

**BEFORE THE MARLBOROUGH SALMON FARM RELOCATION ADVISORY PANEL  
AT BLENHEIM**

**UNDER** the Resource Management Act 1991  
**IN THE MATTER** of Regulations under ss 360A and 360B of the Act  
**BETWEEN** **THE MINISTRY FOR PRIMARY INDUSTRIES**  
**Applicant**  
**AND** **THE MARLBOROUGH DISTRICT COUNCIL**

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**STATEMENT OF EVIDENCE OF ANDREW CHRISTOPHER CLARK IN SUPPORT OF THE  
NEW ZEALAND KING SALMON CO. LIMITED'S SUBMISSION  
Dated this 11th day of April 2017**

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 New Zealand King Salmon

## Introduction

- 1 I am the Chief Financial Officer for New Zealand King Salmon, a role I have held since 2011. I hold a Bachelor of Commerce from the University of Canterbury and a CA from Chartered Accountants Australia and New Zealand. My previous experience includes 17 years in the dairy industry, including time living and working in the United States, Venezuela, Uruguay and New Zealand, as well as experience with many other jurisdictions and commercial activities in Europe, Latin America and Asia and short periods living in Australia and Russia.
- 2 I will deal with a number of topics from the New Zealand King Salmon company submission and my personal submission.

## Supply and demand is incredibly positive

- 3 New Zealand King Salmon faces a very positive demand picture, in fact on reviewing compared to the situation in 2012 when we applied for waterspace under the EPA Board of Inquiry process, I believe that the current prospects are even more positive.
- 4 In the three financial years to June 2016, we grew our sales volume by 7% from 5,705mt to 6,115mt, and our revenue by 20% from \$95.1m to \$114.1m. Overall average selling price in NZ dollars thus increased by about 12%, due to a combination of outright price increases, a focus on better-returning markets, and on better-returning products.
- 5 In our Product Disclosure Statement (PDS) and related Prospective Financial Information (PFI) prepared in September 2016 in the lead-up to New Zealand King Salmon's Initial Public Offering and listing on the NZX and ASX, we projected further significant growth in sales volumes, allied to modest price increases. Our December 2016 interim results announcement affirmed that we were fully on track to achieve the 2017 projections, with volumes up 13% and revenue up 12% year on year. Since then our sales have continued to increase in line with our PDS projections.
- 6 I note that we have been able to implement at least one price increase in all markets within the last 12 months, with some markets seeing multiple increases. On a recent trip to the US to meet with customers I was reassured from conversations with customers that there remains significant untapped demand, we have a number of new customer initiatives and opportunities that will continue to grow our sales volume, whilst we will also be able to continue to secure price increases periodically.

- 7 My view is that the outlook beyond 2017 remains very positive. In our PFI we projected to sell around 6,900mt in FY2017, and around 7,500mt in FY2018, and I believe that we are fully on track to achieve those figures.
- 8 I believe our success has been based on branding, differentiation of our story and our product, and an absolute focus on the premium end of foodservice and retail both internationally and in New Zealand. We are one of only 7 producers of King salmon globally, or about 0.5% of global salmon production.
- 9 I note that in our PDS we projected that around 75% of our production growth would go into export markets. We launched the Ōra King brand in October 2012, and since then have grown our average selling price in NZ dollars for fresh export whole fish (this is effectively much of our Ōra King sales) from NZD 11.75/kg in 2012 to NZD 19.65/kg in 2016, an increase of 67% in five years and reflective of the strength of our story and the prices that customers are willing to pay to obtain what I believe is amongst the finest seafood that money can buy.
- 10 I presented at an investor and analyst seminar in Sydney last week, along with a range of other protein producers, and there were a number of unsolicited positive comments regarding the strength of our branding, the wonderful story around where our fish comes from, and the quality of our product.

**As a biological-based business we inherently face risk**

- 11 In my view it is not a question of whether we will have challenges, but when. Risk management is therefore critical to our business. We actively look to build resilience and flexibility into our business. Examples include:
- (a) Our target to develop the premium frozen market in Europe, as frozen allows some flexibility in harvest and planning timelines.
  - (b) A range of products that caters to fish size and quality. In FY2016, 28% of our sales were from smoked products, and a further 23% from fillets and portions. These products can take a less than perfect whole fish – say with scale loss from rubbing on a net, and turn the flesh inside into a top quality premium smoked product.
  - (c) Our goal is to be 100% branded and differentiated. In 2016 around 60% of our sales were branded all the way to the end consumer – restaurant diner or supermarket shopper. Branding builds certainty of business for us.
  - (d) Flexibility in input – we are able to thaw frozen input for smoking, and achieve a top quality product.
  - (e) Supply and demand mismatch – we are able to speed up or slow down our harvest timing without compromising fish quality. We use lights to manage

maturation and thus spoilage of fish. Growth may be better or worse than forecast, so we may need to speed up or slow down slightly. We are able to spawn eggs at various times during the year to manage fish size upon transfer to sea, and thus eventual harvest size.

- (f) Our vertical integration reduces reliance on others – many overseas salmon producers buy in smolt for example.
- (g) We hedge financial risks such as foreign exchange (up to 4 years ahead) and interest rate risk.

12 These factors are all about creating certainty for our business.

13 Low flow sites have a correlation with poorer fish health and performance, and thus more volatility in financial outcomes. Mortality correlations that we have found are high water temperatures, low water flow, and poor diet. Where 2 of the 3 are present we tend to struggle. I note that some submitters have mentioned concerns around potential for global warming to affect sea temperatures, and I thank them for that – it is exactly one of the reasons why we are supportive of the MPI relocation proposal to relocate to higher flow sites, as that improves one of the factors correlated with mortality.

14 To give a specific example, which is evident in our PDS – our worst mortality outcome was in FY2015, with 18.7% mortality overall. The mortality occurred in late summer on a low flow site – in February through April primarily. We had to cover a gap in our harvest plans for September / October of nearly 8 weeks. We were able to manage that through extensive work with customers, unfortunately having to ration sales to many customers for a significant period in order to slow sales, then blending year classes to maintain a range of fish sizes during the problem period.

**We can deal with that risk via relocation to high flow sites, which deliver much better outcomes than low flow sites**

15 Not only are the fish health and fish performance outcomes much better from high flow sites, but the economics are much better.

16 Economics of sites are critical. We already cross subsidise low flow sites with other high flow sites, for example we do not farm Otanerau through the summer due to historic mortality. Instead we put smolt to sea in high flow sites, then transfer them to Otanerau in April each year, to complete their growout and harvest by about December. The high flow site used for smolt entry thus cross-subsidises Otanerau.

17 Implementation of Best Management Practice (BMP) guidelines without relocation WILL put jobs at risk. According to the NIWA feed discharge projections, the low

flow sites are at best not viable on their own. We have projected (refer to PwC report prepared for MPI) that under the best case BMP NIWA feed projections, we could operate Otanerau, Forsyth and Waihinu for part years, cross-subsidised by high flow sites. At the lower end of the NIWA projected feed range if BMP were implemented on low flow sites, none of the six sites would be commercially viable even with cross-subsidisation from high flow sites.

- 18 The figures we provided to PwC indicated that fish produced in our Ruakaka low flow site are approximately \$1.50-\$2.00/kg more expensive than our Tory Channel high flow sites, due to higher mortality of low flow sites, and smaller scale. The total FY2016 New Zealand King Salmon EBITDA of \$13.8m equates to about \$2.25/kg, and our Net Profit of \$2.6m equates to about 40c/kg. It can easily be seen that \$1.50-\$2.00/kg is fundamental to our business!
- 19 As I've noted, low flow sites have significantly poorer survival rates. Each 1% in mortality is worth about \$1.2m pa to us in terms of cost of fish and the lost margin opportunity. With mortality currently at 11% in our PDS but as high as nearly 19% in the most challenging year, high flow sites are critically important to our overall business performance.

#### **High flow sites allow community expectations to be met**

- 20 I note that we want to improve our practices every year; we recognise that is important for pride in our product, perception of our customers and consumers, and critical for us to earn the right to operate in our local communities. Part of that is increasing compliance costs – additional monitoring requirements (for example, our EPA sites have 84 consent conditions, oversight by a Peer Review Panel and Tangata Whenua Panel, whereas some of the historic low flow sites have minimal conditions). That expectation has to be funded. To do that requires a profitable company, which can be achieved through high flow sites.
- 21 Biosecurity remains a risk area that can be improved via the relocation proposal. It would provide better opportunity through more space to be able to move towards single year class of fish on each site, which is something that we have done successfully in Pelorus Sound this summer. We remain reliant on strict NZ border controls and careful practices, and have been fortunate to avoid major biosecurity issues. A full relocation of all six farms is in my view the best option to improve biosecurity, as it would provide a good balance of production levels between Tory Channel and Pelorus Sound, whilst allowing sufficient sites to implement single year class.

