Report of the Independent Chair:

MOU Steering Committee

Newfoundland and Labrador

Fishing Industry Rationalization and Restructuring

February 2011

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February 16th, 2011

Hon. Clyde Jackman
Minister of Fisheries and Aquaculture
Government of Newfoundland and Labrador
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Dear Minister Jackman,

I am pleased to submit the Report of the Independent Chair: MOU Steering Committee on Fishing Industry Rationalization and Restructuring. In the process of compiling this report and summarizing the work of the MOU Steering Committee and its attendant working groups, I repeatedly heard it expressed that the work of these committees represents the most comprehensive examination of the Newfoundland and Labrador fishing industry that has ever been undertaken. I think you will find this to be the case.

Over the past eighteen months, the Financial Analysis, Harvesting, Processing, and Seafood Sales & Marketing working groups have examined recent developments in al facets of the Newfoundland and Labrador fishing industry and subsequently reported their findings to the MOU Steering Committee.

The report outlines the conclusions that have been reached by the various working groups and the MOU Steering Committee. It also discusses the types of initiatives that may be required to bring a measure of stability to the industry in the short-term, while also helping the industry position itself for long-term success in the global seafood marketplace.

Industry professionals in the harvesting, processing and seafood sales and marketing sectors, have contributed a significant amount of their time and energy in helping the MOU Steering Committee achieve its objectives. I would like to acknowledge the work of the members of the MOU Steering Committee, its working groups and the staff of both the provincial Department of Fisheries and Aquaculture and the federal Department of Fisheries and Oceans. Senior level staff, in both departments, attended all of the meetings and contributed greatly to the work of both the working groups and the MOU Steering Committee.

I look forward to discussing these findings with you as the Government of Newfoundland and Labrador and the Government of Canada considers the implications of these findings.

Yours truly,

Thomas B. Cliff
Independent Chair

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Executive Summary

In the summer of 2009, in an attempt to end a protracted strike in the Newfoundland and Labrador (NL) shrimp fishery, the Fish, Food and Allied Workers (FFAW), the Association of Seafood Producers (ASP) and the Government of Newfoundland and Labrador signed a Memorandum of Understanding (MOU). The MOU was designed to provide the level of analysis required to inform the debate on the rationalization and restructuring initiatives necessary to ensure the long-term stability of the province's fishing industry. This report outlines the conclusions that have been reached by the various working groups and the MOU Steering Committee, and also discusses the types of initiatives that may be required to bring a measure of stability to the industry in the short term, while also helping the industry position itself for long-term success in the global seafood marketplace.

At present, more than 20,000 individuals in NL rely on the fishing industry as their primary source of employment income. Approximately 11,000 individuals, scattered throughout 500 communities, are employed in approximately 3,800 harvesting enterprises and over 10,000 individuals find employment in one or more of the province's 102 primary fish plants. In 2010, the value of production in the NL fishing industry was about $942 million, a 45% increase in value over a 20-year period and a 14% increase over 2009. The value of landings has also increased by more than 80% over the past 20 years, while the volume of landings has declined by 40%. These shifts in value and volume have induced significant changes within the industry. In particular, the industry has witnessed rather dramatic declines in the number of fish harvesters, processing plants and, in turn, the number of plant workers.

As the 2011 fishing season approaches, and we examine the financial performance of the industry over the past five years, a number of things become apparent. Most notably we have recognized, based on the results of the 2009 season, that the industry may not be strong enough financially to withstand two successively poor fishing seasons. The analysis suggests that in the event of such an occurrence, the magnitude of potential losses could be very dramatic, thus accelerating the closure of a number of marginal plants that have been the mainstay of their respective communities.

To help in the process of refining the understanding of the scale and scope of these potential challenges, the parties to the MOU and the MOU Steering Committee established a number of working groups, each with a specific mandate to examine the current situation in the areas of harvesting, processing and seafood sales and marketing. Each working group was to assess the current situation in each sector and make recommendations for change. The Steering Committee also appointed a Financial Analysis Working Group (FAWG), whose mandate it was to manage extensive surveys of industry participants in both the harvesting and processing sectors and report back on the current financial health of the industry.

The financial analysis of the harvesting sector that was undertaken by Deloitte suggested that between one-third and two-thirds of the fish harvesting operations currently operating in NL are viable, depending on the viability measure employed. They also noted that viability levels varied widely across the various fishing areas or regions. The Deloitte survey data suggested that nearshore fleets (vessels >40') appear to be more viable compared to inshore fleets (vessels <40'), although debt levels are greater in the nearshore fleets.

The Harvesting Rationalization Working Group (HWG) analyzed several options for industry rationalization, including proposals from the FFAW, the NL Inshore Shrimp Fleets and the NL Independent Fish Harvesters Association (NLIFHA). The HWG supplemented the Deloitte database with data from the Department of Fisheries and Oceans (DFO) in order to remove any anomalies in the original dataset and to facilitate a more detailed analysis on individual fleets. A series of assumptions were made with respect to potential outcomes for such key variables as market prices, prices to harvesters, resource availability and fuel costs.

The viability targets established by the HWG to determine fleet rationalization requirements included a reasonable return on equity and reasonable income levels for owners and crew members. In the inshore fleet sector, the required levels of rationalization range from slightly above 30% to almost 80%. The highest required levels of rationalization are concentrated, geographically, on the northeast and west coasts of Newfoundland and in southern Labrador, while the lowest levels of rationalization are required in the Avalon and the southern coastal regions of Newfoundland.

In the nearshore fleets, the required levels of rationalization range from 0% to almost 50%. The highest levels of rationalization are concentrated, geographically, on the northeast coast of Newfoundland and in southern Labrador (area 2J3K), while the lowest levels of rationalization are required in the Avalon and the southern coastal regions of Newfoundland. A 50% rationalization level suggests that, in order to achieve the viability targets that were established by the HWG, enterprises would have to harvest roughly double their current volumes.

In recent years, rationalization of the harvesting sector has occured with limited government intervention and will continue to occur in response to changes in resources, income levels and harvester demographics. One question that arises for those fleets that require intervention is: to what extent would policy changes related to buddy-up and combining arrangements affect the financial viability of these fleets? If the answer to this question is that modified policies would do little to improve the present situation, then some form of intervention may be required and, in the most severe cases, a buy-out of enterprises would improve financial results for those that remain, although they would still be unable to achieve all viability targets.

In evaluating the rationalization proposals, governments must consider both the benefits and costs of such an exercise. On a positive note, as referenced by the FFAW in its proposal, a reduction in the number of fishing enterprises would reduce peak landings, allow for much better distribution of landings within the current operating season and allow for a modest expansion of the operating season. While rationalizing the industry should leave the remaining participants better off, a central question that remains is: will their financial situation improve sufficiently to allow the remaining enterprise owners to retain and attract workers in the context of the current demographic profile of the harvesting workforce? In addition, consideration must be given to which party, industry or government, will bear the financial risk of rationalization and to what degree. A number of western governments have supported such rationalization activities in recent years in fundamentally uncompetitive industries and found, to their dismay, that such initiatives have only served to prolong the inevitable decline of the industry in question. Notable examples include: the textile industry in the United States, the electronics industry in Germany, and the auto industry in the United Kingdom.

The financial analysis of the processing sector that was undertaken by Grant Thornton suggested that the level of profitability in the NL seafood processing sector is well below the Canadian seafood processing sector norms and is unacceptable. The profitability level in particular is not sufficient to al-

low participants to secure capital and make the types of investments in plant and equipment that are required to achieve long-term viability.

The Processing Restructuring Working Group (PWG) also analyzed several options for industry rationalization, including the proposal by ASP, the principal components of which included a 30% reduction in the number of existing crab and shrimp plants (volume based), a 'reverse auction' as a mechanism to facilitate the redistribution of available resources and an independent panel to review and approve offers.

The results of the subsequent analysis conducted by the PWG indicate that a rationalization rate of 30% would allow the processing sector to achieve gross margins in the 15% range, which is similar to the performance of the Canadian Seafood Producing Sector (excluding NL). This level of rationalization will have a positive impact on net income and other measures of financial performance and should increase the ability of the processing sector to access the level of capital that is deemed to be required in order to sustain its enterprises and compete more effectively in the global seafood marketplace. To date, rationalization of the processing sector has occurred with only a modest level of government intervention and will continue to occur in response to changes in raw material supplies, market returns and demographic challenges associated with labour supply.

Under ASP's proposed rationalization plan, the financial health of the processing sector would improve and the impact on workers and communities could potentially be better managed. However, the current ASP proposal is for industry controlled buy-outs. This could potentially lead to outcomes (plant closures) that are contrary to current provincial policy objectives, notably regional balance. Likewise, without some mechanism to enforce capacity reduction in the processing sector, the benefits that could be realized from season extensions (such as improved worker incomes), would likely not be realized. Further to the ASP proposal, the process of a reverse auction and the proposed conditions of ownership of purchased plants should be strengthened, via arm's length evaluations of proposals, if a government supported rationalization of the sector is to be considered.

The Grant Thornton report and work of the PWG both suggest that a 30% rationalization in the number of shrimp and crab plants will allow processors to achieve significant improvement in gross margin performance and improved profitability in the short term. However, long-term profitability and sustainability will likely require fundamental structural changes if the NL processing sector is to achieve the objectives of the MOU, which were identified during the Fishing Industry Renewal (FIR) initiative and highlighted in Section 1 of this report.

The report of the Seafood Marketing Working Group (MWG) proposes the establishment of a number of sales consortia with financial incentives being put in place to offset incremental start-up costs and other associated costs, including a provision for inventory financing for a period of three years. The MWG identified the need for flexibility in the criteria used to establish such consortia so as to encourage collaboration. A seafood marketing council has also been proposed by the MWG. Key activities of the council should include market intelligence, image development, product promotion and long range market planning.

The analysis of the financial health of the industry suggests that, while the industry showed a reasonable recovery in 2010 relative to 2009, it continues to be in a rather volatile state and is perhaps one or two relatively poor seasons away from further economic misfortune. Action must be taken to so-

lidify and improve the present financial position of the province's harvesters, processing industry and plant workers if the industry is to engage in the kind of meaningful restructuring that is required to allow the industry to be self-sustaining.

