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A Tale of Two Ratios Driving Aquaculture Success

There are a couple of deceptively simple metrics that best help management tell their story to investors. How can we use them in promoting Recirculating Aquaculture Systems? Read on!

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INTRODUCTION

When it comes to aquaculture, in general, there are two ratios that investors look to for predicting future success. On the surface, **deceptively simple ratios** to interpret, as total revenues or costs are divided by total weight produced, typically measured in pounds or kilograms, depending on the region.

Revenue

by unit weight

Production Cost

by unit weight

Simple doesn't mean insignificant.

Production methods, cost structure, marketing, and branding variations can lead to stark differences in the financial picture of one farm to another, which often bears out in the value of these ratios.

A great management team can distill these benchmarks into the fundamentals of the farm and business model for investors. If explained well, these numbers can illuminate a story about the strength of the company's brand and how margins are impacted by it. It can inform investors how a cost-conscious operating team minimizes per-unit production costs. The story behind these ratios should explain how a business intends to succeed and differentiate itself from the competition.

Benchmark Tool

It can be challenging, naturally, to compare the performance of two farms if they are different sizes or selling various products. However, standard sizing performance down to the unit economics eliminates most comparability issues. Using **weight as a common denominator** allows one to benchmark from farm to farm.

Projection Tool

These ratios can also help project how scale may impact company profitability because going from unit economics to the performance of the total enterprise is a simple multiplication by estimated production.

Gross Margin Indicator

The difference between these ratios calculates a farm's "gross margin" by weight; whether this spread can be enlarged, consistently maintained, or shrunk will be a significant determinant of profitability.

Let's look at the key drivers behind these ratios in RAS (Recirculating Aquaculture Systems).