#### **Community relationships are important to us**

- 22 The EPA process under the RMA was inherently very divisive for the community, as submitters were required to be in favour or against the proposal. The situation

became very emotive for many people, to the extent that some of our team members felt embarrassed to be identified as working with New Zealand King Salmon, with all the negative publicity that a few loud opposing submitters managed to create, along with what appeared to be very receptive media.

- 23 Since that time we have worked very hard to reach out to the community and build relationships – we would like to have the privilege of operating in perpetuity in the local community, and recognise that community support is only given once earned.
- 24 Initiation of BMP guidelines was a key way to work with Council and the local community to agree how best to operate and take concerns into account.
- 25 This proposal is also key to the longer term, via improving environmental and social outcomes, whilst allowing a more sustainable business in terms of fish performance and health, and therefore more steady profitability.
- 26 I note that our recent IPO has been valuable in terms of community involvement. We offered something which to our knowledge has not been offered before – a priority share pool based on residency – of Top of the South in our case. As a consequence we now have around 400 shareholders in the Nelson / Marlborough region, including about 60 team members.

#### **Investment in the future requires certainty**

- 27 Certainty of tenure is important – the investment for a typical new salmon farm is around \$6m, with a further \$8-10m of working capital, being mostly salmon in growout towards harvest. The aquaculture industry currently faces a significant risk with about 70% of licenses (mostly mussel licenses by number) expiring in 2024 – this includes several of our sites. To have the confidence to invest in new infrastructure, and job creation, requires certainty of tenure. The 35 year term for the EPA sites provides excellent certainty, whilst the 20 year term for recent renewals and adoption of BMP guidelines for Te Pangu and Clay Point sites provides a good degree of certainty. The relocation proposal would provide a good degree of certainty, with at least 20 year consents.

#### **We want to implement BMP guidelines**

- 28 Adoption of BMP guidelines as part of relocation also provides certainty, via consistency of standards across all farms, rather than the current variety of historic consent requirements.
- 29 We want to implement BMP guidelines as we see that it would be a positive in terms of overall brand perception, quite apart from being the right thing to do for the environment.

### **The relocation proposal will bring quality jobs to the Top of the South**

- 30 Projections in the PwC report are for a net increase of 261 direct roles in New Zealand King Salmon, as well as 146 others in the wider Top of South community through related industries and services. Our current headcount as at February 2017 is 443 people or 425 FTE. We believe that through the ongoing development of the three new farm sites granted via the EPA process, we will be able to create some 150 additional roles. Together with the 261 via a full relocation process, and further future opportunities that could be created through scale of related activities (eg processing of by-products), we eventually see opportunity for a total direct employment in New Zealand King Salmon of some 900 team members, which would be made up of some 400 in Nelson region, about 400 in Marlborough and a further 100 in other parts of NZ or overseas.
- 31 On a net basis I expect we will still increase total headcount due to development of new sites irrespective of whether existing low flow sites are in operation or not, however I note that we have previously been criticised by opposing submitters for not creating jobs fast enough, so it is somewhat disappointing to again see submitters opposing the potential creation of significant new jobs via relocation.
- 32 I note that in my view the PwC report is somewhat conservative in its estimates of GDP and FTE. The direct economic impact is noted as \$286k / 100mt salmon produced. In the FY2016 year New Zealand King Salmon sold approx 6,100mt, so therefore the Top of South direct economic impact should have been \$17.5m. In our audited financial statements we have disclosed payments to employees of \$27m - now, not all of them are Top of the South, but the vast majority are. So in payments to employees alone, we have more than the \$17.5m estimated in the PwC report – this is partly because our wages are above local averages (eg the starting wage in our Processing area is about 16% above the latest minimum wage and is about to be renegotiated so expected to increase). The direct economic impact will be more than that as we make supplier payments locally.
- 33 Direct FTE is noted as 3.05 per 100mt produced, or for 6,100mt would be 186 FTE directly employed by New Zealand King Salmon in the Top of the South. In Processing (all Top of the South) we have approx 240 employees (see PDS), and in seawater 85 - all of these are Top of the South. In addition there are sales and admin people in Top of South, as well as Takaka hatchery. The numbers are higher than quoted in the PwC report, as we have been hiring as we increased production with the new (EPA) farm sites coming on stream.

**Relocation of farms to most appropriate sites has precedent in other countries**

- 34 I have personally seen examples of salmon farms that have been relocated from poorer quality low flow waterspace to more appropriate higher flow locations, in both Norway and Canada.
- 35 In June 2016 I visited Norway as part of a delegation from NZ attending the biennial AquaVision industry strategy conference organised by Skretting. The mayor of the Rogaland province outlined the process by which farm relocations could be achieved via a local regulatory process including community involvement. The overriding impression I have from two visits to Norway is the way in which an industry 100x the size of the NZ salmon industry is present in unspoilt environments with minimal visual and environmental impact, and has been able to preserve opportunities for people to live and work in rural and provincial communities.
- 36 More recently (just last month) I visited a salmon farm in British Columbia, Canada, which had been moved from a low flow location to its current high flow location, again via a process involving the regulatory authority and local community consultation. There is clear successful precedent in both Norway and Canada for the current relocation process.
- 37 Even in Norway, however, the industry has to deal with misguided perceptions – Rogaland officials said to us last year that it is ironic that a new oil discovery is celebrated in Norway, yet some segments of the community think it is terrible when a new salmon license is issued.

**I have noted some written comments on this proposal that require addressing**

- 38 I have reviewed written comments in the economic or financial area by the McGuinness Institute, Kenepuru and Central Sounds Residents' Association (Kenepuru Residents'), and Environmental Defence Society (EDS) (refer to Appendix 1).
- 39 PwC has reviewed the economic reports in the Kenepuru Residents' and EDS submissions (refer to Appendix 2) and the 2016 McGuinness Institute report (refer to Appendix 3).

**I personally believe in and am very proud of what we do**

- 40 I am incredibly proud of our story, what we do and the way we do it. We are helping build Marlborough and New Zealand's reputation as producers of the finest food and beverages, pitched right at the premium end of the market.
- 41 I've chosen to work here because it's a story that I buy into, which motivates me much more than say pursuing a more lucrative career overseas. We are absolutely

proud of our story, the potential for our business, and wanting to do the right thing and make NZ a better place.

- 42 New Zealand will be exporting something – whether it is the finest food and beverages, or kids looking for jobs. I think we owe it to our children to seek improved environmental, social and economic outcomes so we create the choice and ability for them to work in regional New Zealand, or large cities in NZ or overseas.

#### **Conclusion**

- 43 My firm belief is that the farm relocation proposal represents a win:win for all stakeholders in terms of improving the environmental, social and economic outcomes from the salmon industry in the Top of the South. It is perhaps the best opportunity we will see in a generation.

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*Andrew Christopher Clark*

**Appendix 1: Review of other economic / financial submissions to MPI  
salmon farm relocation proposal**

## **Appendix 1 – review of other economic / financial submissions to MPI salmon farm relocation proposal**

### **McGuinness Institute**

I will respond to some aspects of this submission as I have personally observed some opposing submitters using previous McGuinness reports as gospel when in fact the reports contain various fundamental errors or do not present a balanced picture.

I asked PwC to review the McGuinness Institute 2016/02 report as this report in particular appears to be used by opposing submitters. Their report is attached and highlights various issues with the conclusions drawn in the McGuinness report.

Turning now to the latest submission. A brief review has identified many errors, which I have noted below. A number of these could have easily been solved by reference to publicly available information. The submission also appears to contain many unsubstantiated comments, which could create a misleading impression in the mind of a reader. Note that we have not had time to check all figures, so it is possible that some of the graphs contain further errors.

I contacted MPI four times suggesting that Wendy McGuinness contact me to discuss her outstanding questions to MPI. This contact between myself and MPI occurred on the 20th, 29th and 31st of March and on 24th April.

I am aware that at least the offer made on 31 March reached Ms McGuinness. This was not presented as a formal direction from MPI to Ms McGuinness but was added on to the end of answers to a list of questions.

I understand that the McGuinness Institute submission of 27 March was draft, pending further information which had been requested of NZKS indirectly through MPI on 29 and 31 March, and 24 April.