If one is to look objectively at the initiatives that have been recommended herein, it should be clear that most of these fall within the domain of activities typically associated with rationalization, as opposed to restructuring. A cursory examination of such activities in other jurisdictions in Canada (such as the automotive parts supply industry in Ontario) and around the world (the textile industry in the southeastern United States) demonstrates that the approach taken in these sectors was also multi-phased.

Phase one of this process (i.e. rationalization), as it may come to be known in relation to the NL fishing industry, could allow the industry to improve its current financial position and ready itself for the more complicated and more fundamental restructuring that is required and that already has been operationalized in other fisheries such as Iceland. If the NL fishery is to survive and prosper, it must become more competitive internationally. This will only come through initiatives that are rooted in technological innovation and that utilize a highly skilled workforce that is focused on the supply of high quality, differentiated products to suppliers who are willing to pay a premium price for NL seafood.

1.0 Introduction

In 2009, an unusual combination of recessionary pressures resulted in historically low market prices for most seafood products in many regions of the world. In Canada in particular, the combination of depressed market prices and adverse exchange rates resulted in reduced returns for seafood processors and ultimately resulted in lower than average raw material prices being paid to harvesters. In Newfoundland and Labrador (NL), these developments sparked a lengthy price dispute in the shrimp sector, with the result being a three-week delay in the start of the fishery. At that time, approximately 330 enterprises were engaged in shrimp harvesting, with 13 plants licensed to process shrimp in the Province of Newfoundland and Labrador. Combined, these activities employed between 3,500 and 4,000 people annually, primarily in fishery dependent communities.

In an effort to open the 2009 shrimp fishery, before the season was lost, the Provincial Government agreed to reimburse processing license fees for 2008 and 2009 and work with the Fish, Food and Allied Workers (FFAW) union and the Association of Seafood Producers (ASP) to develop a plan (eventually referred to as the MOU on Fishing Industry Restructuring), to rationalize and restructure the NL fishing industry. On July 14, 2009, an MOU was signed by the three parties. The signing of the MOU was central to the opening of the 2009 shrimp fishery and resulted in the employment of a large number of harvesters and plant workers who depend on this industry for their livelihood.

The primary objective of the MOU is to develop proposals to rationalize and restructure the industry in a manner that would ensure the viability of the remaining fishing and processing enterprises. As a result, a plan will be presented to both the federal and provincial levels of government for consideration. The concept of rationalizing the fishing industry is not new. For many years, there has been a general recognition that there are too many harvesters, and too many fish plants, and this has been documented in several reports on the fishery. In 2006, Premier Danny Williams launched what became known as the Joint Canada-Newfoundland and Labrador Fishing Industry Renewal (FIR) initiative, which commenced with the Premier's Summit on May 24, 2006. The FIR consultation process consisted of more than 40 stakeholder meetings. These consultations resulted in a general consensus that structural deficiencies exist within the fishing industry. Excess capacity was cited as the most critical underlying structural challenge. Other structural challenges include: low income levels, workforce recruitment and retention issues, seasonality, quality and marketing. It was envisioned that the FIR initiative should result in a sustainable, economically viable, internationally competitive and regionally balanced industry which is able to:

- adapt to changing resource and market conditions;
- extract optimal value from world markets;
- provide an economic driver for communities in vibrant rural regions;
- provide attractive incomes to industry participants; and
- attract and retain skilled workers.

In the initial stages of the FIR process, government-industry working committees identified the challenges facing the industry, clarified the issues, and outlined the options that could be considered. Approximately 800 individuals, including industry organizations, harvesters, plant workers, community leaders, regional development organizations and aboriginal groups, were involved in the consultation process. Some individuals and companies suggested plant closures, while other individuals and groups

wanted to maintain plant capacity at current levels. Some groups wanted outside buyers, while others did not.

The strategy that followed consisted of several federal and provincial initiatives that supported self-rationalization of the processing and harvesting sectors, and the long-term viability, international competitiveness and sustainability of the industry.

The provincial elements included renewal of the processing sector; enhancement of marketing initiatives; implementation of new technologies; enhancements to the provincial Fisheries Loan Guarantee Program (FLGP); enhanced safety initiatives; and workforce adjustment measures. In total, the province committed $15 million in direct funding under the FIR initiative, an estimated $25 million in reduced capital gains taxes, and $100 million in potential risk, underwriting through loan guarantees.

Federal initiatives included the strengthening of the owner-operator fleet separation policies; the introduction of the combining policy to allow harvesting rationalization; changes to the vessel replacement policy; the conversion of temporary shrimp permits to licenses; an increase in fisheries science initiatives; license fee review; capital gains exemptions; and a commitment to allow licenses to be used as collateral.

In 2009, the challenges facing the fishing industry led the signatories of the MOU to seek an accelerated approach to achieving the objectives established during the FIR initiative. Accordingly, the MOU was designed to generate the type of strategic and financial analysis that would support the development of a plan to accelerate rationalization and restructuring of the NL fishing industry. This report outlines the MOU process and the conclusions reached by the various working groups and committees regarding:

- **harvesting rationalization;**
- **processing rationalization; and**
- **sales and marketing initiatives.**

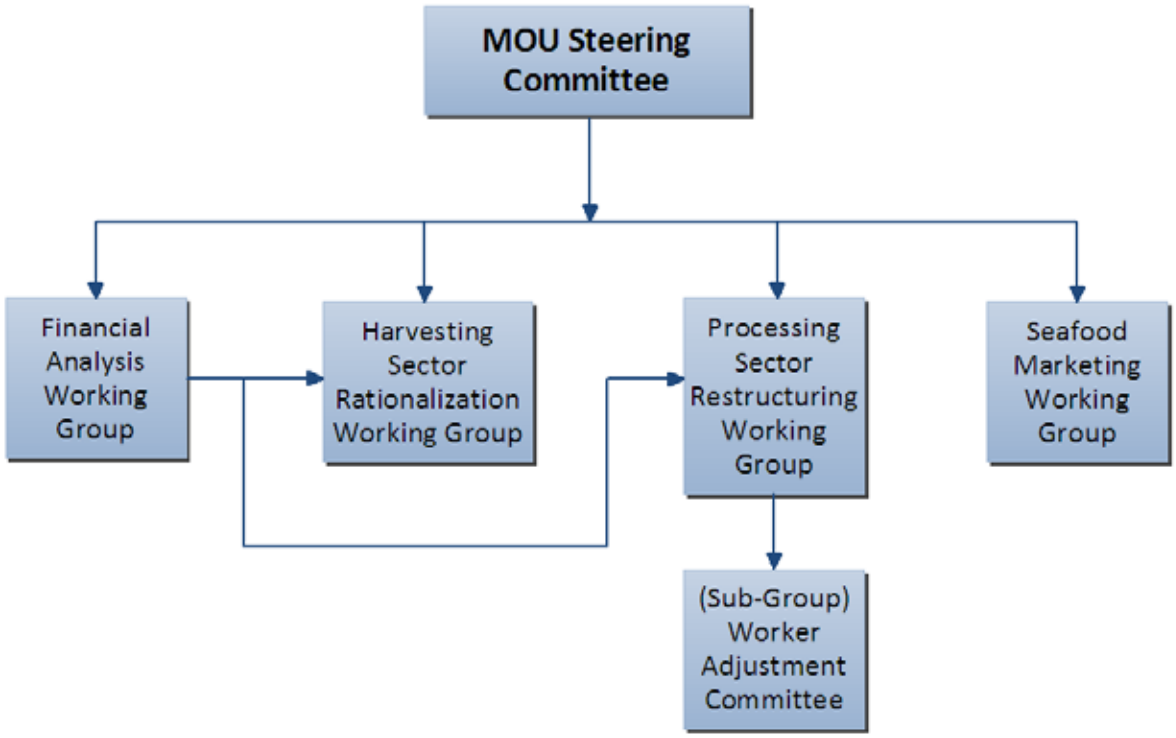
Conclusions, including any limitations and concerns identified, are summarized at the end of the report.

2.0 Overview of MOU

Soon after the signing of the MOU on July 14, 2009, a Steering Committee was formed to oversee the process and outcomes of various working groups that were established to support the completion of an Industry Rationalization Plan. These working groups included a Financial Analysis Working Group; a Harvesting Rationalization Working Group; a Processing Restructuring Working Group (that also included a Worker Adjustment Subcommittee); and a Seafood Marketing Working Group. Membership consisted of individuals from the FFAW, ASP and the Department of Fisheries and Aquaculture (DFA) (see Annex 2). DFO fully participated in the process and attended all working group and Steering Committee meetings in an ex-officio capacity. The Provincial Government committed $800,000 to cover work and related analyses for the MOU process.

The Steering Committee oversaw the entire MOU process, including the establishment of the aforementioned working groups and Worker Adjustment Subcommittee. The initial meeting of the Steering Committee was held on July 17, 2009, and its first tasks involved finalizing nominees for the Steering Committee and identifying an independent Chair for the MOU Steering Committee. Appointment of the Chair of the Steering Committee was confirmed on July 30, 2009. The role of the Chair was to provide direction to the Steering Committee and to prepare a report on the working groups' findings. The various responsibilities of the working groups are outlined below, along with the process each group undertook to meet their mandates. In total, more than 80 committee and working group meetings were held prior to the completion of this report. The terms of references for the Steering Committee and working groups are provided in Annexes 3 to 7.

Figure 2.1 Memorandum of Understanding Structure



2.1 Working Group Structure and Mandate

The FAWG was the first working group established in August 2009. Its objective was to undertake a comprehensive analysis of the financial health of the harvesting and processing sectors, a necessary step for evaluating options for restructuring the fishing industry. In order to achieve this objective, proposals were invited from consultants in mid-August to undertake financial reviews of both sectors, and in early November contracts were awarded to two consulting firms, Grant Thornton and Deloitte. Grant Thornton completed a financial assessment of the processing sector in March 2010. Deloitte completed a similar report for the harvesting sector, also in March 2010. Financial information provided by participating enterprise owners and processing firms was available only to the consultants, and only aggregate information was provided to the FAWG and, subsequently, the HWG, PWG and Steering Committee.