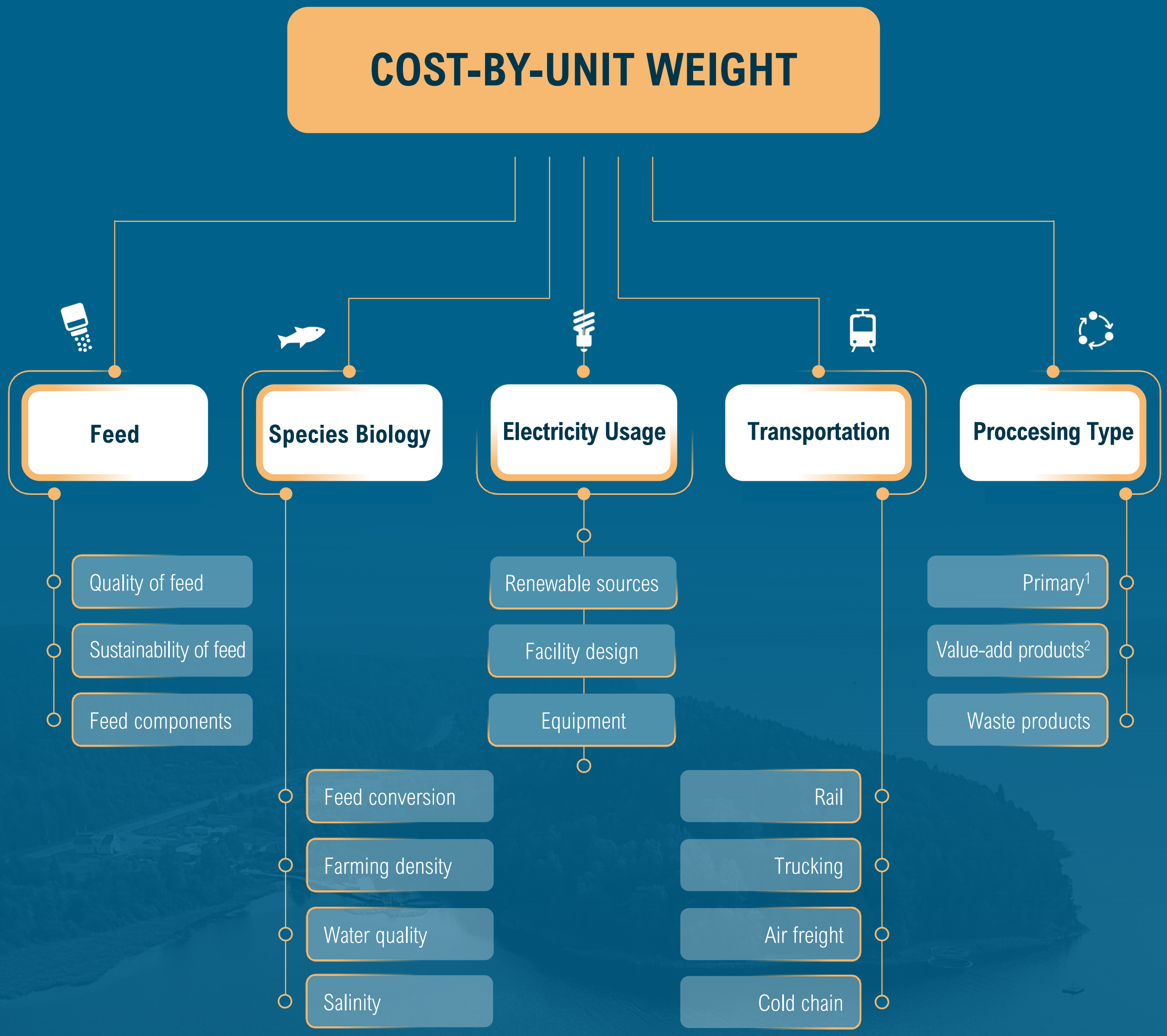
DIAGRAM A

REVENUE-BY-UNIT WEIGHT

- **Species**
  - Atlantic salmon
  - Arctic char
  - Shrimp
- **Products**
  - Head-on gutted
  - Offal products
  - Value-add products[1]
- **Branding**
  - Proprietary
  - White label
- **Distribution**
  - Retail
  - Wholesale
  - Ecommerce
- **Certifications**
  - GMP[2]
  - ASC[3]
  - Others[4]

1. Cold or Hot smoked | Ready-to-eat | Portions | Filets
2. Good Manufacturing Practice
3. Aquaculture Stewardship Council
4. Seafood Watch | Monetary Bay Aquarium

DIAGRAM B



1. Head-on-gutted 2. Cold or Hot smoked | Ready-to-eat | Portions | Filets

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TWO RATIOS IN RAS

A RAS can take many "paths" to success (or failure), as our graphs depict, and every management team must chart its own course. The important part is for management to help investors understand their unique path by explaining how a strategy will ultimately be reflected in these critical ratios – and the resulting gross margin of the farm.

Salmon

Tilapia

Take for Example

Growing Atlantic salmon versus tilapia will result in contrasting business models. Both can be successful but would require different approaches to work.

Market

Salmon has a premium market reputation globally, resulting in higher revenue-to-unit weight economics than the more affordable tilapia, sometimes called the "chicken of the sea" for its commonness.

Production

Tilapia's production costs, should be lower given a faster growth to harvest weight, freshwater production, and resiliency of the fish.

Strategy

A tilapia farmer may want to be a volume producer of the ubiquitous white finfish eschewing investment into branding in favor of production efficiency and scale. A salmon farmer, meanwhile, might invest heavily into sustainability credentials to maintain access to premium retailers where sustainability has become a must, driven by discerning consumers.

This difference in strategy would show up in the unit economics of the two businesses. And it's this difference in the numbers that should drive management's conversations with investors.

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THE STORY BEYOND THE RATIOS

For investors, understanding the story behind a farm's key ratios and gross margin is an important beginning – not an end. If a compelling story drives the farm's gross margins, it's time to understand how the rest of the company is run, financed, and capitalized. Here are some diligence FAQs that should always be readily available for investors:

- How will the company be capitalized?
- What will be the use of invested proceeds?
- What will the farm's capital expenditures and maintenance be?
- What are your SG&A (Selling, General, and Administrative) costs?
- What is the corporate tax rate?

But none of the answers to these frequently asked questions will be as crucial as investors understanding and believing in the Revenue and Production costs by unit weight. After all, these ratios drive a company's ability to invest, meet obligations, and drive future growth. Put it directly, even the best-capitalized farms will inevitably lose the interest of investors and fail if they can't produce a compelling gross margin, as we've already seen across the world of publicly traded RAS companies.

WANT MORE RESEARCH?

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