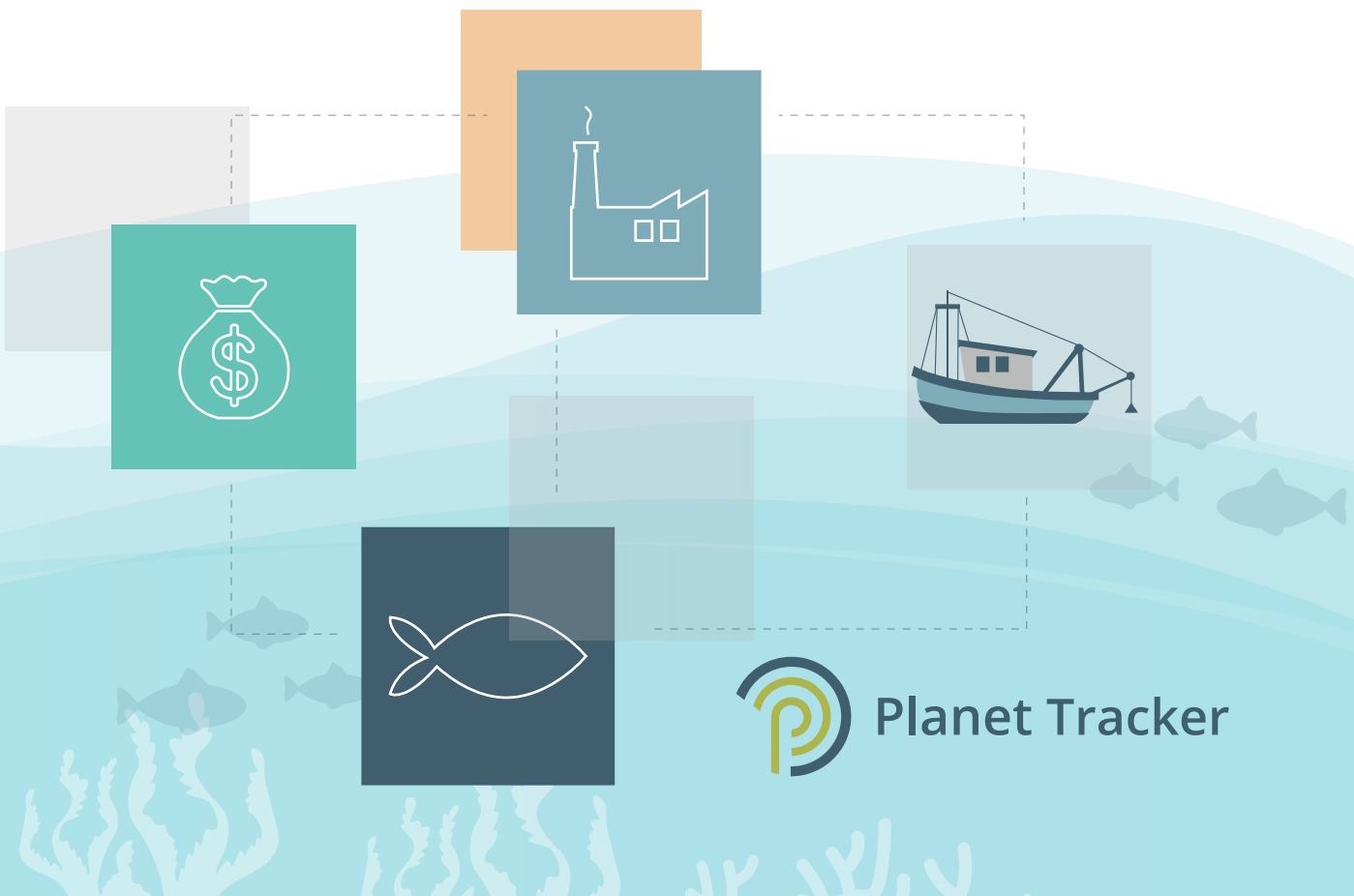


TRACEABLE RETURNS

*Traceability could double the margins of
seafood processing companies and increase
the sustainability of the entire seafood industry*

OCTOBER 2020



ABOUT PLANET TRACKER

Planet Tracker is a non-profit financial think tank aligning capital markets with planetary limits. It was created to investigate the risk of market failure related to environmental limits. This investigation is primarily for the investor community where environmental limits, other than climate change, are poorly understood, even more poorly communicated and not aligned with investor capital.

Planet Tracker generates breakthrough analytics to redefine how financial and environmental data interact with the aim of changing the practices of financial decision makers to help avoid both environmental collapse and financial failure.

SEAFOOD TRACKER

Seafood Tracker investigates the impact that financial institutions can have on sustainable corporate practices through their funding of publicly listed wild-catch and aquaculture companies.

Our aim is to align capital markets with the sustainable management of ocean and coastal marine resources.