The HWG was established in August 2009. Its objective was to develop a comprehensive rationalization model for the harvesting sector, taking into consideration the timing of other measures taken under the MOU. The HWG was also mandated to develop a strategy that ensured that the fishing enterprises that remained (post-rationalization) could acquire additional quota at a minimal risk to the enterprise, using existing collateral to access the incremental/available resource. Additionally, the group was mandated to ensure that any rationalization program was designed in a manner whereby possible government funding initiatives would improve the viability of those who remain in the industry. Further, this was to be achieved while not artificially inflating the cost of acquiring licenses or quotas from enterprises that would be retired as a result of the rationalization process.

During development of the HWG recommendations to the Steering Committee, members considered many sources of information, including the financial analysis prepared by Deloitte, data provided by DFO, including catch and effort data, cost and earnings survey data, as well as various support and feedback provided by DFO throughout the analysis. Further, DFA engaged the services of Eric Dunne Consulting to assist both the FFAW and the inshore shrimp fleet with their analyses and proposal preparation, and Pisces Consulting to provide analytical support to the HWG.

The PWG was also formed in August 2009. Its objective was to develop restructuring models for the processing sector. The working group was mandated to consider current processing overcapacity, an aging plant workforce, recruitment and retention issues associated with the seasonality of work, out-migration, and the effect that the ongoing rationalization of the harvesting sector might have on processing operations. The PWG considered the Grant Thornton report, which assessed the financial state of the processing sector, during its deliberations. DFA also engaged the services of Pisces Consulting to provide analytical support.

A Worker Adjustment Subcommittee was formed to address workforce adjustment issues that may arise in the face of industry restructuring and/or rationalization. The role of this subcommittee was to examine the rationalization and restructuring options being considered by the PWG, and to provide input to the working group on the implications from a worker adjustment perspective.

The MWG was formed in September 2009. Its objective was to undertake a comprehensive analysis of options to more effectively and efficiently market NL seafood and, using this analysis, to make recommendations to improve seafood sales and marketing. The primary goal was to achieve a more coordinated, integrated and coherent marketing strategy for NL in the global seafood marketplace, thereby optimizing returns to industry stakeholders.

Proposals - In an effort to move the MOU process forward, in late 2009, the Minister of Fisheries and Aquaculture encouraged industry stakeholders to submit proposals regarding restructuring/rationalization and marketing for consideration by the harvesting and processing working groups. Proposals were received in early 2010 from the ASP, the FFAW, NL Inshore Shrimp Fleets, the Newfoundland and Labrador Independent Fish Harvesters Association (NLIFHA) and the Seafood Processors of Newfoundland and Labrador (SPONL).

Table 2.1 Key Milestones of the Memorandum of Understanding Process

Activity	Date
MOU Signed	July 2009
Steering Committee Established	July 2009
MOU Chair Appointed	July 2009
Deloitte/Grant Thornton (Consultants) Contracts Awarded	November 2009
Industry Proposals*	by January 2010
Financial Analysis of Processing Sector (Grant Thornton Report)	March 2010
Financial Analysis of Harvesting Sector (Deloitte Report)	March 2010
Harvesting Rationalization Working Group Final Report to Steering Committee	October 2010
Processing Restructuring Working Group Final Report to Steering Committee	October 2010
Seafood Marketing Working Group Final Report to Steering Committee	December 2010
Final Steering Committee Meeting	October 2010
Draft Report to DFA	December 2010
Final Report to DFA	February 2011

* Proposals received from NL Inshore Shrimp Fleet Chairs, ASP, FFAW, NLIFHA, SPONL and Beothic Fisheries.

3.0 Overview of the Newfoundland and Labrador Fishing Industry

Table 3.1 Industry Snapshot			
	1989	2010E	% Change
Value of Production ($millions)	$650	$942	44.9
Volume of Landings (tonnes)	506,000	301,397	-40.4
Value of Landings ($millions)	$242	$439	81.4
Harvesters (Peak)	16,665	10,802	-35.2
Processing Plants (Primary)	214	102	-52.3
Plant Workers (Peak)	21,000	10,340	-50.8

E=Estimate

Source: Professional Fish Harvesters Certification Board; DFA; and DFO

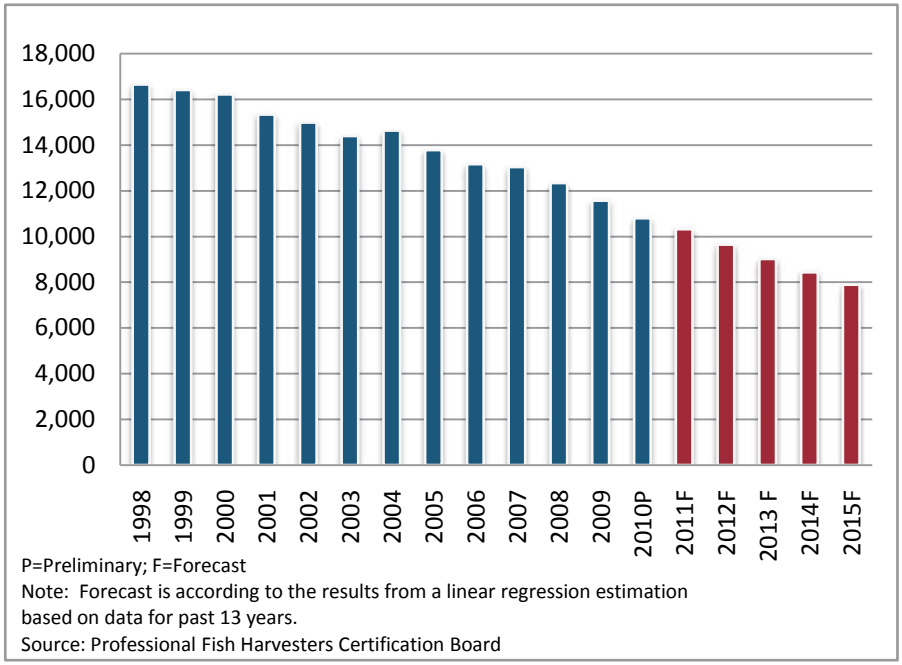
Prior to presenting the detailed analysis and findings of the MOU Steering Committee and the working groups, it will be helpful for the reader to understand some of the large-scale changes that have occurred in the NL fishing industry since the moratoria. This background information will serve to put the findings noted in this report into perspective.

The structure of the industry has changed significantly since 1989, just prior to the moratoria. After the groundfish moratoria of the early 1990s, the industry began to shift from one that harvested primarily groundfish to one harvesting primarily shellfish. This change had notable effects on the industry. As shellfish fisheries tend to have lower volume, but higher value, overall fish landings have declined; however, the value of these landings has risen. With this shift, the industry has observed a steady decline in the number of fish harvesters. Also, as a lower volume of fish is landed and less processing is required for shellfish, there has been an even more significant decline in the number of processing plants and, in turn, a decrease in plant workers in the province. This has occurred during a time when landed value increased, thereby increasing harvesters' average fishing income.

3.1 A Perspective on the Newfoundland and Labrador Harvesting Sector

There are approximately 10,800 individuals currently employed as professional fish harvesters in the province and they are scattered along the province's coastline in some 500 communities. These harvesters are employed in the 3,833 enterprises that operate in the NL fishing industry. This group of enterprises include 2,972 that operate in the province's inshore fishing sector (< 40' vessels) and 861 that operate in the nearshore sector (> 40' vessels).

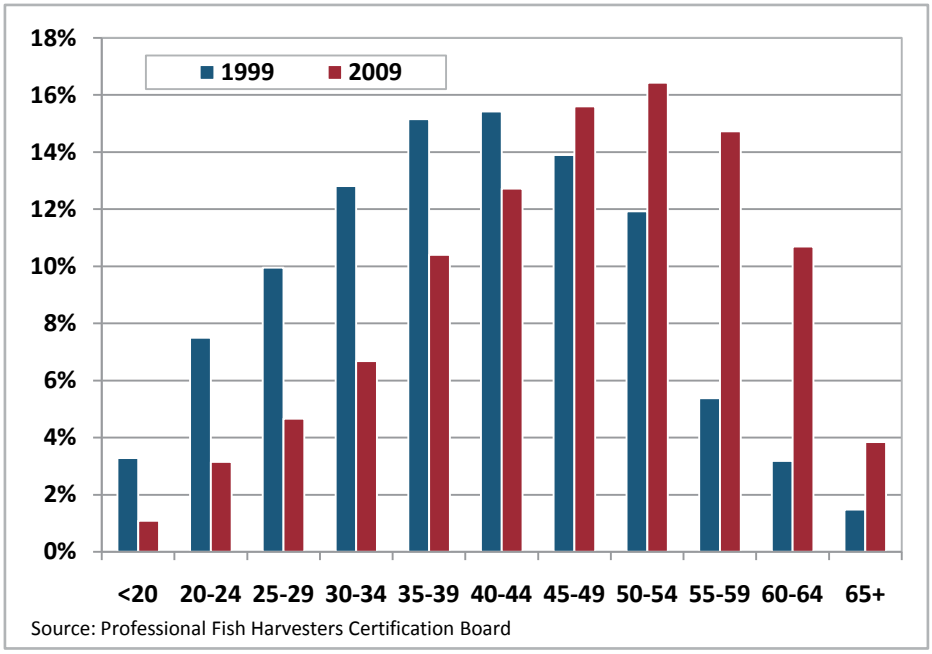
Figure 3.1 Number of Self-Employed Fish Harvesters



P=Preliminary; F=Forecast
Note: Forecast is according to the results from a linear regression estimation based on data for past 13 years.
Source: Professional Fish Harvesters Certification Board

The number of fish harvesters in this province declined by 31%, from 16,655 in 1998 to 11,566 in 2009. This trend continued into 2010, declining a further 6.6% to 10,800 workers. This decline in harvesters is expected to continue, with 500 or more harvesters projected to leave the workforce annually between now and 2015.