We wish to be transparent even with those whom we know are going to submit against us, as we believe that once people understand our business properly they are more likely to support us. Ms McGuinness has subsequently contacted me directly on 27 April, when she became aware of this Statement of Evidence of 11 April. Ms McGuinness was concerned I had misrepresented the situation by implying that she had been directly contacted by me and was avoiding my invitations.

### **Appendix 1 – letter to Minister for Primary Industry**

*Criticism of use of two different mechanisms within 5 years, to consider water space matters*

To my mind there are clear differences between an application for additional water space (the EPA / Board of Inquiry process) and relocation of existing water space (current proposal)

#### *Benefits to the Crown.*

There is a statement that NZKS has only contributed cash to the economy of \$1,009k in the last two years. This statement ignores \$4.8m of GST paid in FY2015 and \$4.2m paid in FY2016. It ignores more than \$25m pa paid to our team members in salaries and wages, the vast majority of which goes into the Top of the South economy, and will largely be spent in the NZ economy including via PAYE paid directly by NZKS to IRD, or GST paid by team members spending their salaries and wages. It ignores payments made to local suppliers for purchases of goods and services, some of which will also end up indirectly as GST or other taxes paid to the Crown.

Certainly a relocation to high flow sites will increase profitability (other things equal) and therefore increase NZKS' income tax payments, which may address the McGuinness Institute's concern.

It is noted that NZKS is not paying a direct levy for water use. However we have publicly indicated a number of times that we are willing to pay some form of user charge, provided that all water users such as jetty / mooring owners, marinas, and marine farms also do so. We do pay significant amounts for annual monitoring of seabed and water quality, which is information then provided to publicly available data sets.

There is a statement that the Crown allows the water to be polluted. It is unclear how the water is being polluted, given that the Marlborough Sounds has wild fish as well as NZKS' fish, and presumably wild fish would be doing similar activities in the sea water as our farmed fish.

#### *Risks to the Crown*

A list of 11 risks to the Crown is cited, without any evidence or assessment of likelihood / magnitude. This appears odd given that in Attachment B the McGuinness Institute has criticised PwC for failing to review the risks by probability or magnitude.

The list of risks includes risks which in my opinion have very little likelihood of occurring. Equally I could prepare a list of risks to this hearing, which might include the risk of a jumbo jet crashing through the roof, but without disclosing that it's highly unlikely.

#### **Attachment A: Perceived lack of independence – PwC economic assessment and EY review**

This attachment is particularly concerning as it makes a number of statements that do not appear to be factually correct.

It is noted that Wendy McGuinness was referred directly to NZKS. In fact, I was contacted by Bill Kaye-Blake regarding questions from Wendy McGuinness, this contact was in an email directed to both MPI and to me, wherein Bill noted he had been contacted by Wendy McGuinness with some questions. I responded volunteering that it would be easiest for Wendy to contact me directly, if appropriate, (as I considered I would be best placed to answer the questions or provide any further NZKS information).

It is noted that Bill Kaye-Blake was the "Economics Expert for King Salmon at the Board of Inquiry in 2012". The reality is that Bill Kaye-Blake was originally contracted by the EPA itself in 2011 prior to the hearing process, to independently review an economics report that NZKS' economics expert Dr Doug Fairgray had prepared. Then in 2012 during the hearing process, my understanding is that the Board of Inquiry, having heard evidence from a number of economists commissioned by both NZKS and opposing submitters, requested a peer review. Bill Kaye-Blake provided that peer review. Although it is recorded as rebuttal evidence with NZKS' legal counsel on the cover, the peer review makes comment regarding 5 economists including those supporting and against the proposal being considered by the EPA Board of Inquiry. In the peer review document these comments can clearly be seen – in my mind there is no suggestion that Bill Kaye-Blake was NZKS' expert witness.

I have only been with NZKS since 2011 however had made enquiries as to prior history regarding the reports noted by McGuinness Institute: a 2009 EY report and 2010 NZIER report, which were then reviewed by a 2010 LECG report commissioned by Ministry of Fisheries. My understanding is that NZKS was only peripherally involved in any of those reports – with the only contact being Mark Gillard attending a meeting of 1-2 hours with the head of Aquaculture NZ and consultants. My understanding is also that the 2010 NZIER report was authored by other persons shortly prior to Bill

Kaye-Blake joining NZIER. It is therefore hard to understand the McGuinness Institute comment that Bill Kaye-Blake has had a long relationship with NZKS.

Similarly with the current EY 2016 peer review of PwC's 2016 economic impact assessment report. To the best of my knowledge I have never met nor spoken with Chris Money. I'm not aware of Chris having spoken with anyone at NZKS. I believe I have met Peter Goss only once, when I was in a previous role with Fonterra in about 2006 or 2007. I believe the matter discussed at that time was milk price calculations. I have had no conversations or meetings with anyone from the EY team during their peer review process.

Note that the external audit is run out of Christchurch as noted by the McGuinness Institute submission. The EY Transaction Advisory Services work was run out of Auckland (not noted in McGuinness submission) and did not involve any Wellington based staff. My understanding is that the economic peer review was completed solely by Wellington staff.

It is interesting that the McGuinness Institute highlights potential conflicts of interest, but without the latest submission disclosing that Wendy McGuinness owns property in the Marlborough Sounds, although if you read the fine print in the 2016/02 report it is clearly disclosed that Wendy owns property on Arapawa Island.

#### **Attachment B: Concerns over the content of the PwC report**

McGuinness Institute raises concerns that there is not an assessment of demand and supply side, price sensitivity, risks, costs and benefits. I would highlight that NZKS has recently completed this exercise very thoroughly as part of our IPO, and preparing Product Disclosure Statement and Prospective Financial Information, both of which are documents with significant legal consequences if investors are misled. Directors do not sign such documents lightly.

In our PDS we highlight that we believe we are and will be supply-constrained – so that whatever volume is available can be sold, at premium prices. Our track record over the last 5 years supports this fully. As we stand, I can reiterate my view that we remain on track to achieve our PFI for FY17 and we are of course bound by NZX continuous disclosure obligations at all times.

There is a comment regarding overstatement of capital expenditure benefits if materials were purchased outside the Top of the South region. This is correct, and also explicitly highlighted in the PwC report. We have endeavoured to source materials locally where possible, including for example a current project building a new farm barge. In any event the ongoing economic impact of salmon production is way more important than the capital expenditure impact, and as noted in my evidence I believe the PwC report is somewhat conservative.

There is criticism regarding the lack of a timeframe for the economic assessment – I don't see this as an issue, on the assumption that NZKS will work to renew licences as they expire, thus benefits are annual and in perpetuity unless renewal does not occur.

We don't actually sell our salmon for \$17m per kg as stated in Attachment B. A visit to any supermarket would have revealed that \$17m per kg was an impossible price given it is freely available in retail for prices starting at about \$30 per kg for fresh fillets!

There is an odd discussion about "PwC used the figure of 6,028, whereas the reality was 6695". Although what is being talked about is not explicitly mentioned in Attachment B, I suspect it is most likely referring to our sales volume. The PwC report used 6,028mt as a forecast sales volume for FY2016. The eventual sales total was 6,115mt. The McGuinness Institute says our figure was 6,695,

having calculated it from the opening and closing livestock liveweight in the water and harvested volume. This of course does not necessarily bear any relationship to sales, as it fails to adjust for mortality, and also for the liveweight / gilled and gutted conversion factor. We actually provided full public disclosure of both our harvest and sales volumes, as well as the 0.88 conversion factor, in our PFI at pages 20 and 22. Note that the conversion between liveweight and gilled and gutted is standard industry practice. It can be found in the Marine Harvest handbook, an excellent industry reference book published annually by the largest salmon producer Marine Harvest of Norway, and which comes up readily in a Google search for (say) salmon industry information.

We also disclosed our selling price per kg by market on p26 of the PFI.

## **Appendix 2**

This version of the 2016 McGuinness Institute report appears to be the 6<sup>th</sup> version, with a number of previous revisions including after NZKS pointed out basic accounting errors in earlier versions.

## **Appendix 4**

These graphs do not appear to have any conclusions drawn – are the trends positive or negative?

Again there is confusion between liveweight and gilled and gutted sales, which explains the 2015 / 2016 point noted.

Figure 3 – harvest liveweight therefore wrong for 2016.

Figure 4 – not clear from this graph whether this is biological asset value (\$) to harvest (mt) ratio? It appears to be, although it would appropriate to highlight to the reader that 2016 biological assets are stated at fair value and thus well above cost, which has led to a higher ratio, other things equal.

