

## Jumpstarting Chilean salmon industry

A huge crisis has fallen over this industry for the last twelve months. In 2008 it exported US\$ 2.47 billion and almost 445.000 net tons of fish. Half of them – in tonnage - were based on the Atlantic salmon; the other half, on the trout and Pacific salmon. The first ones were gravely affected by the ISA virus and farming was then stop until its causes were eradicated or better controlled. However, the industry appeared to be heavily indebted[1]: its total debt was thought to be close to US\$ 2.4 billion including banks, suppliers and other financial intermediaries. This debt, unless the industry creates the incentives to receive fresh resources to restart its most valuable Atlantic salmon production again, will not be worth its par value. In other words, the problem will not lie on the economics of this industry as an ongoing concern but on the excessive financial leverage and lack of new equity, after having had losses that could have compromised between a quarter and a half of its fish stock, or US\$ 400 to US\$ 800 million.

In approximate figures, to get one kilogram of salmon 1.4 kilograms of fishmeal or equivalent nutrients are needed. At US\$ 1.000 per ton of fish meal – at present prices - and considering a weight loss of approximately 30% of the farmed salmon when processed, feeding costs would amount to US\$ 2 per kilogram of “net” salmon. Assuming feeding costs account for nearly 50% of total cost, US\$ 4 per kilogram would be the operational cost to produce salmon – averaging all species -. On the other hand, the average sale price for salmon for the last twelve years, in US\$ 2008, was close to US\$ 5 per kilogram exported – FOB basis -. Under these approximate figures, a leveled industry annually exporting 400.000 net tons would then generate profits around US\$ 332 million per year, after taxes[2]; a leveled industry at 200.000 net tons, US\$ 166 million. Within this range, total industry debt would be serviced on a long term basis, but the eventual upside for present shareholders would be quite small. Under a now stressed industry, both financially and operationally – due to new sanitary standards and practices –; would the above situation be stable? The answer is no, due to lack of sufficient incentives for the present parties involved to get new resources to restart growth.

It would be naïve to expect from new debt terms – which basically afford for time - the return to a profitable and financially solvent industry. They seem more related to accounting magic than to economic reality. To attract new investments between US\$ 400 million and US\$ 800 million preferential shares seem more apt to the problem. They would be preferential to both old debt and equity and after having been paid, the excess would start flowing to old debt and equity. Old shareholders would bet on a feasible long term upside, old debt on a revitalized industry and new equity on an attractive shorter term return which would be limited in compensation for its preference. Present uncertainties distort too much economic values and produce too wide a range for them; a preferential share scheme does not need to enter into equity and debt value negotiations and eventual wealth transfers that when looked into perspective seem abusive. It just jumpstarts the industry, a potentially big accomplishment, indeed.

Given southern Chile natural conditions and the fact that world fisheries have seen its annual captures stagnated around 90 million tons for the last five years, but strongly grown under aquaculture to over 50 million tons from 40 million tons within that same period, long term prospects for salmon industry and other aquaculture species in Chile– irrelevant in terms of world volume - are good. The main actor, China, accounts for over 50 million tons per year, including capture and aquaculture productions[3].

From a policy point of view, the salmon industry to be revamped is clearly distinguishable from its individual actors. In that sense, it would not be right to "cartelize" the industry and artificially reduce fish farming permits so as to make more profitable its present members. This is also valid for the fishery capture in general, where there should exist a national quota and perhaps geographic ones, open to all who wanted to exploit its resources and not only to the present ones.

From a financial point of view, it is surprising how highly exposed the banking industry was to this "unknown" and heavily indebted industry, directly holding two thirds of its total debt. Its exposure, representing a little over 11% of its equity, is no small amount, considering its stress status. No wonder state guaranties and regulatory authorities are coming to their help, as they are apparently getting accustomed[4]. Would the banking industry have been under this situation if it had been a genuine competitive industry, with no implicit guarantees? Certainly not.

From a legal point of view, individual and sometimes arbitrary payment pressures based on our bankruptcy code have existed, to the detriment or endangering of a global solution. Reducing approval quorums to a restructured financial plan, as it is in the US, would greatly help to avoid in the future these weakening threats that take place under a non competitive banking industry that holds a destabilizing 60% of total credit – in the US, it represents less than 20% -.

The salmon industry is worth fighting for. If its solution encompasses a more thorough review to the banking industry, its practices and competitive level and bankruptcy laws, it would be definitely much better.

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[1] There are no official figures for the industry; majority of firms is privately held.

[2] Chilean corporate tax rate is 17%.

[3] World Review of Fisheries and Aquaculture, 2008, FAO.

[4] Fourth quarter 2008 banks received support from Pension Funds and Central Government holding their deposits.