This report focuses on seafood processing companies, which handle most of the world's seafood. Effective implementation of traceability solutions in this fragmented and low-margin industry could increase both its profitability and its sustainability.

Seafood Tracker is a part of the wider Planet Tracker Group of Initiatives.

ACKNOWLEDGEMENTS

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Planet Tracker would like to acknowledge the input of those who reviewed draft papers, including Mark Campanale, Bernd Cordes, Kees Lankester and Tony Long.



This report is funded in part by the Gordon and Betty Moore Foundation through the Finance Hub, which was created to advance sustainable finance.



PREFACE

Planet Tracker's research under the Seafood Tracker initiative has so far focused on investigating the financial and environmental stability of the commercial fishing and aquaculture industries, the starting points of the seafood supply chain. In 'Perfect Storm', Planet Tracker showed that rebuilding sustainable stocks of wild-catch fish could transform the seafood industry, increase profits, preserve its reputation and reduce financial risk to investors. PT's subsequent Tracker report on aquaculture, 'Loch-ed Profits', demonstrated that while salmon production is fast approaching the physical limits permitted by current coastal farming methods, the industry is still some way from moving to more sustainable and cost-effective methods at scale.

In this new Tracker Report, we move one notch down the seafood supply chain to focus on seafood processing companies, positioned half-way between harvesters (wild-catch fishing and aquaculture) and consumers. An under-researched industry, seafood processing is carried out by around 4,000 companies globally, which together handle most of the seafood produced globally. Many of them are also involved at other stages of the supply chain.

THIS REPORT HAS THREE PURPOSES

- 1** It maps out the universe of the seafood processing industry, analysing financials of public and private companies and establishing its key profit pools and sources of growth.
- 2** It also demonstrates how desirable traceability is for the seafood industry and outlines the opportunities of its industry-wide implementation, as well as the challenges to overcome, many of which are found at the processor level.
- 3** Lastly, it shows how seafood processing companies could become significantly more profitable and help increase the sustainability of the entire seafood industry by investing in traceability solutions.

KEY TAKEAWAYS

- Implementing seafood traceability could double the profit margin of fish processors while reducing investors' risks.
- Positioned between the harvesters and consumers, seafood processors that trace their products are pivotal to the process of validating sustainability claims.
- While there are recognised operational challenges, new global standards are overcoming the major issues of lack of interoperability and poor data capture and management.
- A handful of companies have become early traceability adopters, but more widespread implementation is needed and would reduce traceability gaps, to the benefit of the entire supply chain.
- We urge investors to engage with seafood processors to adopt traceability solutions to improve sustainability, profit margins and risk exposure.

EXECUTIVE SUMMARY

Seafood traceability is desirable and profitable

There is a growing gap between those who consume seafood and those who produce it. The number of retailers and consumers who care about the sustainability of their fish is increasing faster than the supply available to them from sources that are certified or rated as sustainable. About 75% of seafood sold today is not certified or rated as sustainable.¹ Sea to plate traceability – the ability to systematically identify seafood products, track their location and reveal any treatments or transformations they undergo – would go a very long way to bridge this gap. In short, traceability does not guarantee sustainability, but claims of sustainability cannot be guaranteed without traceability.

In spite of that, traceability is not yet widely implemented. Is it because traceability is not profitable? Planet Tracker's research shows that this argument just does not hold.

There are recognised obstacles...

Currently, the main obstacles to industry-wide traceability are a lack of interoperability between companies because of system incompatibility, poor data capture and management, and traceability gaps in the supply chain – sometimes caused, for instance, when a whole fish is mixed with others in processing. This lack of interoperability needs to change.

...and a solution is available

In March 2020, the Global Dialogue on Seafood Traceability (GDST) launched a set of traceability standards that at once are open-source, non-proprietary and based on a common digital language - the first and only set standards of its kind.



GDST is an international business to business platform, convened by the World Wildlife Fund (WWF) and the Global Food Traceability Center, and guided by a steering committee that includes thirteen companies and associations across the seafood value chain and across the world. As such, the steering committee and the wider GDST membership very deliberately designed the new standards to be used by all types of companies, from independent fishers using a mobile phone to large integrated seafood companies and large retailers. It protects business-sensitive information while facilitating regulatory compliance.

While the GDST standards leave room for improvement, their near-term industry-wide adoption would seriously reduce the lack of interoperability among companies along the supply chain and encourage better data capture and management. Many large retailers have already pledged to adopt and implement them. Yet among large, listed seafood producers and processors, so far only Thai Union (Thailand) has publicly pledged to do the same.

Seafood processors are key to implementation

Traceability gaps in the supply chain are most pronounced at mixing points, such as when seafood is processed. Therefore, this report seeks to highlight questions of profitability and practicality in the seafood processing industry. These companies convert whole seafood into a variety of other products, such as fresh fish fillets or steaks, or frozen, canned or smoked products. They are instrumental in the pursuit of traceability.