Again it appears to be divided by the incorrect liveweight figure and thus not consistent with the earlier years.

## **Appendix 5**

The graphs show feed discharge stopping as consents expire. In the ordinary course of business we would hope and expect to renew at expiry. Our intention is to farm the sites sustainably in perpetuity.

It is unclear what purpose these graphs serve?

## **Appendix 6**

Selling prices are inaccurate for at least 2016 and from first glance, some other years as well – probably due to confusion over liveweight / gilled and gutted. In our PFI we disclose all data for 2014 onwards, which would allow calculation of these figures.

The harvest / sales graph has many inaccuracies:

- Y axis legend is noted as NZD/mt. In fact none of the figures are NZD/mt
- The “sales” figures are NZD 000s
- The “annual harvest (gilled and gutted)” is a mix of liveweight and gilled and gutted figures, with the 2015 and 2016 actual being liveweight, and the “budget” 2016 being gilled and gutted.
- Figures noted as “budget 2015/16” are not budget. They appear to be the forecast used by PwC.
- “Average price (NZD/kg)” is incorrect as noted above

## **Appendix 7**

Figures appear correct at first glance, except we are unsure where the 2016 figure of approximately 320 FTE comes from. The reality at June 2016 was 418 FTE, slightly up on the December 2015 figures disclosed on the GSI dashboard. 2016 figures will be disclosed soon.

#### **Questions from MPI**

Q1 – has highlighted that the current process does not follow the law – that seems an odd statement given that ss 360A and B, which are the proposed mechanism for the potential relocation, are part of the RMA!

Q5 – has highlighted costs (visual impact) but not benefits (existing farms removed). Again inconsistent with McGuinness Institute preferred approach that projects should be considered on their net benefit. Has highlighted feed discharge as pollution – irrespective of amount? Without noting that there is an economic and social benefit, that the benthic impact is reduced by using high flow farms, and that there are stringent monitoring processes for ensuring feed discharge “pollution” is managed sustainably.

Q27 and 29 has highlighted impact on king shags and Hector's dolphins without providing any evidence – I would have expected that evidence would be provided rather than an unsubstantiated comment.

### **Kenepuru and Central Sounds Residents' Association**

#### **Trevor Offen report**

##### **Summary – is the current proposal insignificant?**

In the summary, the Offen report states that the current proposal is insignificant to the Top of the South region as the local economy is \$4.5 Bn in size. I believe that view is completely irrelevant. Using this measure, most likely there would never be any new initiatives, as any initiative by itself is unlikely to be economically significant. My personal view is that the potential creation of about 400 new jobs in the Top of the South is actually very significant, as that means about 400 more families who will have the opportunity to move to or remain in a region with virtually unparalleled quality of life, **provided** they have access to jobs that pay at least a reasonable wage, which NZ King Salmon does.

##### **Net benefit vs gross benefit**

There is a view outlined in the summary and paras 3.5 and 3.6, and para 7.4 whereby only the net economic impact should be taken into account and that the region has limited economic resources. I believe this would understate the benefit of the current proposal.

Clearly if there are sufficient job opportunities in the Top of the South, then people will relocate to the region which will have positive flow on effects for the local economy. My understanding is that the Nelson region in particular is currently growing relatively strongly, in part due to population growth. The jobs in the relocation proposal do not currently exist, so will either attract more people or retain people in the region (rather than having to leave to find employment). I would expect that adding some 400 jobs (which do not currently exist) to the regional economy would add around \$20m in salaries and wages alone, most of which would be spent in the local economy, so it is hard to understand Mr Offen's calculation of a net economic benefit as only \$6.9m pa.

##### **Double counting?**

Mr Offen also mentions that the PwC report double counts GDP and FTEs. That is not my understanding from reading the PwC report –it highlights GDP impact, but **also** FTE (not seeking to

sum the two) simply because people are inevitably interested in whether a proposal will create jobs or not.

### **Financial viability**

In section 6 especially para 6.7, Mr Offen runs an argument that because NZ King Salmon already has access to new waterspace obtained through the EPA process that it can grow, there is no issue regarding commercial viability of existing low flow sites.

I agree that NZ King Salmon is currently commercially viable in total. And that as production grows on the new high flow sites obtained through the EPA process, it will remain commercially viable in total.

However existing sites will become unviable economically on an individual fully costed basis, so NZ King Salmon would make what is a rational decision and close those sites if not relocated and production drops to unviable levels under BMP, as expected by NIWA modelling. That economic activity will in fact be fully lost to the economy (not just the net change, as noted by Mr Offen – see above). Mr Offen implies this by saying it's ok because there is a net benefit through increased volume even if offset by existing sites not being viable. This completely misses the point that each site has its own viability calculation and will be operated or closed depending on that – which has an overall impact on NZ King Salmon and therefore the economy. It is perhaps fortunate that NZ King Salmon has access to new high flow sites to remain commercially viable in total.

I note a minor point in Mr Offen's analysis at para 6.3 whereby he states that 2018 EBITDA is expected to be \$26.1m. This is on a full IFRS basis, which includes non cash gains from biological assets (salmon) of \$3.7m, which shouldn't be included if one is calculating profitability. The amounts are clearly disclosed in our Prospective Financial Information prepared prior to IPO.

### **Other**

Finally regarding paragraph 7.11, nearly 50% of NZ King Salmon is held by New Zealand-based shareholders; Mr Offen's statement implies that the percentage is small. I agree the NZ shareholding is not predominantly in the Top of the South – the approx 400 shareholders in this region are mostly individual retail investors and whilst they make up about a quarter of our shareholders by number, it is a smaller percentage of shareholding.

## **Appendix 2: PwC review of economic reports in Kenepuru Residents' and EDS submissions**



**Private and Confidential**

Ministry for Primary Industries  
118 Vickerman Street  
Private Bag 14  
Nelson 7042  
Attention: Hamish Wilson  
Cc: Andrew Clark, NZ King Salmon

11 April 2017

***Marlborough Salmon Relocation: review of economics submissions***

Dear Hamish

In accordance with our contracts dated 2 May 2016 and 31 August 2016 and further discussions with MPI and New Zealand King Salmon, we provide some review points on the economic comments in the submissions received regarding the proposed salmon farm relocation. Please note, this document should be read in conjunction with the Restrictions in Appendix A.

***Background***

We have reviewed submissions proposed to the relocation proposal that provide critiques of PwC's economic impact assessment:

- the report of Offen Advisors Limited, supporting the submission of the Kenepuru and Central Sounds Residents Association Incorporated (the Offen report)
- NERA Economic Consulting submission (the NERA submission).

For each submission we will outline:

1. the key idea of the report or critique
2. any flaw in the model and/or reasoning used
3. the results based on correct model and/or reasoning.

***The Offen report***

***CBA methodology***

The Offen report is a cost-benefit analysis (CBA) "about understanding the economic benefit of a proposed relocation of six salmon farms (the benefit) so that this benefit can be assessed against the potential adverse environmental effects (the costs)." It focuses on the net economic benefit to the Nelson and Marlborough regions, after accounting for opportunity cost. The Offen report concludes

that the net annual economic benefit of the relocation proposal is insignificant to a combined Nelson and Marlborough economy with a GDP of \$4.5 billion per annum.

Correctly applying a CBA framework requires the right conclusion to be drawn from the model results. CBA weighs the economic benefits against opportunity costs of the proposal. It is important to keep in mind that the opportunity costs are the costs of the *next best alternative* use of resources.

Materiality or significance is irrelevant in a CBA framework. The Offen report suggests that we should consider the materiality of the impacts. Materiality, however, is an accounting concept and is not an economic decision-making concept.

A resource allocation decision rule is the only relevant consideration to a CBA. A CBA looks at whether the benefits outweigh the costs, whether the net economic gain is positive, or whether the project is the most efficient allocation of resources to a society. All of these are synonymous in the CBA framework.

The presence of economic gains (not materiality) determines the decision rule in a CBA framework. If risk and opportunity cost are properly accounted for, a net economic benefit of \$1 would mean a proposed project is \$1 more valuable to society than the next best alternative and is therefore the best allocation of resources.

The Offen report estimates a positive net economic benefit of \$73,746 per 100 tonnes per annum. The proposed relocation therefore offers an annual value of \$73,746 for each 100 tonnes produced, compared with the next best use of the resources. Under this result, the relocation proposal will result in the best use of scarce resource and, applying a CBA framework, supports relocation.