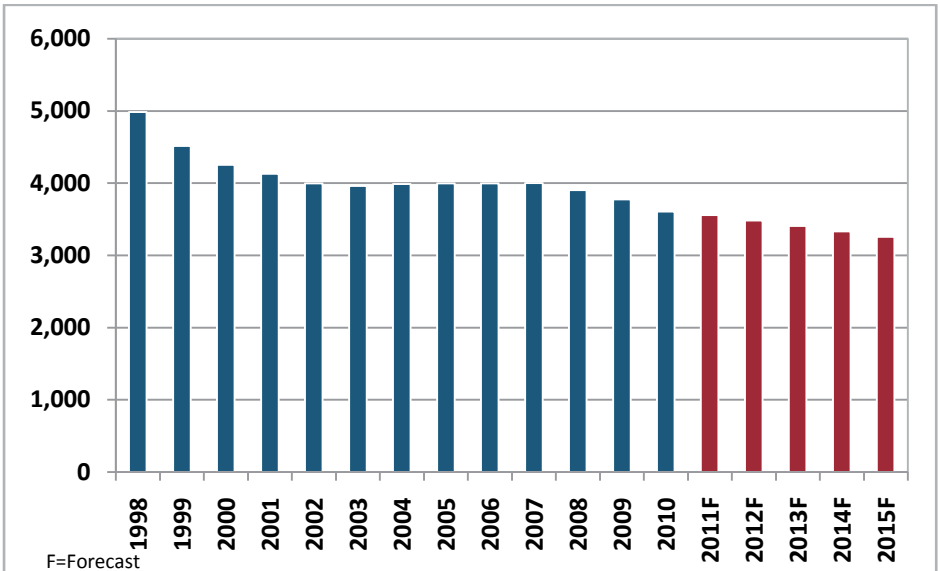
Figure 3.2 Age Profile of the Harvesting Sector



Source: Professional Fish Harvesters Certification Board

The workforce in the harvesting sector is aging. Since 1999, the percentage of harvesters in all age categories has been declining, except for the percentage of harvesters in the 45 and older age categories. In 2009, 29% of harvesters were 55 years of age or older, while only 10% of harvesters fell into this age group in 1999.

Figure 3.3 Number of Core Fishing Enterprises

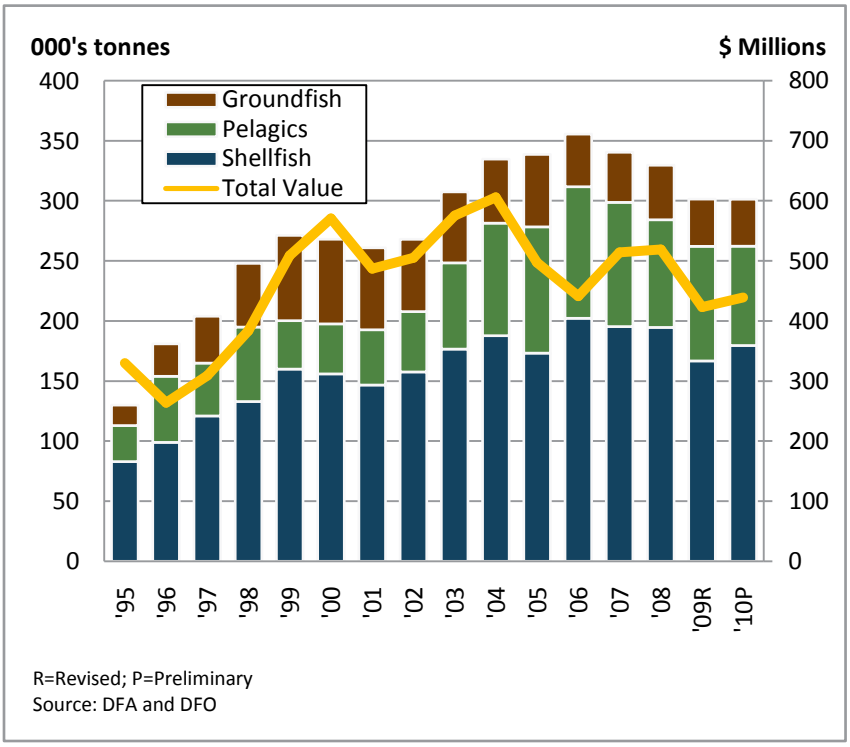


F=Forecast
Note: Forecast is according to the results from a linear regression estimation based on data for past 13 years.
Source: DFO

The number of core fishing enterprises engaged in the fishery has also declined since 1998, from 4,986 to 3,607 in 2010 (a decline of 28%). Between now and 2015, this trend is expected to continue, with more than 50 core enterprises projected to leave the industry annually. The average vessel ages of 35-64 ft. fleets are outlined in Annex 8. Increased use of licensing combining options would accelerate this decline.

The volume of landings declined 41%, from 506,000 tonnes in 1989 to 301,000 tonnes in 2009. However, with a shift in harvesting toward higher valued shellfish species, the value of landings increased. The landed value increased substantially, from $330 million in 1995 to a high of $606 million in 2004; however, it declined to $420 million in 2009. This value decline in 2009, compared to the previous year

Figure 3.4 Fish Landings By Species Group

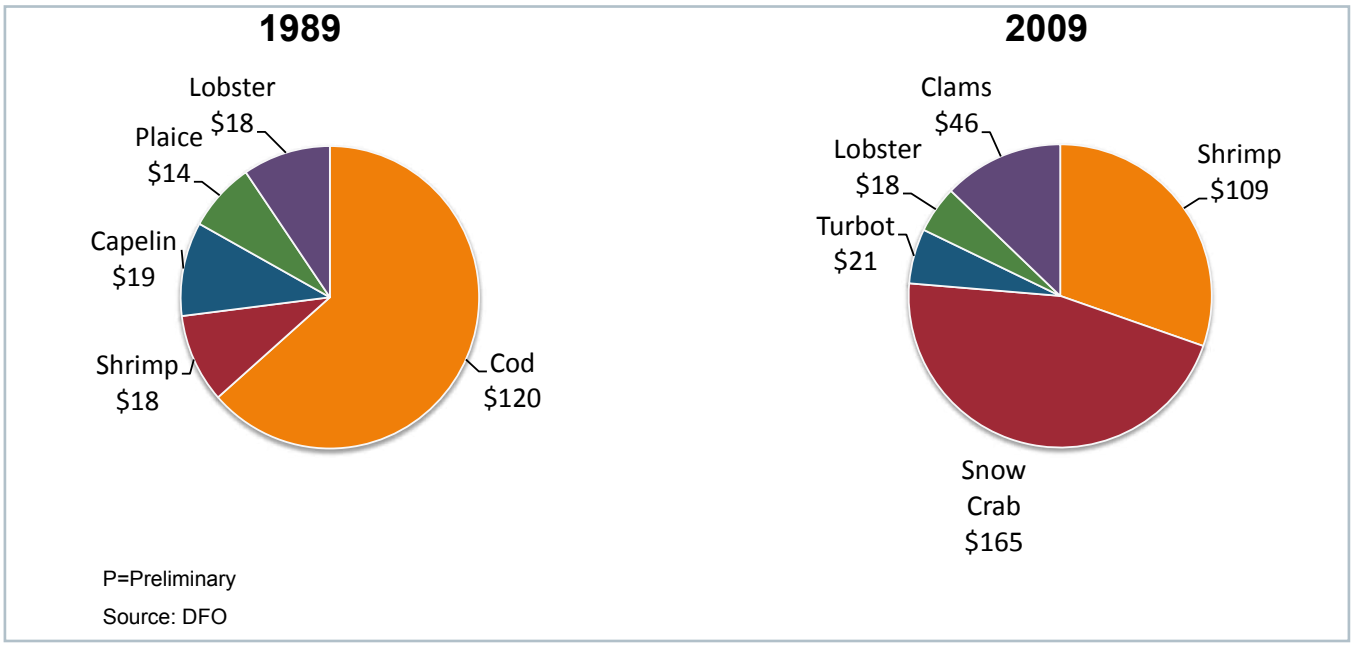


R=Revised; P=Preliminary
Source: DFA and DFO

($519 million), is primarily the result of a global economic recession. The volume of landings dropped in 2009 by 8.5% (approximately 28,000 tonnes), relative to 2008, while the value of these landings declined by 19% (roughly $100 million). The decrease in landed values between 2008 and 2009 is largely due to increased international competition (on the supply side), which resulted in lower market prices and lower prices paid to harvesters. At the same time, the increased value of the Canadian dollar, relative to other key currencies (notably the American dollar), also served to put additional pressure on participants in the NL fishing industry. This, coupled with high operating costs, has placed many participants in the fishing industry in a rather precarious financial position. In 2010, preliminary statistics indicate total landings approached 301,000 tonnes, with a landed value of approximately $440 million, with the volume of landings on par and the value up by 4% from the previous year.

The proportion of landings accounted for by shellfish has more than doubled since 1995. Shellfish landings peaked in 2006, when over 200,000 tonnes were landed. This volume was equivalent to 57% of the total landings for that year. Since that time, the percentage of the total landed volume (in the NL fishery) that is comprised of shellfish has remained relatively stable, between 55% and 60%, while the value of shellfish landings is over 80%.

Figure 3.5 Top Species by Landed Value ($ Millions)



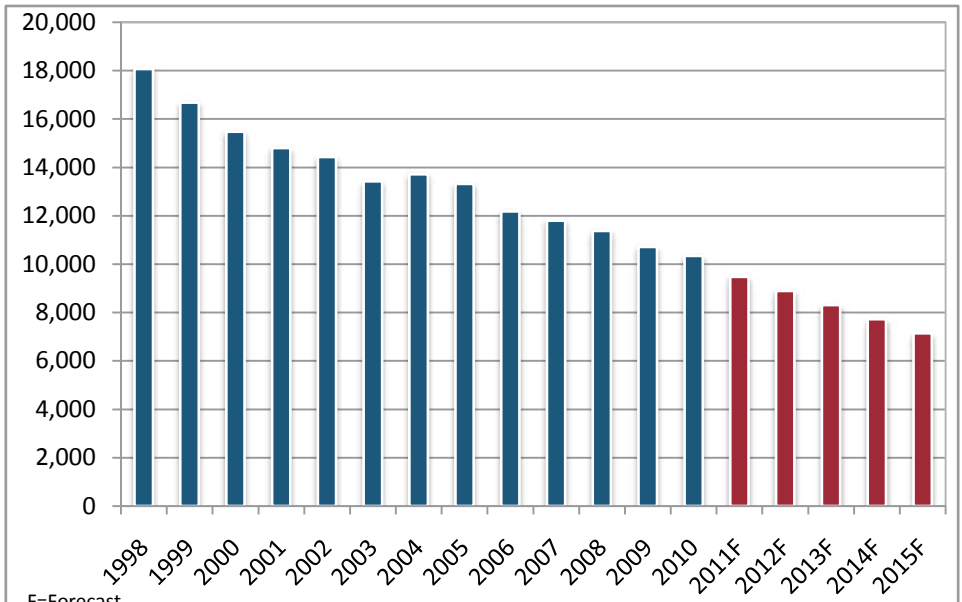
The volume of pelagic fish species landed by NL harvesters has increased since 1989. Over the past four years, pelagic species have accounted for between 27% and 32% of the total landed volume. During this same period, the groundfish landings have remained relatively stable, accounting for 12% to 14% of total landed volume.