Shining a light on the processors

Positioned half-way between the harvesters of wild-catch fish and aquaculture and the consumers, in long, complex and transnational supply chains, seafood processors handle most of the fish produced worldwide. 89 companies engaged in seafood processing are listed on stock exchanges globally, but beyond that little is known about this USD 140 billion industry. It is dominated by companies based in Japan, Norway, the United States and Thailand, but seafood processing is often only one of a range of business activities for those companies, and their supply chains very often span many countries and time zones. Planet Tracker has outlined the fragmented nature of the seafood processing industry, which comprises more than 4,000 companies globally. Our research reveals that the most fragmented markets, notably Japan and China, are also among the least profitable for seafood processors – see Figure 1.

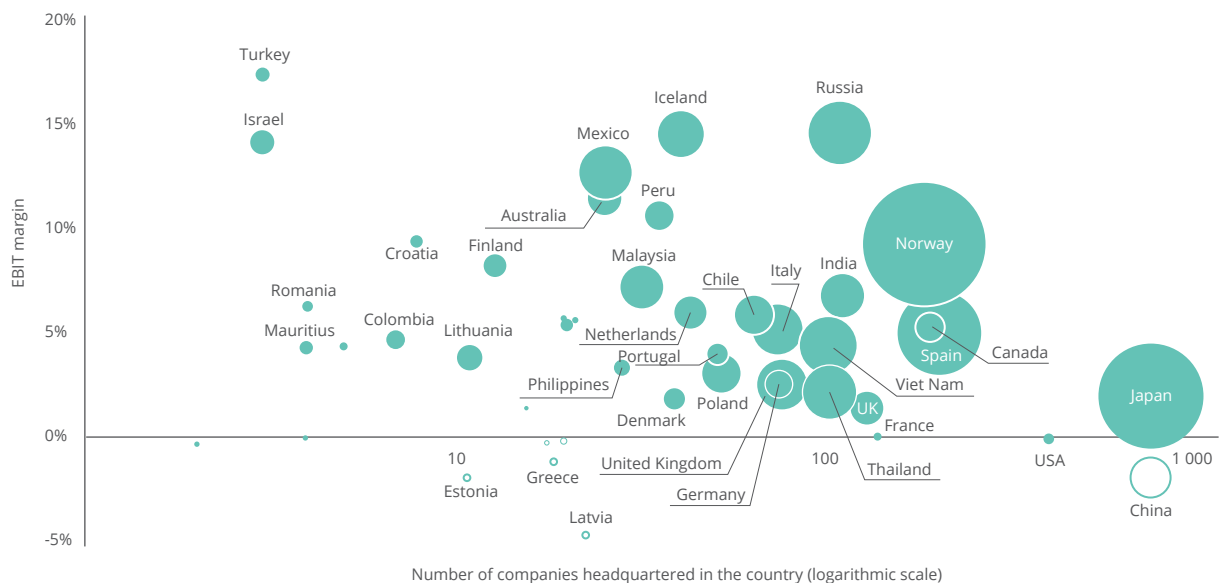


Figure 1: Seafood Processing Companies: EBIT Margin and Number of Companies per Country (size of the bubble proportional to the country's profit pool).²

Note: countries where the estimated EBIT margin is negative (e.g. China) have no infill colour.



Struggling to improve profit margins

For company executives wishing to tackle the low profitability of the seafood processing industry - which records a 3.4% earnings margin before interest and tax (EBIT) on average - several options exist. Among them are:

- Volume growth, but that risks putting further pressure on fish stocks;
- Price inflation, which is challenging in a fiercely competitive industry;
- Lower costs, which are difficult for many of the smaller players if the capital expenditure is significant; and/or
- Consolidation, which is a constant in the seafood industry, explaining two-thirds of 2017-19 revenue growth by Planet Tracker's calculations.

Traceability is an attractive investment

Traceability represents another, viable option. This report demonstrates that traceability is a very compelling way to reduce costs and increase margins for seafood processors. If we analyse the financial position of the typical seafood processor, we can show that implementing a GDST-compliant traceability solution can double the EBIT margins of the typical seafood processor. Fewer product recalls, lower product waste and a decline in legal costs mainly explain that three percentage points (%pts) margin gain.

