Ag & Vet Weekly

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All the news on ASX-listed agriculture and veterinary companies

Dr Boreham's Crucible: Clean Seas Seafood

By TIM BOREHAM

ASX code: CSS

Share price: 71 cents

Shares on issue: 92,418,465

Market cap: $65.6 million

Chief executive officer: David Head

Board: Terry O'Brien (chairman), David Head, Nick Burrows, Raelene Murphy, Helen Sawczak, Marcus Stehr

Financials (September quarter 2019): receipts $11,978,000, loss of $516,000, negative cash of $1,860,000*****, estimated current quarter outflows $15,920,000
***** The difference between $3,079,000 cash balance less $4,939,000 overdraft. The company subsequently raised $9.6 million in a convertible note issue

Year to June 30, 2019: revenue $46.1 million (up 11%), earnings before interest tax depreciation and amortization $4.8 million (down 19%), loss of $1.4 million (previously $3.4 million deficit).

Identifiable major holders: Bonafide Wealth Management 17.5%, Australian Tuna Fisheries 6.4%.

The ASX-listed seafood sector has not exactly provided investors with an ocean of joy over the last decade or so, but it has sure kept the insolvency profession busy.

Notable ASX-listed failures include the Lachlan Murdoch-backed Western Kingfish, Australis Aquaculture and Cell Aquaculture (barramundi) and, in its first iteration, the now successful salmon producer Tassal.

The Port Lincoln-based Clean Seas hasn't avoided a few piscatorial problems along the way either - and that's somewhat of an understatement.

A decade ago, the company thought it had cracked the code of breeding southern blue fin tuna - the Rolls Royce of sushi ingredients in captivity.

The program worked - to a point - but when the baby fish were put to the sea pens they died *en masse*.

"We don't mention the 'T' word around here these days," says Clean Seas CEO David Head.

Clean Seas has since turned its attention back to yellowtail kingfish, which is less difficult than tuna - but a premium breed nonetheless.

Just ask the world's great chefs the company has duchessed.

After a "jagged history", Clean Seas looks to be gaining traction with its global sales push, based in part on a frozen product that uses a patented technique to cool the fish quickly to prevent them from becoming soggy when thawed.

In Mr Head's not quite disinterested view: "It's arguably the best raw fish in the world."

Swimming against the tide

Founded by local tuna identity Hagen Stehr in 2005, Clean Seas listed in late 2005 after raising $9 million at 50 cents apiece.

After the tuna trauma, Clean Seas struck a "feed crisis" that resulted in kingfish mortalities soaring from 15 percent to 80 percent.

The disaster, which resulted in 4,000 of the 4,500 tonnes of feedstock dying, cost the company $100 million.

Mr Head arrived four years ago and "reworked the fundamentals of the organization", replacing almost every sales and marketing person. Only one "pre feed crisis" director remains.

In 2012, marine biologist Craig Foster came on board as CEO and the company nutted out that the problem was due to a dearth of a sulphuric acid (called taurine) in the diet.

Mortalities fell back to 15 percent. But the recovery was a doubled-edged sword, financially speaking, because the company ended-up with excess inventory (too many fish), resulting in a $10 million write down.

At the height of the problems Clean Seas withdrew from the US and European markets. It was also forced to sell half its assets and dismiss half its staff.

In the aftermath Clean Seas is suing the feed supplier Gibson's (trading as the Tasmania-based Skretting Australia) which has denied all responsibility (more below).

"In many ways it might have been easier if the company had gone broke and we had started all over again,'' muses Mr Head.

If you knew sushi

Clean Seas export volumes have since recovered and grown, thanks partly to a "chef activation program" targeting the brand name kitchen toilers such as Neil Perry and Gordon "this fish is f…ing good" Ramsay.

As a result, Clean Seas' fruit of the sea is served at posh venues including Sake and Rockpool in Australia, London's Roka and Sexy Fish as well as Milan's Nobu.

In the 2018-'19 year the company's volumes increased 13 percent to 2,688 tonnes, with a further 17 percent improvement in the September quarter to 650 tonnes.

The improvement was best in North America - up 42 percent - while European and Australian volumes were up 21 percent and 16 percent respectively.

Asian volumes declined 38 percent, but only because of the timing of a large container shipment.

The company's frozen brand, Sensory Fresh, rose 141 percent, with fresh sales edging up two percent.

The freezing technique involves rapidly freezing the fish to minus 35°C in 22 minutes, 10 times faster than conventional methods.

