



3.07 MEMO – WHAKOTOHEA MUSSELS OPOTIKI LIMITED

DATE 7 August 2019

TO Independent Advisory Panel

SUBMITTED BY Jason Hall, PDU

SUBJECT **VARIATION TO ORIGINAL WHAKOTOHEA MUSSELS OPOTIKI LIMITED (VMOL) APPROVAL**

RECOMMENDATION:

Discuss and approve a variation of the original approval received for WMOL's Mussel processing plant and expansion.

BACKGROUND

1. Following on from the RED Ministers approval in December 2018 for Stage 1 (\$0.85m business case) and then a \$19m Commercial Information on the basis recommended by the PDU/IAP provided the business case was positive. The PDU was advised by ministers to await the outcome of the business case before negotiating the terms of the Crown's equity type investment. The basis recommended by the PDU/IAP was:

- A grant of \$850,000 to complete a refreshed business case
- An investment of \$^{Comme} for an equity stake (held in trust for the Whakatohea Māori Trust Board)
- Another equity type instrument that could give certainty to a proposed \$^{Commerci} equity raise by the company.

2. Commercial Information

3. The Investment and Sectors Team are working with MPI's aquaculture team and the applicant to determine a way forward. MFAT's original advice was tested and it again recommended that the project proceed on a commercial basis.

4. Subsequent to receiving the draft business case, the applicant raised Commercial Information

They have also prepared an addendum to the draft business case that fits within the original approved support level.

5. The PDU were provided with an updated financial model in the week of submission deadline to the IAP which we are evaluating, and due diligence (with MPI) is also underway.

6. Although remaining within the \$19.85m approval, the current proposal differs from the original approval receive in the following key ways:

- Commercial Information



PROVINCIAL DEVELOPMENT UNIT

- The new proposal allows for a greater number of lines in the water to support the larger facility.
- As a result there is a greater level of job creation earlier on (Comm in Stage 2 and Comm in Stage 3 vs Comm initially proposed), under the current proposal.

- Commercial Information

7. The applicant's preferred option seeks support of the PGF for:

- \$^{Commercial} of equity (held in Trust for Whakatohea Māori Trust Board ("WMTB"))

- Commercial Information

Appendix A at the end of this memo articulates some of the reasons for the changes in the requirement for funding as stated by the applicant in response to a number of questions from the PDU.

PDU RECOMMENDATIONS AND REQUEST FOR GUIDANCE FROM THE IAP

8. Commercial Information

9. Commercial Information
the PDU recommends that it continue working with the applicant on a way forward within the \$^{Commercial} remaining envelope and seeks guidance from the IAP in this regard.

10. The PDU requests guidance from the IAP on investigating whether a smaller quantum of support is possible by using the following approach with WMOL:

- Commercial Information
- Encourage WMOL to Commercial Information to improve the projects return on equity and allow the PGF to potentially assist in the \$^{Commercial} external equity raise).
- Supporting up to \$ Commercial Information) of the \$^{Commercial} equity raise by way of an Commercial Information Given the potential cornerstone investor (we will insist on validating this), this should provide certainty for the capital raise.

11. Any agreement would have to be post a successful outcome to the financial and technical due diligence currently being undertaken and agreement to continue by the PDU and MPI.



APPENDIX A

The following statements from the CEO best articulate the reasons for WMOL’s preferred approach:

- **Commercial Information**

Below are our responses to your **questions in black**:

i) Why the different configurations of processing (between your Funding Application 2018 and the two options), including an explanation of why half-shell is in there (something the originally IAP advised to exclude)

- The Draft Business Case of April 2017 provided the fundamentals for the Funding Application of 2018.
- The Funding Application of 2018 was to review and refresh the Draft Business Case of April 2017. The review was to include a **Commercial Information** and further the marine farm development.
- The Funding Application of 2018 allowed for marine farm development of \$^{Commer}, the remainder of the \$^{erica} was then used to provide a budget of what a processing plant and equipment could achieve. Whilst reviewing the Draft Business Case processing design, the following were highlighted as constraints to the business:
 - Limited storage capacity of raw material, the design allowed for 3 days storage, where as our storage design allows for 10, and will ensure processing can continue when harvesting is limited during severe weather events. This limited the downtime of processing, ensuring continuous employment.
 - The original processing factory design was compact. This reduced building costs, but did not allow for future expansion for additional equipment.
 - The movement of people into high hygiene areas is critical for working with high risk products. The original design did not allow for safe and easy accessibility to the work stations.
 - **Commercial Information**
 - The Draft Business Case, was a high level estimate of developing a processing plant ^{Commercial Information}. A series of assumptions were made in relation to the services (Power, Water (Potable), Waste Water, Refrigeration) which would be required. In 2016/17 there was limited consultation with District and/or Regional Council in relation to consents, and services to be provided as there was limited understanding on the services that would be required by all parties. There has been a significant cost associated in the provision of such services which are not provided for by local infrastructure.
 - Examples of previously reviewed costs:
 - (1) Power to site & Electrical: \$ **Commercial Information**
 - (2) Water to site: \$ **Commercial**)
 - (3) Waste Water Treatment: \$ ^{I f ti} **Commercial Information**)
 - (4) Refrigeration \$ **Commercial** ^{I f ti}



PROVINCIAL DEVELOPMENT UNIT

- The Funding Application 2018, also identified the need for further development (Stage 3) in the future for a half shell processing facility, as capacity was only available with the current contract manufacturer until [Commercial Information]

ii) Why have costs changed so significantly?

- The draft business case costings were collated in 2016, hence changes to costs are associated with the following: inflation, changes to building legislation, increased costs for building materials and size of the premise. Technological advances in processing equipment from 2016 to 2019.
- The premises are larger and hence costs relating to building and services to support have increased.
- The significant difference between the two proposals, is the difference in developing one versus two processing facilities.

iii) Please elaborate on this to help us understand the cost changes. For example, a simple read of Table A raises questions like:

(a) why the different configurations of processing (between your Funding Application 2018 and the two options), including an explanation of why half-shell is prioritised (something we originally felt would be best excluded)

- Business models, driven by farm production, processing (in-house and contract manufacturing), product utilization and wastage, process efficiency and market demand were modelled. It was determined that the most sustainable and profitable model was achieved when all manufacturing was controlled by the company under one roof.
- Two processing facilities are proposed to manage the food hygiene risk. Half Shell mussels are classified as ready-to-eat and have different food safety criteria to [Commercial Information].
- The physical separation of the two processing factories, manages people, products and process flow to ensure no chance of cross contamination between the two factories.
- When reviewing the processing plant design which was focused on primarily producing [Commercial Information] was seen to be higher risk in a standalone basis, as it will take time to establish a market for [Commercial Information] as it is a high value commodity product. A more considered approach is being taken to entering the market, with a balance of half shell to existing customers. The [Commercial Information] market is relatively new and our entry to the market would introduce a significant volume, and could cause a fluctuation in product pricing, as we believe that at this stage as a commodity item it will be volume sensitive.
- Current contract manufacturing models, sees wastage which is unusable (or unrecoverable) of over [Comm]%. This waste stream is recoverable when operating a half shell processing, [Commercial Information]. Contract manufacturing fees reduce the available margin on any sales. [Commercial Information]

(b) why the cost changes?

- Costs are associated with, building size, equipment requirements, and associated services.
- The premises is larger and hence costs relating to building and services to support have increased.
- The significant difference between the two proposals, is the difference in developing one versus two processing facilities.”

In summary the current proposal is riskier for the PGF than the previous approval received, but is viable and thereby more profitable for existing shareholders, whilst also delivering jobs in a more accelerated timeframe.