### *Dynamics*

The Offen report confuses scarcity with fixed resources. Resources are scarce, which gives them value, but not all resources are fixed into the future. The Offen report offers a static analysis premised on the assumption that labour resources will not increase. This ignores the reality of how resources change over time. If the regions are to grow in population, employment of labour is required and those jobs will be created by firm expansion and creation of business. The NZKS proposal is that some of these new jobs will be in salmon farming.

The critique in the Offen report, that the PwC analysis neglects the fixed supply of labour, is particularly important for temporary boosts to the economy. For example, estimates of economic impacts from one-off sporting events or concerts should give some consideration to temporary impacts on labour supply. The NZKS proposal is not for that type of temporary impact, but for a long-term contribution to the economy.

### *GDP and Employment*

The Offen report notes that the PwC assessment reports both the number of jobs that will be generated and the GDP impacts. The PwC report provides two different metrics because they provide two different pictures of the impacts. The PwC report does not imply any additional economic value is created from employment separate from value add. Reporting both value-add or GDP and employment impacts is standard for economic impacts assessments.

***The NERA submission***

The NERA submission responds to the use of input-output (IO) modelling in estimating economic impacts of relocating the six salmon farms. The NERA submission's main thesis is that PwC's analysis shows only that the increased production at the relocated salmon farms will generate additional economic impacts and that this is a tautological result.

There are two issues with the NERA submission, which likely reflect misunderstandings of the original engagement between PwC and MPI/NZKS:

1. The NERA submission is premised on an interpretation that the PwC report's results are intended to show economic benefits, not impacts. The PwC report was not presented as a cost-benefit analysis. The PwC report was prepared as an input into a process of "reviewing the performance and impacts of existing farms and developing recommendation for their future." The assessment was commissioned in accordance with this purpose and IO modelling is an appropriate method.
2. The second issue is the NERA submission misunderstands what the PwC report shows. The purpose of the PwC impact assessment was to estimate the size of the impacts, not to show that there are impacts. The NERA submission fails to take account that the purpose of the PwC assessment is to measure the impacts, not justify the relocation.

***Conclusion***

This information is provided subject to the restrictions noted in the Appendix to this letter.

Thank you for engaging PwC to conduct this analysis. We have found it an interesting assignment and hope the report provides some useful insights.

Yours sincerely

A handwritten signature in black ink, appearing to read 'W- VJB' with a long horizontal flourish extending to the right.

Bill Kaye-Blake  
Director  
Finance and Economics

## *Appendix A Restrictions*

This letter has been prepared solely for the purposes stated herein and should not be relied upon for any other purpose. We accept no liability to any party should it be used for any purpose other than that for which it was prepared.

This report is strictly confidential and (save to the extent required by applicable law and/or regulation) must not be released to any third party without our express written consent which is at our sole discretion.

To the fullest extent permitted by law, PwC accepts no duty of care to any third party in connection with the provision of this letter and/or any related information or explanation (together, the "Information"). Accordingly, regardless of the form of action, whether in contract, tort (including without limitation, negligence) or otherwise, and to the extent permitted by applicable law, PwC accepts no liability of any kind to any third party and disclaims all responsibility for the consequences of any third party acting or refraining to act in reliance on the Information.

We have not independently verified the accuracy of information provided to us, and have not conducted any form of audit in respect of the organisation for which work is completed. Accordingly, we express no opinion on the reliability, accuracy, or completeness of the information provided to us and upon which we have relied.

The statements and opinions expressed herein have been made in good faith, and on the basis that all information relied upon is true and accurate in all material respects, and not misleading by reason of omission or otherwise.

The statements and opinions expressed in this letter are based on information available as at the date of the letter.

We reserve the right, but will be under no obligation, to review or amend our letter, if any additional information, which was in existence on the date of this letter, was not brought to our attention, or subsequently comes to light.

This letter is issued pursuant to the terms and conditions set out in our contracts dated 02 May 2016 and 31 August 2016.

### **Appendix 3: PwC Review of the McGuinness Institute report on New Zealand King Salmon**

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# ***Review of the McGuinness Institute report on New Zealand King Salmon***

## **An economic and financial perspective**

*Ministry for Primary  
Industries*

*April 2017*



**Private and Confidential**

Ministry for Primary Industries  
118 Vickerman Street  
Private Bag 14  
Nelson 7042  
Attention: Hamish Wilson  
Cc: Andrew Clark, NZ King Salmon

11 April 2017

***Marlborough Salmon Relocation***

Dear Hamish

In accordance with our contracts dated 2 May 2016 and 31 August 2016 and project scope dated 10 March 2017, we present our report reviewing the McGuinness Institute's paper, 'New Zealand King Salmon: A Financial Perspective'. We also provide some discussion on the economic and financial perspective of New Zealand King Salmon, as it relates to policy, the development of new sites and the relocation of low-flow sites. Please note, this document should be read in conjunction with the Restrictions in Appendix A.

Thank you for engaging PwC to conduct this analysis. We have found it an interesting assignment and hope the report provides some useful insights.

Yours sincerely

A handwritten signature in black ink, appearing to read 'W- VSB'.

Bill Kaye-Blake  
Director  
Finance and Economics

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# *Executive summary*

This report explores issues raised by the McGuinness Institute in its working paper, 'New Zealand King Salmon: A Financial Perspective' (McGuinness Institute, 2016) (the Institute Paper). We discuss some of the issues raised in the Institute Paper using publicly available information about New Zealand King Salmon (NZKS), its operations and the regulatory environment in which it operates.

In essence, the Institute Paper makes specific assertions that NZKS's financial performance and position has deteriorated over time, and that it is vulnerable to a range of economic and financial shocks. This vulnerability is asserted to indicate that the putative economic benefits of NZKS's activities will not materialise, and consequently that the Government should not 'support' NZKS by allowing relocation of salmon farms in the Marlborough Sounds.

The Institute Paper derives from these specific assertions some general recommendations for greater financial and business disclosures by private firms that use public resources. The greater disclosures are intended to support decision making by resource consenting authorities (the inference being that current disclosures are inadequate for these parties to make appropriately informed decisions).

In relation to the Institute Paper's analysis of NZKS's financial performance and position, we make the following observations:

- NZKS has shown a profit in four of the six years from 2010 to 2015, and the profits have outweighed the losses over that period.
- NZKS's gross margins fall within the expected range for businesses in the primary sector.
- NZKS's capital structure shows modest levels of debt (ratio of Total Liabilities to Total Liabilities plus Total Equity of 26 per cent as at 31 December 2016)
- NZKS's working capital position and liquidity is positive
- NZKS manages a number of its key risks through insurance (biological events) and hedging (interest rate and currency exposures).

More generally, we note that NZKS has received a clean audit opinion in 2016, and has recently been successfully floated on the NZSE. We also note that the Institute Paper is incorrect in its application and interpretation of a number of the financial ratios or metrics that are used in its analysis.

## *NZKS's financial position is in shape*

The historical financial information between financial years 2010 and 2015 shows that although gross profit has decreased, it has remained at a satisfactory level for a primary industry firm. Historical net profit appears to fluctuate, but it has increased on average 6.4% each year from 2010 to 2015.

One issue raised is shareholder loans to NZKS, which are a bit like shares (equity) and a bit like debt. Companies have some scope for how they record funds from investors. This looks to be a historical choice by previous investors on how to structure NZKS's debt and equity. This does not relate to the NZKS's operation and is not a cause for concern. These shareholder loans were eliminated as part of the process in October 2016 to offer shares to the public, so public investors would be on equal footing with the other investors.

Finally NZKS has continued to hold more than enough current assets to satisfy its current liabilities, once adjusted for term debt that was recorded as current liabilities.

## *NZKS actively manages its risk exposures*

NZKS faces risks just like all businesses. These risks may be financial, economic or environmental. NZKS actively manages its risk in several ways.

- NZKS manages the risk of salmon mortalities using livestock insurance. Further the relocation of low-flow sites means the chances of significant mortality events are likely to decrease. NZKS also differentiates its product across diverse markets to manage the risk of falling salmon prices.
- NZKS's risk from increasing interest rates is not as big a problem as the Institute Paper suggests. Most of NZKS's debt was held by shareholders and incurred little interest. Most of the term debt with the company's bank was charged at a floating interest rate but this debt was locked in at a fixed rate by NZKS using other financial products.
- NZKS continues to actively manage its interest rate and exchange rate risks by using specific financial instruments. It uses financial instruments called derivatives to hedge risks of interest rate and foreign currency values changing.