The frozen market will be crucial, as it accounts for 76 percent of kingfish consumption in North America and 80 percent in Asia.

(Australians and Europeans have a penchant for the fresh stuff).

Getting the best price

Clean Seas' success to date lies with its ability to extract a premium price for what's a relatively more expensive fish to produce.

As Mr Head explains, the biology of the fish means more feed is required to achieve the same kilogram of growth relative to a barramundi or a salmon.

Given the cold water of the Spencer Gulf relative to other growing areas such as Hawaii and New Mexico or Geraldton in Western Australia, Clean Seas' kingfish take twice as long to grow.

But like a Grange Hermitage ageing in a dusty cellar over decades, the slow development produces a tastier result.

Finances and performance

Clean Seas has just completed a convertible note raising by way of a rights issue that brought in $9 million, shy of the targeted $15.3 million.

The notes pay interest of eight percent a year and are convertible to ordinary shares within three years (at an eight percent discount to the prevailing price).

Mr Head says the convertible note option was less dilutive than raising ordinary equity, with shareholders sending the message that they were sick of discounted share raisings.

It also stacked up favorably relative to debt financing.

"We hope it will be the last round of funding we need to grow the business," he says.

Earlier, the company raised $6.6 million by way of a share placement to specialist aquaculture fund Bonafide Wealth Management.

Clean Seas reported "receipts" of just under $12 million in the September quarter, for a loss of $516,000.

In the year to June 30, 2019, the company generated revenue of $46.1 million, up 11 percent, with earnings before interest and depreciation and amortization of $4.8 million (down 19 percent).

The headline loss of $1.44 million compared with a previous $3.38 million deficit.

Clean Seas is eyeing annual sales of 4,000 tonnes by 2022, up 50 percent with a further 'stretch' target of 5,000 to 6,000 tonnes by 2025. At that point, the company expects to achieve "sustained profitability".

One wildcard is the company's claim against Gibson's, which is due to be heard in the South Australian Supreme Court in February next year (if a mediation session scheduled for November 28 fails).

"We are not going to get $60 million but I would like to think we will not get zero," Mr Head says.

Clean Seas investors have been on a rocky journey: at the height of the tuna fervor in 2010, the company was worth $150 million.

After the tuna trauma and the kingfish mortalities, the shares slumped to as low as 1 cent and the company was worth $7 million.

The company is now valued at $67 million.

An ocean of demand

Clean Seas is riding a wave of demand for seafood protein as an alternative to red meat, at a time when wild fisheries are under immense pressure. The rise and rise of sushi does no harm to the company's prospects, either.

Tuna-mad Japan leads the demand for kingfish, with per capita consumption of 1,000 grams (one kilogram) for the farmed product and 800 grams for the wild catch.

Australians are the next voracious consumers: 91 grams (farmed) and 118 grams (wild).

North America lags at 63 grams, but of course it's a much bigger market and consumption has quadrupled over the last decade.

Put another way, North America accounted for 69 percent of Clean Seas' volumes in the 2018-'19 year, compared with 12 percent for Asia, 10 percent here and nine percent in Europe.

While the company has an 88 percent market share of yellowtail kingfish, here, it has a 45 percent share in Europe and 12 percent in Asia. But in North America the company still accounts for less than one percent of the market.

Dr Boreham's diagnosis:

Given its profitability history - or non-profitability history - Clean Seas needs to bring home the bacon (so to speak) to its largely loyal 7,000-strong shareholder base.

But we gotta say the company is dancing to a different tuna - a far more upbeat one - these days.

Apart from flogging more kingfish - frozen or fresh - management is minimizing working capital and deploying automated husbandry techniques as well as selective breeding.

While the company intends to focus on kingfish, it's interested in using its expertise in premium seafood for "other species".

But they won't be four-legged ruminants on terra firma.

Mr Head posits - quite speculatively - that ASX-listed Huon Aquaculture's ocean trout business would be of interest were it to be up for sale.

Clean Seas has emerged as the world's biggest western kingfish producer outside Japan, with output about five times bigger than its nearest rival.

Meanwhile, the southern blue fin tuna program survives in the background, although the company is well past throwing dollops of cash at it.

"There may, one day, be the opportunity to take the brood stock and partner with someone," Mr Head says.

"But we still don't know why the fish died when they went to sea."

Hmm: like who really shot JFK and the whereabouts of Lord Lucan, perhaps we will never know.

Disclosure: Dr Boreham is not a qualified medical practitioner and does not possess a doctorate of any sort. But hopefully he can detect the fishier claims emanating from the corporate sector.