During the 1989 to 2009 period, the top species (by landed value) has also changed dramatically. In 1989, cod accounted for almost two-thirds (63%) of the top 5 species, at $120 million. In comparison, in 2009 snow crab was the number one species at $165 million (39% of the total value), followed by shrimp at $109 million (26%).

3.2 A Perspective on the Newfoundland and Labrador Seafood Processing Sector

In 2010, there were approximately 10,300 individuals employed as processing plant workers in the NL fish processing sector. As a result of lower landings and a shift to shellfish processing (which requires less processing labour than groundfish), the number of processing plant workers has declined 43%, from 18,070 in 1998. On average, 600 plant workers left the industry each year during this period and there were 672 less plant workers in 2009 compared to 2008. This trend is expected to continue, with more than 600 plant workers projected to leave the workforce annually, between now and 2015.

Figure 3.6 Processing Plant Workers (Peak Employment)

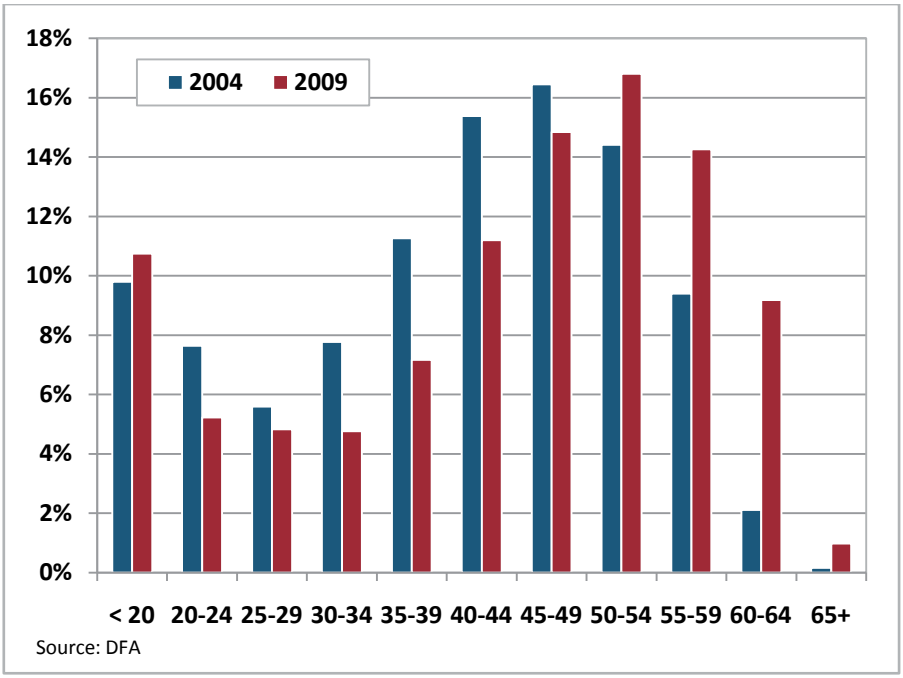


F=Forecast
Note: Forecast is according to the results from a linear regression estimation based on data for past 13 years.
Source: DFA

The seafood processing sector, like the harvesting sector, has an aging workforce. The number of processing plant workers is lower for all age categories between 20 and 50 years compared with the same categories in 2004. The percentage of workers in the age categories older than 50 years was significantly higher in 2009, compared to 2004. Additionally, in 2009, 24% of plant workers were aged 55 or older, while in 2004 approximately 12% were in this age category.

There has been a significant downsizing of the industry over the past 20 years (fish harvesters, number of enterprises, number of plants and number of plant workers). This trend is likely to continue. As illustrated, the age profile of harvesters and plant workers has gotten significantly older. Both sectors have very few new (young) entrants, and most exit the industry at age 65. Therefore, there could be a serious labour shortage within the next 5 to 10 years.

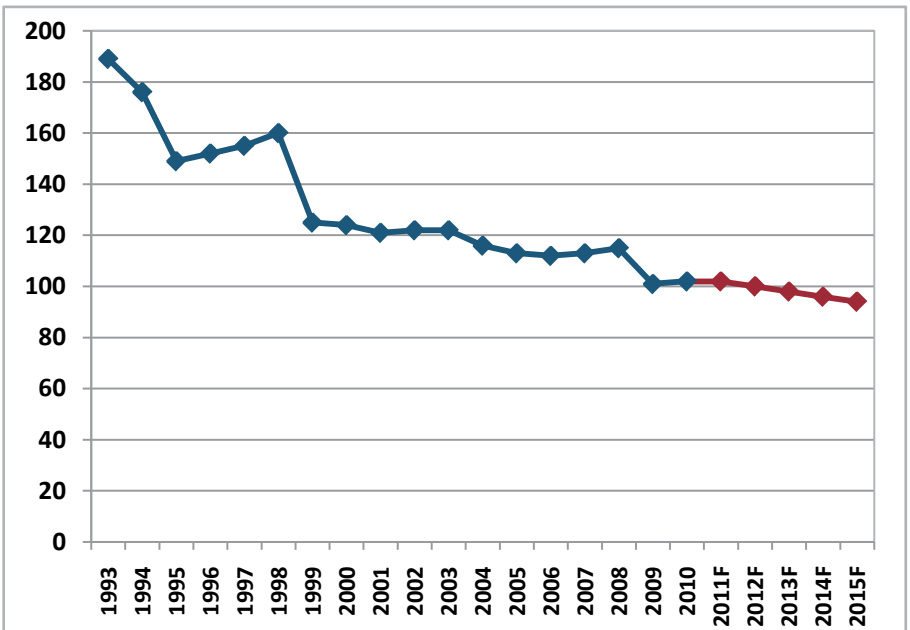
Figure 3.7 Age Profile of Processing Workers



Source: DFA

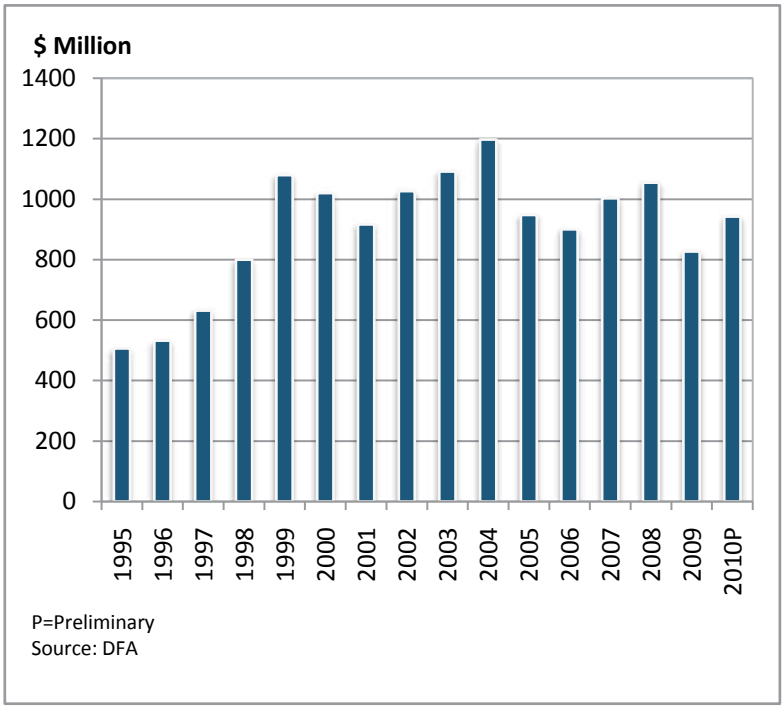
The past two decades have resulted in some rather dramatic changes in the NL seafood processing sector. The number of primary processing plants declined 46%, from 189 in 1993 to a low of 102 plants in 2010. The dollar value of provincial seafood production rose to a high of $1.2 billion in 2004, before falling to $827 million in 2009. This decline in production value, combined with the appreciation of the Canadian dollar and the increase in competition globally, resulted in the elimination of already slim profit margins in much of the seafood processing sector. These challenges provided the impetus for the establishment of the MOU on Fishing Industry Restructing, and subsequently the MOU Steering Committee in the summer of 2009.

Figure 3.8 Primary/Core Plants - 1993-2010



F=Forecast
Note: Forecast is according to the results from a linear regression estimation based on data for past 12 years.
Source: DFA

Figure 3.9 Production Value, Newfoundland and Labrador



It is noteworthy that production value is estimated to have rebounded considerably in 2010, to approximately $942 million. With the shift in production, from an industry based on processing mostly groundfish to an industry processing mainly shellfish, equipment and process changes were required in many processing plants. One of the most significant challenges facing a company when it invests heavily in new equipment (beyond overall market development) is the requirement to achieve a gross margin percentage on selling price sufficient to allow the company to retire the debt associated with the investment in new processing infrastructure (plant and equipment).

During the FIR process, and in the months leading up to the establishment of the MOU Steering Committee, ASP indicated that the circumstances processors were encountering inhibited the sector from competing effectively in the international marketplace. The external factors that impede competitiveness include a high Canadian dollar, increased cost of fuel, international competition from low-cost producers, cyclical market price variations, tariffs and market access barriers, and the increasing world aquaculture supply.

The internal factors that impede competitiveness include the short fishing season (which requires maintaining processing capacity that remains idle in the off-season); the high number of plants (which under stable or declining landings does not permit operators to increase supply and reduce corresponding fixed costs); and the associated sales and marketing methods of seafood by producers (which results in lower than average returns from the market).

Table 3.2 outlines the various factors influencing the returns to industry participants. The fishing industry has limited control over external forces and will have to adapt to global challenges. However, industry initiatives or changes to government policies can influence the domestic issues faced by harvesters and processing operations in the province.