### ***The proposed sites are economically beneficial***

- Improved environmental and community outcomes contribute to the regional economy and build community resilience. NZKS has resource consents to 11 seafarm sites in the Marlborough Sounds. Six low-flow seafarms are going to have difficulty complying with the BMP guidelines without significantly reducing production and employment. The Minister for Primary Industries has proposed relocating the six farms.
- Moving low-flow seafarms to sites where the water is deeper and has higher flows is expected to improve environmental impacts and productivity without changing surface space. This would provide more economic benefits through greater production within the BMP guidelines constraints without increasing the environmental impacts on the Marlborough region. This proposed relocation also translates into more employment in the region.

### ***NZKS is working for and with the wider community***

- NZKS, the Marlborough District Council (MDC), the Ministry for Primary Industries (MPI) and other key stakeholders and experts have worked together to develop the 'Best Management Practices for managing farms in the Marlborough Sounds' (the BMP guidelines). NZKS is committed to implementing the BMP guidelines on all their farms.
- NZKS is engaged in a collaborative process with MPI, MDC and the public around relocating some of its seafarms. The Minister for Primary Industries commenced a consultation process for relocating up to six seafarms in the Marlborough Sounds. The relocation is being considered as a way to ensure environmental outcomes are improved through implementation of the BMP guidelines, to create jobs, move farms away from areas of high-competing use and increase the economic benefits that salmon farming yields.

NZKS is voluntarily doing more than the resource consents and regulations require. The BMP guidelines are additional to the terms of its consents to operate seafarms in the Marlborough Sounds. An increase in production, employment and GDP contributions along with an improvement in environmental outcomes would provide ongoing benefits to the wider community.

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# Introduction

- As part of the ongoing MPI consultation process for the relocation of up to six seafarm sites, we have been asked to provide an independent view on the economic and financial issues raised in 'New Zealand King Salmon: A financial perspective' (McGuinness Institute, 2016) (the Institute Paper).
- The Institute Paper explores the relationship between public policy and actual practice by reviewing approvals granted to NZKS to use water space in the Marlborough Sounds. The Institute Paper is based on publicly available information, including NZKS's financial statements for the years ended 30 June 2010 to 30 June 2015. The version of the Institute Paper we have reviewed is dated 14 September 2016 and contains information up to that date.
- The Institute Paper makes observations about NZKS's business activities and financial position, and far-reaching policy recommendations to a range of public institutions, concerning what it calls 'private companies that utilise public resources'. The Institute Paper
  - chose NZKS as a case study of a private company using public resources, for which it suggested that more disclosure is necessary
  - directed some of its recommendations solely to NZKS based on publicly available financial information it has selected
  - made observations on the potential future economic impacts of salmon farming in the Marlborough Sounds
  - discussed NZKS's financial profitability and sustainability as well as its ability to realise economic benefits from its production activities.<sup>1</sup>
- The substantive sections of our report are structured as follows. First, we present the some discussion on policy around private firms that use public resources, information-disclosure requirements and regulatory processes. Secondly, we discuss financial observations made about NZKS. Thirdly, we discuss the risk management practices of NZKS. Fourthly, we discuss the economic impacts of the three new sites that were built in 2016 and from the potential relocation of low-flow sites.

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<sup>1</sup> The report explicitly states "it does not undertake any economic analysis of the salmon market or undertake any in-depth financial analysis of the company into the future." (McGuinness Institute, 2016, p. 1). Nevertheless, the actual discussion does undertake economic analysis and forecast.

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# *Policy recommendations from the Paper*

## *The Institute Paper lacks a policy framework*

The Institute Paper begins its case study suggesting a list of regulatory changes concerning public disclosure by private entities with government support and that make use of public resources. This discussion does not give any reasons for the suggested policy changes and does not justify them under any policy framework. For example, a common framework is The Treasury's Better Business Cases guidance. Using that approach, we might ask:

- What is the aim of the policy?
- What are the key drivers for changing policy?
- Are the potential gains of changing policy likely to exceed the costs of that change?
- What evidence is available to support the above?

The Institute Paper suggests that NZKS is a case study that demonstrates the need for policy changes for private companies making use of public resources. Importantly, it does not define which entities fit within this category, nor does it provide a rationale for this category or a framework for policy to ground the discussion. The Institute Paper does not explain why NZKS is an appropriate example of this class of companies or how this particular company was selected.

This lack of framework is particularly important when evaluating the choice of NZKS as a case study. Most firms in New Zealand make use of public resources in their business activities. Roads and electricity networks, for example, are used to some extent in the normal course of business, either by businesses themselves or their customers. Thus, the definition 'private company that makes use of public resources' is very broad. As a result, it is also important to understand what is relevant about NZKS that it becomes the single correct case study for understanding most New Zealand companies.

The Institute Paper also mentions private entities receiving government support. This is similarly a broad group of firms, who access various Ministries, agencies and Crown entities. Even the public support of standards through Standards New Zealand is support for various entities and business activities. Without a policy framework that describes the policy aims and drivers, it is unclear how NZKS represents a useful case study for this broad group of companies.

## *NZKS operates effectively within its regulations*

From the perspective of economics and policy, businesses require some level of certainty about the regulatory framework under which they operate. An uncertain policy environment increases business costs, reducing economic activity. Thus, policy change should have a goal or rationale. A regulator modifies policy in order to induce a behaviour change. Policies are then modified until the desired change is achieved.

The Institute Paper explains that a gap exists between what information is provided and what is required. The Institute Paper does not define what is required or why, but claims the goal of its ideal information disclosure is to ensure well-informed decisions regarding the use of public resources in the future. Importantly, the level of information required should consider both costs and benefits. It should seek to balance the costs of providing more information with the potential benefit of providing it. Economically, this level is probably not full disclosure of all information; that level is likely to be too costly and not beneficial. The regulator can, over time, determine the appropriate level of information provision and communicate with businesses to reduce uncertainty.

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NZKS has historically complied with disclosure regulations, except for a late filing of its 2014 financial statements with the Companies Office. The record of compliance does not appear to be at issue in the Institute Paper. NZKS is currently in compliance with disclosure regulations and makes public disclosures additional to the requirements of the Companies Office. These disclosures include feed statements formulations, food trust certifications and sustainability indicators.

NZKS has not had a major failure in its regulatory compliance. NZKS's late filing was a relatively small offence, met with a commensurate financial penalty. Further, unless there were major changes to operations, NZKS's previous financial statements would have served as a reasonable proxy for reviewing their operations.

Now that its shares are publicly traded, NZKS is also subject to more disclosures, including Tier 1 IFRS reporting and has already produced a set of half yearly financial statements for the period ended 31 December 2016.

NZKS has complied with the regulations that the Government has decided are appropriate, including the payment of a fine. These are the regulations that the Government has established as appropriate for managing and monitoring this business and this industry. Thus, any policy advice should work to demonstrate how poor result are being achieved even with full compliance.

## ***NZKS is involved in a collaborative process***

The Institute Paper appears to be concerned with the public having a voice in how public resources are used. Its policy advice is focused heavily on improving reporting, including use of integrated reporting. The unstated and untested assumption is that more information would improve public participation.

By contrast, NZKS and MPI are involved in a collaborative process that includes public participation. They are putting into practice a participatory approach to decision-making about public resources.

- The NZKS application to the Environmental Protection Authority in 2012 for new salmon farms in Marlborough highlighted the need for cooperation between industry, the MDC and the community when managing the effects of salmon farming on the environment (Marlborough Salmon Working Group, 2016)
- NZKS, MCD, MPI and other key stakeholders and experts have worked together to develop the BMP guidelines for managing farms in the Marlborough Sounds. NZKS has stated its commitment to implementing the BMP guidelines on all their farms
- NZKS is currently engaged in MPI's consultation process with MDC, iwi and the public around relocating its low-flow seafarm sites that do not or are not expected to comply with the BMP guidelines. The Minister for Primary Industries commenced a consultation process around relocating up to six seafarms in the Marlborough Sounds.
- The relocation is being considered as a way to ensure environmental outcomes are improved through implementing the BMP guidelines, with the added benefit of generating additional employment and benefits to the regional economy.
- NZKS, MPI and MDC are joined in a collaborative and open process to potentially establish new sites that meet the requirements of BMP guidelines. Instead of an adversarial system that focuses on pinpointing deficiencies in parties' arguments, the collaborative process allows issues to be explored in a more in-depth fashion.
- NZKS is actively involved in this process. The BMP guidelines were implemented in addition to the terms of its consents. Further, NZKS is bearing costs involved in the current process which reduces the burden on tax payers. It aim is to provide benefits to the wider community.

This work is attempting to assess the problems associated with site development, their size and importance, and, in a collaborative process to collectively solve these problems. A collaborative process can allow well-informed analysis and decision making over new seafarms and allow public engagement in the process.

