ABULON HOLDINGS Ltd

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24-04-2009

Background Information for Abulon Holdings SGM to be held on 26th May 2009

This report provides background information for shareholders on the current state of the company and, more specifically the implications of the new permit conditions, as stipulated by Marine & Coastal Management (M&CM), the government controlling body for our Industry, regarding the fungus which was detected on our farm in Paternoster and the subsequent enforced destocking of the farm.

As stated in the Notice to Shareholders dated 12-11-2007, and further reported on in the Cautionary Notice dated 15-05-2008 which was discussed at the 2008 AGM, a fungus was detected on the farm and although much has been done by experts to isolate and identify the exact nature of the fungus, the situation has not yet been resolved. However, we believe and have demonstrated that by using alternate farming techniques the fungus can be controlled and reduced to have minimal, if any, impact.

The real problem however is, that in the absence of a full understanding of the nature of the fungus, M&CM have, as a precautionary measure, implemented a very stringent set of conditions to our permit. In essence, they require that all farms which demonstrate the presence of the fungus must sell or dispose of the entire stock on the farm, and that the entire farming infrastructure be disinfected and left fallow for a period of six weeks. In addition to which, the experts are still considering whether it is feasible in the medium term to farm on the land even after ‘destocking’, as the fungi is said to be of a very hardy nature. This obviously has serious implications on the feasibility of the business in the short term, and consequently the future viability of the company.

In January 2008 our legal representation communicated with the Minister and challenged the Government’s extreme attitude in this regard. Since then we have continued to engage with the experts and with Marine & Coastal Management (M&CM) but have as yet been unable to persuade M&CM that this is not a major threat to the industry or to the well-being of wild abalone. At the last meeting held in December 2008, M&CM chose to ignore the evidence we produced that by changing from a ‘recirculation’ system of tank farming to a ‘through-flow’ system the presence of the fungus was substantially reduced with negative impacts brought under control. Our request for a new Risk Assessment Report to be carried out by an independent body was turned down and they subsequently issued our new Permit conditional upon a total ‘destocking’ of the farm by 30th April 2009. We have been told by the experts that no final scientific conclusions will be available for many months or even years.

Because our interventions with M&CM have not produced any positive outcome for the farm to date, we have been forced to follow a ‘destocking’ programme. We have used our best efforts to maximise the return to the business by allowing the longest grow out period for the animals on the farm during destocking. This has resulted in generating significantly higher revenue for the company. The destocking programme will have been completed in accordance with our new permit conditions by the end of April 2009. We have projected that the revenue from the sales of the resultant stock of canned abalone will result in approximately R3 million accruing to the business. This will be achieved as a result of taking off all the abalone on the farm. The business will have substantial cash reserves, but the farm being completely devoid of animals will unfortunately have no further earning potential until the re-introduction of spats.

The challenge facing Abulon Holdings management is which route to now take in the best interests of the company and its shareholders.

After seeking professional advice and considering the feasibility and risks, we are of the opinion that there are 3 possible options and require input from the shareholders to assist us in deciding what strategy to pursue:

1. Restock the current farm, after the destocking, decontamination and the six week fallow period.
2. Pursue the development of a new farm on land allocated to a joint venture by Paternoster Fisheries.
3. Enter into a voluntary ‘winding up’ and settle all debt. Distribute to the shareholders; the reserves after accrued net trading revenue from the business, funds from the disposal of current and fixed assets in the companies and proceeds from the sale of the ‘tax loss’ in the company.

Option 1: Restock the current farm.

In terms of our newly issued permit, we may restock the farm and continue operations on the same site, but at our own risk and subject to a 2 year quarantine period during which time we will be subjected to, REGULAR INSPECTIONS and NOT allowed to sell any animals LIVE.

The cash reserves can be used to restock the farm but the shortfall to fund the associated operating costs during the first four years of growth will have to be funded, from the introduction of additional working capital by, shareholders an investor or external borrowings.

Furthermore our lease for the current premises expires in 2013 and the landlord is not keen to extend the lease beyond the expiry date. Therefore the lease period is too short to accommodate the required growth of the animals to enable us to recoup our investment.

In addition the potential risk of the fungus recurring, even if only on one or two animals, is also a factor to be considered when making a decision.

Option 2: Set up a new Farm.

Setting up a new farm requires three major elements; land, capital and expertise.

A joint venture between a landowner, suitable investor and Abulon Holdings could bring all the necessary components together to create a profitable farm.

The estimated cost of bringing a 50ton farm to maturity is between R20 and R25 million (excluding the cost of land) and will normally take approximately 4 years after seeding the first tanks.

We have identified a partner who has land but its viability is still subject to a full Environmental Impact Assessment study and then all the necessary approvals. This process could take up to 2 years to complete. Assuming that this process reaches a successful conclusion and we are allowed to use the land for a new farm, we must then obtain adequate funding to develop the farming infrastructure and provide working capital.

To obtain funding is difficult and we have, to date, been unsuccessful in our endeavours to secure an investor's commitment.

The major issues for consideration in this case scenario are:

a) The costs incurred during the period before the new farm is developed;

(b) The risk of not succeeding with the application to use the land for mariculture purposes; and

(c) The risk of not being able to find and negotiate suitable funding.

These risks must be weighed against the potential returns which may accrue from a share in a joint venture partnership.

Option 3: 'Winding up' the Company.

Enter into a voluntary 'winding up' of the company and make a distribution to the shareholders: of the net realisable assets after providing for tax (if any) winding-up costs and contingent liabilities.

Given that the company has no significant creditors or liabilities, other than the inter-company loans which can be ignored, we will be able to enter into a voluntary 'winding-up' process followed by deregistering the company.

While we continue to pursue every avenue of opportunity, having duly considered all the options, it is the unanimous opinion of the Board of Directors, at this point in time, that we should follow Option 3 and wind-up the company.

Mark Dale
Chairman