Table 3.2 Industry Challenges

External	Domestic
• High Canadian dollar • Increased cost of fuel • International competitiveness • Low-cost producers • Cyclical market price variation • Tariffs and market access • Increasing world aquaculture supply • Global economic challenges	• Overcapacity (harvesting and processing) • Resource fluctuations/declines • Industry structure • Workforce - Recruitment/Retention • Low/Unstable incomes • Seasonality • Dependability/Timing of supply • Varying quality (harvesting/processing) • Vessel design/utilization/efficiency • Marketing (e.g., distress selling, lack of collaborative effort)

4.0 Harvesting Sector Rationalization

Extensive analysis was completed on the financial health of the harvesting sector. Deloitte conducted its financial assessment of the harvesting sector during late 2009 and early 2010, with the final report delivered in March 2010. The consultant assessed the financial health and viability of various harvesting activities of enterprise owners utilizing vessels less than 90' length overall (LOA[1]), and produced a cost-revenue model. The model was designed with the ability to complete sensitivity analysis and enable the HWG to look at various scenarios to determine the impact of resource and market forces on industry profitability. The HWG required a model to examine and evaluate the costs and benefits of options to strengthen various fleets through rationalization (e.g., enterprise buy-outs and license combining) and restructuring. The HWG was to:

- develop a comprehensive proposal for a fleet rationalization plan, cost-shared by harvesters and governments;
- pursue all possible avenues to compel the Federal Government to meet its responsibility to cost-share a fleet rationalization plan;
- develop a strategy to ensure that fishing enterprises acquiring additional quota through rationalization are able to minimize the risk associated with using their existing enterprise assets as collateral against any incremental resource access;
- ensure that any rationalization program is designed in a manner whereby government funding improves the viability of those who remain in the industry; and
- ensure best efforts are made to design a program that does not inflate the cost of acquiring licenses/quotas.

DFO involvement was critical in the work of the HWG. Economic and statistics personnel provided extensive assistance by compiling statistics and data and by providing analytical support, input and feedback to both the FAWG and the HWG.

4.1 Financial Health of the Harvesting Sector

4.1.1 Approach Taken to Determine Harvesting Sector Viability

Originally, Deloitte was to collect financial data to complete an analysis for the last three years (2006-2008), as well as relevant data for 2009. Due to time constraints, Deloitte worked with the FAWG and chose 2008 as the base year for data collection purposes. That year was determined to be reasonably representative in terms of fleet activity and financial circumstances. An online survey was developed and financial indicators of viability were identified. The survey was designed to collect financial data directly from fish harvesters, and to provide the ability to analyze the viability of various fleet sectors using the financial data provided. This required collecting a statistically valid sample of information from harvest-

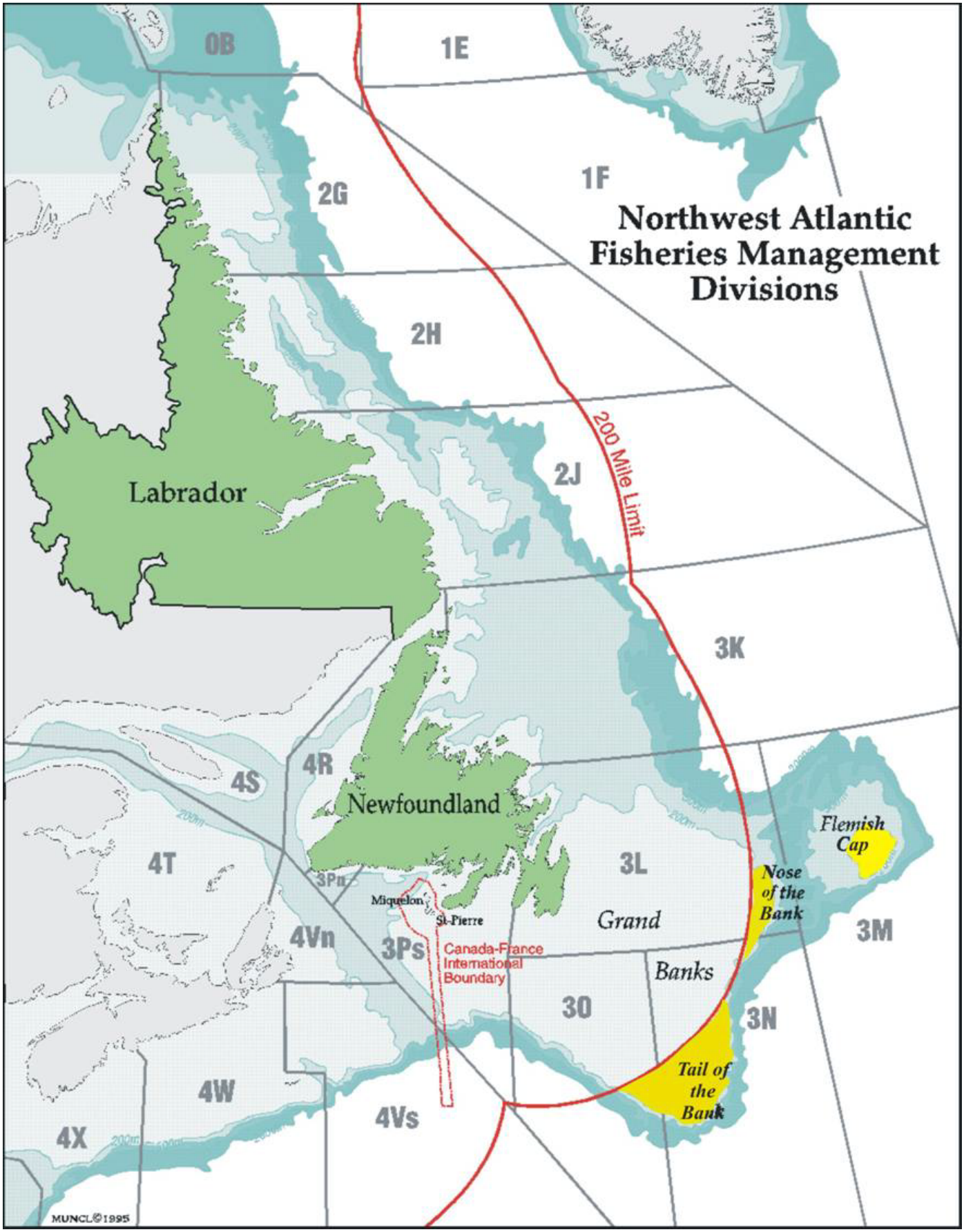
1. The authorization to move from a maximum LOA of 64' 11" to 89' 11" was provided as part of the FIR initiative in 2007 but to date there has been very little take-up and virtually all of the inshore vessels remain at less than 65' LOA.

ers within various fleet sectors. The FFAW, representing the majority of fish harvesters in the province, indicated that its members were willing to participate in this study. Since information was to be sourced directly from harvesters, the FFAW indicated their willingness to facilitate the collection of this information by encouraging harvesters to participate. Data from DFO was sourced, including landed volume and value. This data was used to validate and augment the survey data. Given that enterprise economics can vary significantly depending on characteristics including vessel size, area fished and species harvested, 14 fleet sectors were chosen by Deloitte, 7 less than 40' inshore fleets, and 7 greater than 40' nearshore fleets.

Table 4.1 Number of Fishing Enterprises by Fleet Sector, 2008

Fleet Sector	Number	Responses	Response Rate (%)
Inshore (<40')			
4R North of Point Riche	236	13	5.5
4R3Pn South of Point Riche	449	1	0.2
3Ps Fortune Bay and West (FBW)	370	32	8.6
3Ps Placentia Bay (PB)	378	14	3.7
3L	807	90	11.2
3K	649	92	14.2
2J	83	6	7.2
Total Inshore	**2,972**	**248**	**8.3**
Nearshore (>40')			
4R Shrimp	64	9	14.1
3Ps Supplementary Crab	90	7	7.8
2J3K Supplementary Crab with Shrimp	99	43	43.4
2J3K Supplementary Crab without Shrimp	151	28	18.5
2J3K Full-time Crab	28	2	7.1
3L Small Supplementary Crab without Shrimp	205	14	6.8
3L Large Supplementary and Full-time Crab	112	10	8.9
Other	112	0	0
Total Nearshore	**861**	**113**	**13**
Total	**3,833**	**361**	**9.4**

Where appropriate, for each vessel size category, details were sought on cost factors and contributions for each relevant species license. During survey completion, approximately 100 harvesters responded, of which only 30 provided enough details to be usable. Given that there were about 3,800 enterprises and these were subdivided into 14 different fleet sectors, this sample size was inadequate. In order to collect additional data to help with the financial analysis, Deloitte purchased 331 usable survey responses from an accounting firm. The accounting firm had a great deal of experience in the preparation of financial


Northwest Atlantic
Fisheries Management
Divisions
0B
1E
1F
2G
2H
2J
3K
3L
3M
3N
3O
3Pn
3Ps
4R
4S
4T
4Vn
4Vs
4W
4X
Labrador
Newfoundland
200 Mile Limit
Canada-France
International
Boundary
Miquelon
St-Pierre
Grand
Banks
Flemish
Cap
Nose
of the
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the
Bank
MUNCL©1995

reports and tax returns of individual fishing enterprises and was able to access its files to complete the surveys. In the case of surveys completed by harvesters and those completed by the accounting company, the identities of harvesters were protected. The resulting dataset of 361 surveys constituted a sample of 9.4% and was adequate to enable Deloitte to complete the required viability analysis and model. Table 4.1 provides a list of the fleet sectors that were surveyed, along with the total number of enterprises and the final survey responses in each fleet sector. Obtaining financial details for these fleets was vital in determining the health of the harvesting sector. Using this information, a model was developed to assist the HWG in completing sensitivity analysis on changes to various factors and how they impacted the profitability of each fleet and the sector as a whole.

Having analyzed the available data, Deloitte was then in a position to comment on the profitability and viability of the various fleet sectors which exist within the NL fishery. Deloitte excluded the 4R3Pn south of Point Riche fleet and the 2J3K full-time crab fleet from its final analysis because the number of respondents from each of these areas was considered too small to allow for meaningful representation of the respective fleets.

The analysis undertaken by Deloitte was based on the premise that the compensation realized by the vessel owner and crew members would include employment insurance and there would be sufficient profit to provide a reasonable return to the owner for his capital investment in the enterprise. The consultant was asked by the FAWG to develop a range of viability measures to review the long-term financial viability of each of the fleets. Four measures were developed, which included a return on equity of 9-11% and various income levels, including fishing income and Employment Insurance (EI). Deloitte used a proxy of average employment income in the province ($30,300) as one of the viability measures (see Table 4.2).