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From an economic and policy perspective, there are different approaches to achieving regulation. The approaches may be collaborative, administrative, technocratic or adversarial, for example. Given that there is a process under way, any subsequent advice should consider how the choice of process affects the final outcome, and whether that outcome is achieving the desired policy aims.

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# *Financial observations*

- Following an elaboration of its concerns about the realisation of potential economic benefits, the Institute Paper makes financial observations about NZKS, including its financial sustainability and profitability. The Institute Paper is mechanical and selective in its use of specific accounting items and ratios to query NZKS's ability to deliver sustainable outcomes over the long term.
- The Institute Paper states that assessing a business for sustainability requires an understanding of what would happen if the company or bank had to sell the company's assets. Financial sustainability is not simply determined by the liquidation value of a company. Instead, financial sustainability is better assessed by examining the ability of a company to generate an operating profit sufficient to cover required returns on debt and equity, and for the company to be able to meet its liabilities as they fall due.
- We explore the relationship between profitability and financial sustainability and realising economic benefits. We dive down into the selected accounting items and ratios used to question stability and profitability and discuss the Institute's use of these items and ratios. In particular, we reference the information in the statement of financial performance dated 31 December 2016 (Figure 1).

## *NZKS is profitable*

- The Institute Paper makes several key observations on NZKS's profitability, including on sales revenue, gross profit and net profit. The Institute Paper's analysis does not lead to the conclusion that NZKS is financially unsustainable when from a profitability perspective.
- Sale of goods is up at \$114 million in 2016 compared with \$108 million in 2010. NZKS's gross profit as a percentage of sales (gross profit margin) is 26 per cent in 2016. As discussed by the Institute Paper, this gross profit margin was 37 per cent in 2010. This may imply, as the Institute Paper suggests, that the business is facing an increasingly competitive environment.
- The gross profit margin is at a reasonable level for a primary industry business. Gross profit margins for normal operations in primary industries range from five per cent to 30 per cent depending on what the business produces. For example, Kiwifruit budgets and export apple budgets have gross profit margins of 21 per cent and 29 per cent. Further, net profit fluctuates over business cycles. Overall NZKS net profit increased on average around six per cent each year each from 2010 to 2015.
- The Institute Paper states that retained earnings is the indicator of whether a company has made profits since it was established. Retained earnings indicates whether a company decided to keep or distribute profit to stakeholders over the relevant period. This is a management decision as to what capital is required to fund the future operations of the business. Indicators of whether a company has historically been profitable include profit measures including gross profit, operating profit, and net profit after tax.

## *NZKS' capital structure is under control*

- The Institute Paper explains that vulnerability to changes in interest rates is best illustrated in the case that the owners, rather than investing in the business, issued dividends and increased shareholder loans – in effect swapping equity for interest-free debt.
- NZKS's shareholder loans are like shares, in that funds come from shareholders, and like debt, in that they are obligations to repay funds. Companies have some scope as to how they receive funds from investors. The shareholder loans appeared to have been a choice by the investors of what amount of debt and equity should make up NZKS's capital structure. This does not translate into poor operations.

NEW ZEALAND KING SALMON INVESTMENTS LIMITED AND SUBSIDIARIES

Interim consolidated statement of financial position

AS AT 31 DECEMBER 2016

		31 December 2016	30 June 2016
		Unaudited	Audited
	Notes	\$000	\$000
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents		10,694	2,419
Trade and other receivables		16,210	10,229
Inventories	7	19,244	17,291
Biological assets	8	58,464	45,537
Income tax receivable		173	-
Non-current assets held for sale		421	421
Other financial assets	13	-	2,768
Derivative financial assets		832	526
<b>Total current assets</b>		<b>105,038</b>	<b>79,181</b>
<b>Non-current assets</b>			
Property, plant and equipment		34,294	32,596
Biological assets	8	8,828	7,413
Derivative financial assets		1,985	1,443
Intangible assets		3,800	3,868
Deferred tax asset		1,827	1,987
Goodwill		39,255	39,255
<b>Total non-current assets</b>		<b>89,689</b>	<b>86,542</b>
<b>TOTAL ASSETS</b>		<b>194,727</b>	<b>165,723</b>
<b>LIABILITIES</b>			
<b>Current liabilities</b>			
Interest-bearing loans and borrowings	9	1,239	19,328
Trade and other payables		21,424	15,416
Income tax payable		-	580
Employee benefits		2,481	2,384
Other financial liabilities		-	4,427
Shareholder loans		-	73,114
Derivative financial liabilities		1,820	2,319
<b>Total current liabilities</b>		<b>26,964</b>	<b>117,566</b>
<b>Non-current liabilities</b>			
Interest-bearing loans and borrowings	9	10,140	163
Employee benefits		434	465
Deferred tax liabilities		10,913	7,740
Derivative financial liabilities		1,508	2,775
<b>Total non-current liabilities</b>		<b>22,995</b>	<b>11,143</b>
<b>TOTAL LIABILITIES</b>		<b>49,959</b>	<b>128,709</b>
<b>NET ASSETS</b>		<b>144,768</b>	<b>37,014</b>
<b>EQUITY</b>			
<b>Equity attributed to equity holders of the company</b>			
Share capital	12	122,519	25,298
Reserves		(896)	(2,722)
Retained earnings		23,145	14,440
<b>TOTAL EQUITY</b>		<b>144,768</b>	<b>37,014</b>

For and on behalf of the Board, who authorised the issue of these interim financial statements on 28 February 2017.

Director

28 February 2017

Director

28 February 2017

The above interim consolidated statement of financial position should be read in conjunction with the accompanying notes.

Figure 1 NZKS Statement of financial position, 2016

- Shareholder loans are no longer a cause for concern. NZKS's shareholder loans were repaid in full as part of the process to offer shares to the public in October 2016, so New Zealand investors would be on equal footing with the other investors. The purpose of the initial public offer was to raise capital for New Zealand King Salmon to repay debt, fund future investment and working capital, and to enable its private equity investor, Direct Capital, to realise its investment by selling some of its shares (First NZ Capital and Macquarie Group, 2016). The interim financial statements show shareholder loans have been repaid in full.

The Institute Paper outlines that the debt-to-equity ratio is high and increasing from 0.78 (2009) to 0.83 (2015). The ratio presented in the Institute Paper is actually a debt-to-asset ratio, measuring the relative difference in total liabilities and total assets. The debt-to-equity and debt-to-asset ratios are intended to show, on a comparable basis, the proportions of debt and equity in a capital structure.

There are no longer any shareholder loans listed as liabilities on the balance sheet (New Zealand King Salmon Investments Limited, 2017). The interim half year results show NZKS's debt has been dramatically reduced to a debt-to-asset ratio of 26 per cent.

## ***NZKS has sufficient liquidity***

The last measure used to report the financial unsustainability of NZKS is the current ratio which the Institute Paper states is decreasing from 2.40 to 1.04 (McGuinness Institute, 2016). However, NZKS looks to have sufficient liquidity and has not shown signs of an inability to pay short-term creditors.

The current ratio is a measure of the liquidity in the form of working capital. A high current ratio is typically better than a low current ratio because it displays a company's ability to pay back its short-term creditors. A current ratio of less than one means the company would not be able to satisfy its current liabilities from if all its current assets were liquidated at their book value.

The Institute Paper implies NZKS has a liquidity problem because the current ratio is decreasing. However it does not take into account that some long-term debt is included in current liabilities. Some debt was included in the current liabilities because the expiry date fell within the 12 months following the balance sheet date (New Zealand King Salmon Investments Limited, 2015). However, debt does not reflect working capital management: interest bearing debt in current liabilities is simply a function of expiring facility. If we removed \$20 million of secured bank loans, the current ratio only fell to 1.59. Further, the interim financial statements as at 31 December 2016, the current ratio was 3.90 (or 4.08 when interest-bearing loans and borrowings are removed).

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# *Risk management*

The Institute Paper asserts that NZKS's financial statements indicate it is vulnerable to financial and environmental shocks, and therefore the Government should re-evaluate its support. These shocks include salmon mortalities, salmon price drops, banking crisis, exchange rate risk, rising interest costs, loan repayments and dividend requirements.

NZKS faces the prospects of shocks just like all businesses. A biologically-based business will face financial, economic and environmental shocks from time to time. Instead of worrying when shocks will occur, a viable business will plan in advance how to prepare for shocks and deal with them when they occur. Effective risk management can ensure the sustainable delivery of employment and earnings over the long term.