Comparing traceability to acquisitions

With evidence that traceability is a value-creating investment for seafood processors, we decided to compare it to the important strategic option of acquisitions. Ever present in this fragmented industry - there were 400 transactions in the last decade - mergers and acquisitions (M&A) could become even more enticing, especially for consolidators looking to take advantage of the COVID-19 related challenges faced by some companies. As of June 2020, the combined value of M&A transactions in the seafood industry this year was one of the highest in the past decade. Despite the industry's traditional preference for M&A, Planet Tracker demonstrates that traceability is likely to be a better proposition financially: synergies related to M&A are unlikely to provide a margin uplift for the acquirer of the same magnitude as traceability implementation. If we focus on returns rather than margin development, we calculate that implementing a traceability solution typically yields a five-year internal rate of return (IRR) of 39-62% for the average seafood processing company. This is above the 39% IRR generated on a typical M&A deal in the industry. In addition, and unlike M&A, traceability provides an effective way to reduce risks and raise the sustainability profile of the corporate and the industry - see Figure 2.

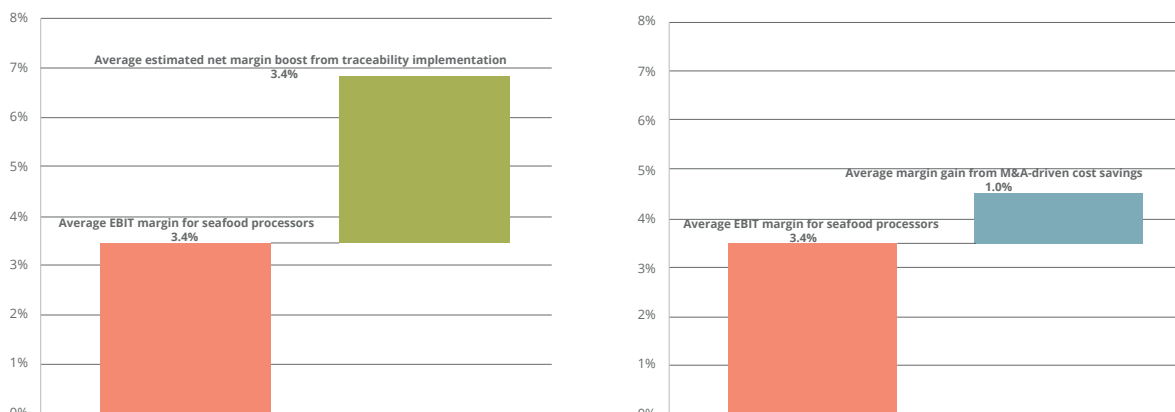


Figure 2: Estimated Average Net Margin Gain from Traceability Implementation Compared to Estimated Average M&A-Driven Margin Gain.³

Note: Assumptions underlying the M&A driven margin gains include: target's revenue at 50% of the acquirer's revenue, target's margin 3%pts lower than the acquirer's and synergies at 6% of acquired sales.



The three main benefits of adopting traceability

The widespread implementation of a GDST-compliant traceability solution offers three main benefits. Firstly, it improves margins and returns, more so than the more glamorous M&A option. Secondly, it gives more credibility to sustainability claims. Finally, it lowers exposure to risks such as illegal, unreported and unregulated (IUU) fishing and food recalls. Given these upsides, it is surprising that listed processing companies do not more readily embrace traceability systems.

We can find only a handful of companies that are actively pursuing this strategy. For instance, among the largest listed companies, only Thai Union has thus far pledged to adopt GDST standards (though other smaller, private companies have, as well).

Traceability opportunities exist for most seafood processors

We have attempted to measure traceability performance across large seafood processors, having built a traceability score based on multiple assessments performed by the World Benchmarking Alliance. Whilst that score has limitations (discussed within), it allows us to identify Thai Union and Mowi as traceability leaders (their traceability score is at least 15 out of 30). Other companies would benefit from additional traceability-related efforts, especially if those efforts are GDST-compliant. Seafood Business for Ocean Stewardship (SeaBOS) could prove to be a good example of how to leverage traceability and corporate structure. SeaBOS is an industry-led, precompetitive platform that includes ten of the world's largest seafood companies and a working collaboration with scientists and NGOs. In 2019, it pledged to work jointly with GDST as both of the organizations developed, with the promise of deploying already existing traceability solutions at greater scale. As just one example, one of its members, Maruha Nichiro, now includes a subsidiary, Austral Fisheries, that has demonstrated the success of supply chain traceability.

AN ENGAGEMENT PROPOSAL

Planet Tracker urges investors in seafood processing companies to discuss with management how traceability could make them more profitable and more sustainable. Discussion could focus on identifying what traceability initiatives are already in place or planned; determining whether these initiatives are or can become GDST-compliant; and debating the financial benefits and costs of implementing GDST-compliant traceability, using a calculator available online.⁴

Many processing companies across the globe have relatively solid balance sheets, making the investment of GDST-compliant traceability solutions financially feasible. This strategy would make these companies more profitable but also help fill in the traceability gaps in the seafood supply chain. Furthermore, both management and investors would be reducing their corporate risk profile.

Essentially, seafood traceability can drive up profitability and increase sustainability.

