what you have seen at Fishpool and Nasdaq. Most of our contracts were done last year. Then we chose the strategy of having rather low contract coverage in the first half of the year, and higher in the second half.

Carl-Emil Johannessen, Pareto:

Well I would claim that Fishpool is extremely high for next year (*Note: Fishpool forward price for year 2023 was NOK 78.50/kg on 22 August*). Is it realistic to achieve contracts close to the Fishpool prices for next year or is it difficult to get retailers to agree to that?

Andreas Kvame, CEO:

As I said before, it is difficult to get them to agree to 50, and it is difficult to get them to agree to 70. Right now there is a lot of uncertainty in the market about where things will end up and where they can commit to prices.

Carl-Emil Johannessen, Pareto:

Thanks.

Atle Harald Sandtorv, CFO:

Now there weren't any more questions, so we thank you all for your attendance.

Andreas Kvame, CEO:

Thanks for having us.