Publicly available information shows that NZKS actively manages this risk in several ways, highlighted below.

## *NZKS manages its salmon mortalities*

- Biological stock mortality is a risk to many agricultural businesses. Salmon farming is no different. Salmon mortality occurs due to environmental factors including warm water, feeding issues, algae bloom, predators and disease.
- The main impacts are decreases in production, which translate into lower sales and a threat against long-term viability of continued operations (see page 69 for a good explanation).
- Because of its potential severity, NZKS actively manages the risk to its business from salmon mortalities. NZKS projects mortality rates at 11 per cent of stock and classifies a 'mortality event' as 30 percent or more mortality at an individual site (First NZ Capital and Macquarie Group, 2016). NZKS has insurance cover in place to transfer the risk of mortality events. For example, mortality events in the financial year 2016 resulted in an expense of \$2.9 million, of which \$1.8 million was offset by insurance proceeds under its insurance policy that year.
- NZKS also effectively manages its farms. The prior mortality events occurred at the Waihinu-Forsyth seafarm during the financial years 2014 to 2016. The PDS explains that Waihinu-Forsyth seafarm has been fallowed. While its Waihinu site will no longer be used as a full seafarm, it is intended to be used in for the growth of smolt. Using the seafarm in this way is expected to avoid any future mortality events (First NZ Capital and Macquarie Group, 2016). Additionally, the relocation of low-flow sea farms to high-flow sites, detailed above, is expected to further mitigate the risk of mortality events.

## *NZKS differentiates its products*

- The Institute Paper also highlights the risk from decreases in the price of salmon. NZKS is subject to this price risk, having no significant influence on the world price of salmon. It is not uncommon for New Zealand exporters to face this risk: most exporters must accept world prices of their produce. NZKS manages this risk through branding, diversifying its product mix and exporting to different export markets, all as means of product differentiation.
- NZKS has three key brands: Ōra King Salmon, Regal and Southern Ocean. Products not sold under the three key brands are effectively unbranded (New Zealand King Salmon label). Its strategic focus is to increase the proportion of its sales under the three key brands. NZKS also has flexibility in product mix allowing for range of size and grades of salmon, to achieve premium branded output and thus prices. NZKS also exports to different markets with its top four exporting markets by revenue in 2016 being North America, Australia, Japan and Europe. (New Zealand King Salmon Investments Limited, 2016).
- By branding for different consumer demographics, firms are able buffer shocks to the demand for their products.

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## ***NZKS fixes its interest rate risk***

- Interest rates increase and decrease. NZKS's finances are affected by changing interest rates but its risk from increasing interest rates is not as concerning as the Institute Paper suggests. NZKS has exposure to interest rate changes due to its long-term debt obligations with floating interest rates. To mitigate the risk of changing interest rates, the financial statements reported that 95 and 100 per cent of this debt in 2015 and 2016, respectively, was fixed by NZKS using interest rate swaps.
- As outlined above, the shareholder loans have been paid off. Further, as at 31 December 2016, only \$10 million of NZKS's \$30 million secured loan facility had been drawn down (New Zealand King Salmon Investments Limited, 2017) the interim financial statements show that, despite its significantly reduced debt position, NZKS continues to actively manage its interest rate risk with interest rate swaps.

## ***NZKS hedges its currency risk***

- NZKS's business is exposed to changes in the value of currencies in which it pays for its feed and from which it receives revenue from sales. NZKS feed is currently paid for in Australian and US Dollars (First NZ Capital and Macquarie Group, 2016). The markets NZKS exports to include North America, Australia, Japan and Europe (New Zealand King Salmon Investments Limited, 2016).
- Like interest rate risk, NZKS continues actively manages its foreign exchange risk through the use specific financial products. These financial products are shown in the financial statements of NZKS, in a section on Financial Instruments. The company uses derivatives including forward contracts to lock in exchange rates and for effective planning.

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# *Economic impacts*

The last two sections of this report have shown that NZKS's financial sustainability and vulnerability to shocks should not cause concern about realising the economic impacts of its planned expansions and relocation, and accordingly are not a justification for the government withdrawing support or exclusive use of public resources.

We now examine the economic benefits claimed by NZKS from exclusively utilising publicly owned water resources. Such economic benefits include the changes in regional employment, benefits from exporting, as well as the multiplicative impacts on regional GDP through upward and downward linkages to other sectors of the regional economies.

## *NZKS's new sites will gradually provide benefits*

In December 2014, new consents were issued for three new farm sites in the Marlborough Sounds for a term of 35 years. Seafarms were selected at the chosen locations because they were high flow, expecting to provide more production with better environmental outcomes.

The Institute Paper highlights its concern that the economic benefits projected in 2012 may not prove as substantial as they were forecast. Using anecdotal evidence, the Institute explains its concerns about the new sites generating less than expected employment and export revenue.

The resource consents for the three new sites have been expected to provide gradual increases in production and employment based on environmental compliance monitoring. NZKS estimates these new seafarms will enable production to increase by approximately 50 per cent in the next five years and at full capacity, will allow existing production to double existing production (First NZ Capital and Macquarie Group, 2016).

The Institute Paper does not recognise that the realisation of economic benefits from these seafarms will be gradual, roughly in line with the way production increases. The expectation set in the Institute Paper does not allow for the gradual increase in production, output and employment which is beginning to be seen.

The evidence of Andrew Clark in the Board of Inquiry suggested it would take seven to ten years to bring the seafarms into full production. Further, the product disclosure statements states the firm production is expected to increase 50 per cent in the next five years. The first harvest from the first site, Waitata was only in July 2016. The job count was 440 jobs according to the product disclosure, implying headcount employment increased by 45 between November 2015 and September 2016.

## *Relocation to high-flow sites will provide more benefits*

NZKS has resource consents to 11 farm sites in the Marlborough Sounds. Six low-flow sites are going to have difficulty complying with the BMP guidelines without significantly reducing production and therefore employment. As outlined above, the Minister for Primary Industries has proposed relocating up to six farms. PwC was commissioned by MPI to complete an economic impact assessment of nine potential high-flow sites in Pelorus Sound, Tory Channel and Queen Charlotte Sound (PwC, 2016). As well as the nine potential sites, PwC's (2016) economic impacts assessment included assessing current low-flow sites, the same low-flow sites with production levels constrained by the BMP guidelines. Moving seafarms to high-flow is expected to improve environmental impacts and productivity without changing surface space of the seafarms.

NZKS is committed to implementing the BMP guidelines on all their sites. Production levels will be limited due to operational considerations, benthic impacts and commercial viability. The economic impacts from maximum allowable production under the BMP guidelines was calculated for the six low-flow sites individually, accounting for commercial viability and operational considerations for each site individually.

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PwC (2016) estimated the economic impacts from implementing maximum allowable production under the BMP guidelines as a loss of \$3.6 million in value-add and a loss of employment of 36 full time equivalents (FTEs).

PwC (2016) analysis further indicates that NZKS would make an economic contribution to the Nelson and Marlborough regions through its operations if any six of the nine high-flow sites were operated under the BMP guidelines. This would result in a minimum of \$22.8 million and employment of 238 FTEs per year added to the economy from the new sites. Compared to the baseline amounts of \$10.0 million per year and 105 FTEs per year, this is more than double the value-add and supported employment (\$12.8 million per year and 233 FTEs per year), without increasing the environmental footprint (PwC, 2016).

This means more economic benefits through greater production and employment within the BMP guidelines.

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# Conclusion

The Institute Paper attempts to explore the relationship between policy and practice by reviewing approvals granted to NZKS to use water space in the Marlborough Sounds. The Institute Paper is based on selected publicly available information, including NZKS's financial statements for the years ended 30 June 2010 to 30 June 2015.

The Institute Paper makes observations about NZKS's business and financial position, and far-reaching policy recommendations to a range of public institutions, concerning private companies that utilise public resources. The recommendations do not appear to rely on robust definitions for the entities affected or a structure policy framework. The Institute Paper directs some of its recommendations solely to NZKS based on the selected publicly available financial information on NZKS.

Our report has addressed some of the concerns raised by the Institute Paper. NZKS discloses sufficient information and complies with its regulations. Further, it is engaged in the community and involved in a collaborative process that could lead to better outcomes for the environment, the regional economy and the community. The company is profitable, has a stable capital structure and actively manages its risks. This combination is promising for financial sustainability and NZKS generating economic benefits and employment.

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We reserve the right, but will be under no obligation, to review or amend our Report, if any additional information, which was in existence on the date of this report, was not brought to our attention, or subsequently comes to light.

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