Table 4.2 Viability Measures – Deloitte

Alternate Viability Measure #	Owner Compensation (including Employment Insurance*)	Return On Investment
1	10% of revenues (using a proxy of replacement skipper share)	11%
2	$20,000	9%
3	$25,000	10%
4	$30,300	11%

Note: * According to Taxfiler data, average EI benefit for harvesters has ranged from 41% to 48% of total income from 2001 to 2006.

4.1.2 Financial Results

Deloitte used the survey data and the aforementioned parameters to calculate the percentage of enterprises that achieved viability based on the four viability measures outlined in Table 4.2. Deloitte's summary financial results for each of the four viability measures are presented in Table 4.3. The executive summary of Deloitte's report is also appended to this report (see Annex 10).

Table 4.3 Percentage of Enterprises Viable By Fleet Sector				
	Alternate Viability Measures			
	#1	#2	#3	#4
Inshore (<40')	**63%**	**57%**	**41%**	**21%**
2J	50%	33%	17%	0%
3K	59%	53%	38%	21%
3L	73%	68%	50%	22%
3Ps FBW	66%	63%	44%	25%
3Ps PB	43%	50%	36%	21%
4R North	38%	23%	8%	8%
Nearshore (>40')	**50%**	**73%**	**65%**	**60%**
4R Shrimp	22%	44%	33%	33%
3Ps Supplementary Crab	14%	43%	14%	14%
2J3K Supplementary Crab with Shrimp	60%	79%	79%	77%
2J3K Supplementary Crab without Shrimp	54%	71%	64%	57%
3L Small Supplementary Crab without Shrimp	50%	71%	64%	50%
3L Large Supplementary and Full-time Crab	50%	100%	80%	70%
Total	**59%**	**62%**	**48%**	**33%**

Based on the results outlined above, and considering the rather conservative viability thresholds outlined in the methodology, Deloitte concluded that:

1. between one-third and two-thirds of the fish harvesting operations currently operating in NL are viable, depending on the viability measure employed;
2. viability levels across the various fishing areas or regions vary widely;
3. the survey data suggests nearshore fleets appear to be more viable compared to the inshore fleets; and
4. debt levels appear to be greater in nearshore enterprises with average loan balances nearing $310,000, compared with $2,150 on average for the inshore enterprises.

Under the most rigorous measure (#4) in the inshore sector, all sectors have a low level of viability, with 2J and 4R North being the least viable. Fleets with low levels of viability in the nearshore sector include the 3Ps Supplementary Crab (14%-43%) and 4R Shrimp (22%-44%). For fleets located in 2J3K Supplementary Crab, 3L Small Supplementary, and 3L Large Supplementary, viability exceeds the 50% level under each of the four viability measures. When the results were received from Deloitte and the revenue data compared to DFO's catch and effort data, it was evident that in some cases the sample results were likely skewed towards highliners or combined/buddied-up enterprises. This would imply that the levels of viability for some fleets may have been overstated in the Deloitte analysis.

DFO's buddy-up policy allows two fish license holders to form a temporary partnership and to fish two quotas from a single vessel. In 2008, there were over 700 buddy-up arrangements for snow crab in the inshore sector. Arrangements also existed for capelin, lobster and cod. In contrast, combining allows individual independent core enterprise holders to buy another core enterprise for the purpose of combining licenses permanently. In 2008, 2% of total enterprises exited through combining in the inshore sector while 5% of the nearshore sector exited.

Table 4.4 Buddy-up Enterprises by Fleet Sector, 2008

	2008 Population	Crab Only	Crab/ Shrimp	Shrimp Only	Lobster Only	Lobster/ Crab	Total	% Buddy-up
Inshore								
4R North of Point Riche	236	-	-	-	100	-	100	42%
4R3Pn South of Point Riche	449	94	-	-	56	38	188	42%
3Ps FBW	370	-	-	-	-	-	0	0%
3Ps PB	378	248	-	-	-	-	248	66%
3L	807	482	-	-	-	-	482	60%
3K	649	534	-	-	-	-	534	82%
2J	83	44	0	0	-	-	44	53%
Subtotal Inshore	**2,972**	**1,402**	**0**	**0**	**156**	**38**	**1596**	**54%**
Nearshore								
4R Shrimp	64	-	-	20	-	-	20	31%
3Ps Supplementary Crab	90	16	-	-	-	-	16	18%
2J3K Supplementary Crab with Shrimp	99	28	10	12	-	-	50	51%
2J3K Supplementary Crab without Shrimp	151	30	-	-	-	-	30	20%
2J3K Full-time Crab	28	8	-	8	-	-	16	57%
3L Small Supplementary Crab without Shrimp	205	24	2	-	-	-	26	13%
3L Large Supplementary and Full-time Crab	112	30	20	4	-	-	54	48%
Other	112	-	-	-	-	-	0	0%
Subtotal Nearshore	**861**	**136**	**32**	**44**	**0**	**0**	**212**	**25%**
Total	**3,833**	**1,538**	**32**	**44**	**156**	**38**	**1,808**	**47%**

Note: Above figures do not include:
- 3K capelin buddy-ups (89)
- 4R cod buddy-ups (248<40ft)
- 3L small supplementary crab with shrimp
- 12 crab; 12 crab/shrimp; 8 shrimp only

The intent of both the buddy-up and combining policies (introduced under the provision of the FIR initiative in 2007) is to enable fishing enterprises to improve efficiency of operations, thereby enhancing their viability. To date, 279 enterprises have exited the industry through combining (165 inshore and 114 nearshore).

Table 4.5 Enterprises Exited through Combining - by Northwest Atlantic Fisheries Organization (NAFO) and Fleet				
License Year	NAFO Area	# Enterprises Exited		
		< 40' Fleet	>= 40' Fleet	Total Enterprises
2008	2J	1	0	1
2008	3K	10	22	32
2008	3L	25	13	38
2008	3PS	22	9	31
2008	4R	0	2	2
2008 Total		**58**	**46**	**104**
2009	2J	5	1	6
2009	3K	13	14	27
2009	3L	22	19	41
2009	3PS	20	6	26
2009	4R	0	7	7
2009 Total		**60**	**47**	**107**
2010	2J	1	1	2
2010	3K	11	5	16
2010	3L	20	9	29
2010	3PS	15	6	21
2010 Total		**47**	**21**	**68**
Total	2J	7	2	9
Total	3K	34	41	75
Total	3L	67	41	108
Total	3PS	57	21	78
Total	4R	0	9	9
All Years Total		**165**	**114**	**279**

Source: DFO

4.2 Harvesting Rationalization Requirements

At this stage in the MOU process, Deloitte's financial viability results, along with the financial model that was developed, were forwarded to the HWG for further analysis and consideration in the development of a plan for industry rationalization.

4.2.1 Rationalization Options

The HWG analyzed several options for industry rationalization. Proposals were received from the FFAW and the NL Inshore Shrimp Fleets. NLIFHA also submitted a rationalization proposal, which essentially built upon the NL Inshore Shrimp Fleets proposal. These were received in early 2010, prior to the financial results being finalized by Deloitte, although members of the working group saw an earlier draft of the report which confirmed the low levels of viability that were anecdotally reported by industry participants. In addition to analysis being completed on the terms and conditions outlined in the FFAW proposal and the NL Inshore Shrimp Fleets proposal, the working group assessed rationalization levels under two additional options, "commercial" and "loan guarantee" terms. The four options are outlined below and summarized in Table 4.6.

1. **FFAW Proposal:**

The FFAW submission calls for a rationalization of the inshore and nearshore fleet sectors. Principal features include:

- a collective buy-out premised on shared resources amongst those who remain;
- 30-40% rationalization level;
- government-industry funded (75% grant and 25% loan[2]); and
- a 10-year program horizon.

2. **NL Inshore Shrimp Fleets Proposal:**

The principal features of the option proposed by the NL Inshore Shrimp Fleets include:

- 90% loan with a 10% maximum downpayment requirement;
- a government subsidized loan (3% interest);
- a 15-year loan term and a 5-year program horizon; and
- flexible payment terms (based on assignment of catch as a percent of revenue).

3. **Enhanced Loan Guarantee:**

This option was designed to examine the potential impacts an improved government loan guarantee program might have on the debt servicing requirements of enterprises that borrow funds for the purpose of combining. Principal features include:

- 15-year term with no downpayment required; and
- 7% interest rate.

4. **Commercial:**

This option was designed to represent the financing conditions currently being experienced by enterprises that are borrowing from financial institutions (without the benefit of government loan guarantees) to fund the costs of combining. Features include:

- 8-year term with no downpayment required; and
- 7% interest rate

Table 4.6 Rationalization Options

	FFAW	Shrimp Fleet	Loan Guarantee	Commercial
Government Grant	75%	0%	0%	0%
Loan Terms				
Interest	6.42%	3%	7%	7%
Term	15 years	15 years	15 years	8 years
Downpayment	0%	10%	0%	0%
Implementation Horizon	10 years	5 years	ongoing	ongoing

Most of the HWGs analysis was focused on the FFAW proposal, particularly the direct fleet rationalization component. However, the various components are discussed below. This proposal is attached as Annex 11.

2. The HWG agreed that the loan board rates (6.42%) would be used in the analysis.

FFAW Fleet Rationalization Proposal

The three components of the FFAW fleet rationalization proposal include a direct fleet reduction program that would be cost-shared between governments and harvesters, an improved loan guarantee program to cover individual quota acquisition through enterprise takeover or combining, and the Lobster Conservation and Sustainability Program (LCSP) (which would apply to most of the under 40 ft. fleets from Fortune Bay West and North to Cape Norman). A summary of the FFAW proposal elements is outlined below, while the proposal is attached as Annex 11.

Direct Fleet Reduction Program:

A direct fleet reduction program is recommended for other fleets not covered under the Atlantic Lobster Sustainability Measures Program (ALSMP) that is cost-shared between governments and harvesters. The FFAW proposal is based on fleet reduction options of 30% and 40%. They suggest the most effective and straightforward method of achieving fleet reduction is through a license buy-out program totally funded by governments. However, they propose a cost-sharing arrangement that would be government-industry funded 75%-25%. The fleet budgets for removals would be related to the value of the percentage effort reduction needed in each fleet. Each fleet would be required to submit a fleet rationalization buy-out proposal within their assigned budget. The program would have a ten-year time horizon.

