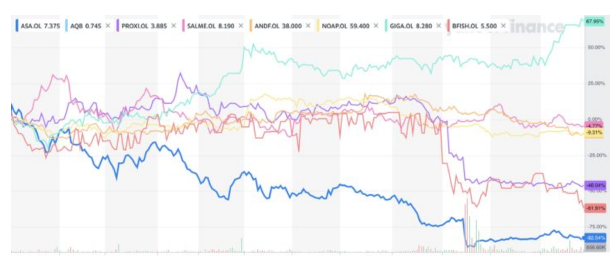
Institutional interest in land-based aquaculture remains, but investors are selective

'As we can see right now, things have changed significantly. Money is no longer cheap,' -- CEO of a New York-based boutique investment firm

By Liza Mayer | Jan. 4, 2023 15:46 GMT

Land-based operators contend that the degree of control they exert upon their systems, in contrast to cage farming, makes them a better risk. But data has yet to back this up, as unfortunate incidents have befallen the world's biggest recirculating aquaculture systems (RAS) operator in the past two years.

This has skewed investors' perception of land-based aquaculture, which, coupled with the stock market's overall performance in the past several months, has led to a sharp decline in the share prices of many publicly listed operators.



Land-based salmon companies saw sharp falls in share prices this year. Graphic: Yahoo Finance

"As a community, we have learned that land-based operations can be very challenging, with construction times taking anywhere from one to two years, followed by one to two years to build out production models and get fish to market size. With heavy CAPEX investments and the potential for inflation, it can take up to four years to generate cash flow. However, any farming issues, such as early maturation of fish, off-flavor issues, or disease, can extend this timeline," Howard Tang, CEO and managing partner at Peritus Capital, told *Undercurrent News*.

Peritus Capital, a New York-based boutique firm, offers equity, debt, and asset financing in aquaculture and seafood, in both land-based and the net pen aquaculture space. They are currently working on three projects totaling over $300 million and have executed over $150m in transactions across the egg-to-plate value chain.

Tang said that despite the challenges, there is still institutional interest in land-based aquaculture, but potential investors are selective.

"A lot of it has to do with the fact that there are only a few successful projects at scale that they can point to and compare. So it makes institutional investors hesitant to jump into the space."

Howard Tang, CEO and managing partner at New York-based Peritus Capital. Photo: Peritus Capital

But there are exceptions, Tang said.

"If you have projects with maturity, especially on the biological and production side, and have demonstrated stability in rearing fish, there is strong interest."

Large greenfield projects, however, are difficult to finance due to inflation that has impacted budgets across the board. In addition, lead times for delivering key equipment have been stretched, contributing to delays and cost overruns, Tang noted.

Creative financing structures are needed

Creative financing solutions, such as asset finance, feed credit, and equity support, are being used to make these projects more attractive.

"This isn't the standard venture capital funded space," said Tang.

"What we've had to do, for instance, at a vertically-integrated farm that we're financing is bring a project finance structure to support the construction and build-out of a recirculating system for rearing their juveniles. We then structured a feed credit arrangement with one of the major feed suppliers. So, it's certainly not a traditional credit facility or equity investment into the business."

"Both facilities have equity support to allow the investors to share on the upside as the farm scales. And the collateral is different than what you would traditionally find in a standard corporate term loan. These types of unique structures are the key to getting these deals done." said Tang.

"As we can see right now, things have changed significantly. Money is no longer cheap, although historically, we're just getting back to average interest rates. As a result, speculative instruments like the boom we saw in special purpose acquisition vehicles are less relevant."

He noted that investors are now more focused on value creation and ensuring that sales growth will translate into profit.

Post-smolt business overshadows grow-out

Land-based RASs are a proven technology in smolt production. In the last five years, the industry has started using them to raise salmon to grow-out size (typically up to 5 kg) in land-based tanks instead of moving them in the second half of their lifecycle to mature in the ocean.

Still, the land-based grow-out business is overshadowed by the post-smolt business – typically growing salmon to up to 1 kg. An industry consultant told *Undercurrent* he expects this status quo to remain in the next five to 10 years.

Tang noted that post-smolt production is a different marketplace with specific market prices and off-take agreements with farmers that can help finance the investment. This market is also different from grow-out, as the smolt is a raw material with more consistent pricing.

"We're now trying to complete a two-phase Chilean RAS project for $100m. And that's going to be a facility focused on supplying post-smolt to one of the mid-sized salmon farmers in the region."

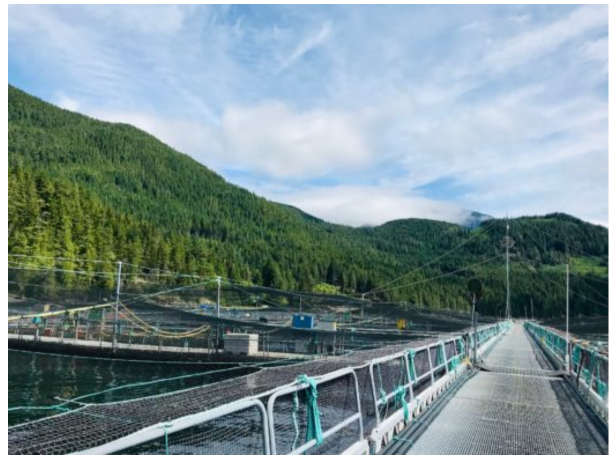
"The one thing I like about this space is that post-smolt economics are different from full grow-out," Tang added. "Smolt prices in Chile tend to be more stable since it's a raw material to farmers, who grow them to harvest size. This means that off-take agreements can be made to finance the investment in these facilities. Additionally, there is potential for cage farmers to transition from 500g to 1kg up to full grow-out as they become more comfortable and confident in the process."

Interest in open net-pen farming

Tang said capital is still available for net-pen farming, but starting any new site has challenges in the regulatory environment and establishing a business that can satisfy the necessary permits, licenses, and good relations with the local community and governments.

He said there are also investors supporting the capital expenditures for related assets such as feed facilities, feed barges, processing equipment, and de-licing vessels.

Tang concluded that the land-based aquaculture space is becoming more and more challenging in the current heightened interest rate environment. As a result, financing these projects is becoming more complicated and requires more equity, which reduces returns.



Capital is still available for net-pen farming, but starting any new site has become tougher. Photo: Liza Mayer

These added costs associated with establishing a RAS facility can lower margins, making it harder to meet the necessary return expectations of institutional investors.

However, ocean sustainability and local food security are becoming increasingly important, so investors are keeping their eyes on projects proving themselves, he said. And while it might be difficult for a new net-pen site to launch, these farmers can tap post-smolt RAS facilities to improve their growth and productivity, which investors have been attracted to.

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