Enhanced Loan Guarantee Program:

FFAW proposes that the loan guarantee program should also be extended to cover acquisition of vessels, gear and equipment as required by the enterprises in the future. Also, combining transactions undertaken back to April 12, 2007, would be eligible for refinancing under this program. It should also cover the financing of 'combining' transactions for those fleets that might opt for that approach. The annual principal repayment would be covered by an assignment of catch provision to guarantee principal payment. Additionally, only the quota/license being acquired in the financed transaction would be used as collateral; not the total holdings for the enterprise. The FFAW indicates that the cost to government will consist of interest relief (difference between the commercial rate and the proposed rate of 3%) and any loan defaults that may need to be covered.

Lobster Conservation and Sustainability Program:

The FFAW submitted a proposal to the ALSMP for an enterprise buy-back initiative, for joint funding by lobster harvesters and both levels of government. The ALSMP is intended to reduce fishing effort, increase economic viability and minimize the debt load of those who remain in the fishery. Since the FFAW submitted the initial Fleet Rationalization Proposal, they have submitted a revised proposal to the ASLMP, encompassing the following costs:

Table 4.7 Lobster Conservation and Sustainability Program Costs

	Amount ($ Million)	% of Total
ALSM Initiative (DFO)	9.78	30
Harvesters*	7.50	40
Provincial Government	9.78	30
Total	**27.06**	**100**

Note: * Does not include $4.43 million as the FFAW valuation of the non-cash contribution by harvesters as part of the Voluntary Trap Retirement Program.

4.2.2 Approach Taken to Determine Rationalization Requirements

In order to facilitate a more detailed analysis of the harvesting sector on a fleet-by-fleet basis, the HWG supplemented Deloitte's data with other data sources. Cost and earnings survey data and catch and effort data collected by DFO were both used. These datasets were used to fill in gaps in the Deloitte dataset, and to make reasonable adjustments to remove the inherent anomalies related to "buddy-up" and "enterprise combining," thus bringing all fleet sectors back to the single enterprise level. The final data used by the HWG is considered to be the best data available for determining the financial health of the harvesting sector, particularly on a fleet-specific basis, and arguably the most exhaustive financial analysis ever conducted on the inshore and nearshore fleet sectors.

To build a comprehensive rationalization model for the harvesting sector, a number of other assumptions were considered. The key assumptions included the quantity of raw material resources available to the enterprises, market prices, landed prices and fuel costs. These were determined through research and analysis and discussion amongst the HWG and the Steering Committee. DFA, with assistance from an external consultant, provided extensive analysis of all of the key variables using internal and external data sources, and validated all sources where possible. Table 4.8 outlines the key assumptions (scenario variables) that were made by the harvesting and processing working groups and were used for the analysis.

Table 4.8 Scenario Variables (Assumptions)

	Crab	Shrimp	Groundfish	Pelagics	Lobster
Market Prices - Gross $Cdn					
Pessimistic	3.27	2.64	1.83	0.74	
Anticipated	3.85	3.10	2.12	0.83	
Optimistic	4.43	3.57	2.41	0.93	
Shore Price - Harvesters $Cdn					
Pessimistic	1.01	0.31	0.53	0.09	3.28
Anticipated	1.24	0.42	0.66	0.13	4.68
Optimistic	1.49	0.52	0.77	0.17	5.66
Resource (tonnes)					
Pessimistic	41,755	36,174	29,763	74,300	2,500
Anticipated	47,194	47,208	35,016	87,412	2,660
Optimistic	52,617	58,242	40,268	100,524	2,972
Fuel Cost ($/litre)					
Pessimistic	1.01	1.01	1.01	1.01	1.01
Anticipated	0.84	0.84	0.84	0.84	0.84
Optimistic	0.80	0.80	0.80	0.80	0.80

The level of rationalization required by each fleet sector to achieve viability was examined. The HWG agreed on a single viability measure for this analysis (different from either of the four measures used by Deloitte). This measure was established by the working group and collectively provided a reasonable expectation of viability, taking into account the current status of the harvesting sector and the fishing industry generally.

The targets used include a return on investment of 7% for enterprises, and an ability to pay both owners and crew reasonable incomes from fishing (defined as $20,000 for crew in all fleet sectors, including owner, for inshore enterprises, and $35,000 for owners of nearshore enterprises). In comparison, the average fishing income for harvesters in 2006 was $9,247, based on the latest Taxfiler data available. The final rationalization assessment was completed on 16 fleets in the inshore and nearshore sectors combined. The expansion of the fleets to 16 from the 12 contained in Deloitte's work was possible by supplementing the dataset collected by Deloitte and using various DFO data sources. The results by fleet sectors were validated through a consultation session with harvesters, the FFAW and DFO.

4.2.3 Rationalization Requirements by Fleet Sector

The HWG completed analysis on seven inshore fleets and nine nearshore fleets. The rationalization requirements to achieve viability for each of the fleets was calculated based on the terms and conditions outlined in the:

1. FFAW Proposal;
2. NL Inshore Shrimp Fleets Proposal;
3. Loan Guarantee Option; and
4. Commercial Option.

Inshore Sector (<40')

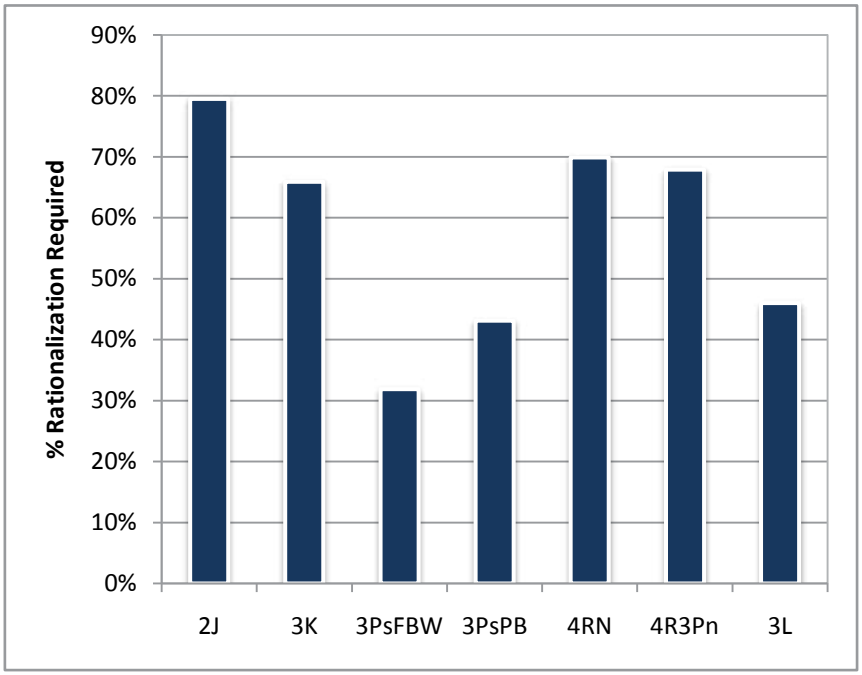
A total of 2,972 enterprises are engaged in fish harvesting operations in the NL inshore fishing sector. These include:

- Area 2J (83 enterprises);
- Area 3K (649 enterprises);
- Area 3Ps Fortune Bay West (370 enterprises);
- Area 3Ps Placentia Bay (378 enterprises);
- Area 4R North (236 enterprises);
- Area 4R3Pn South of Point Riche (449 enterprises); and
- Area 3L (807 enterprises).

This section focuses on the rationalization requirements under the terms proposed by the FFAW based on the "anticipated" assumptions. The FFAW option requires the lowest level of rationalization and the other options require somewhat higher levels due to debt servicing requirements. Nevertheless, the overall results were relatively similar for each option (see Table 4.9). Under the FFAW option, the inshore fleet would require rationalization in the range of 32% to 80% in order to achieve viability, depending on the fleet sector. In total, 1,620 or 54% of the enterprises in the NL inshore fleet would have to be removed (under the terms of the FFAW proposal) in order to meet the income and enterprise viability targets.

The highest levels of rationalization required is in 2J (80% of 83 enterprises), followed by 4R3Pn (68% of 449 enterprises), 4R North (70% of 236 enterprises) and 3K (67% of 649 enterprises). This represents an average rationalization rate of 71% in these four fleet sectors. In other words, on average an enterprise in these fleets would need to harvest roughly four times the resources currently available to it in order to meet the viability targets.

Figure 4.1 Percentage of Rationalization - Inshore - FFAW



Lower levels of rationalization would be required in the remaining fleet sectors (3L, 3Ps FBW and 3Ps PB) under the terms of the FFAW proposal. This represents an average level of rationalization of 41% in these three fleet sectors which means, on average, enterprises in these fleet sectors would need to harvest almost double their current levels to achieve the viability target. Referring to Table 4.9, the average rationalization required in the inshore sector ranges from a low of 54% under the FFAW terms to a high of 66% using commercial loan terms.

Table 4.9 Comparison of Number of Enterprises Pre and Post-Rationalization – Inshore Sector

	2J	3K	3L	3PsFBW	3PsPB	4RN	4R3Pn	Total	Percent Remaining
Enterprises Pre- Rationalization	83	649	807	370	378	236	449	2,972	**100%**
Enterprises Post- Rationalization									
1. FFAW Terms	17	221	436	252	215	71	144	1,355	**46%**
2. NL Inshore Shrimp Fleets Term	13	195	387	241	200	64	130	1,230	**41%**
3. Loan Guarantee	7	182	363	237	193	61	121	1,165	**39%**
4. Commercial Terms *	Unachievable	149	299	222	174	57	108	1,017	**34%**

Note: * Although the commercial option for 2J is unachievable, the HWG calculated the amount required to meet the income target, which resulted in 9 out of 83 enterprises remaining. As such, the total enterprises post-rationalization under the commercial terms include this number.

Nearshore Fleets (>40')

Nine nearshore fleets have been included in this report for analysis purposes. In 2008, there were 861 enterprises engaged in fish harvesting operations in the NL nearshore fishing sector. These are:

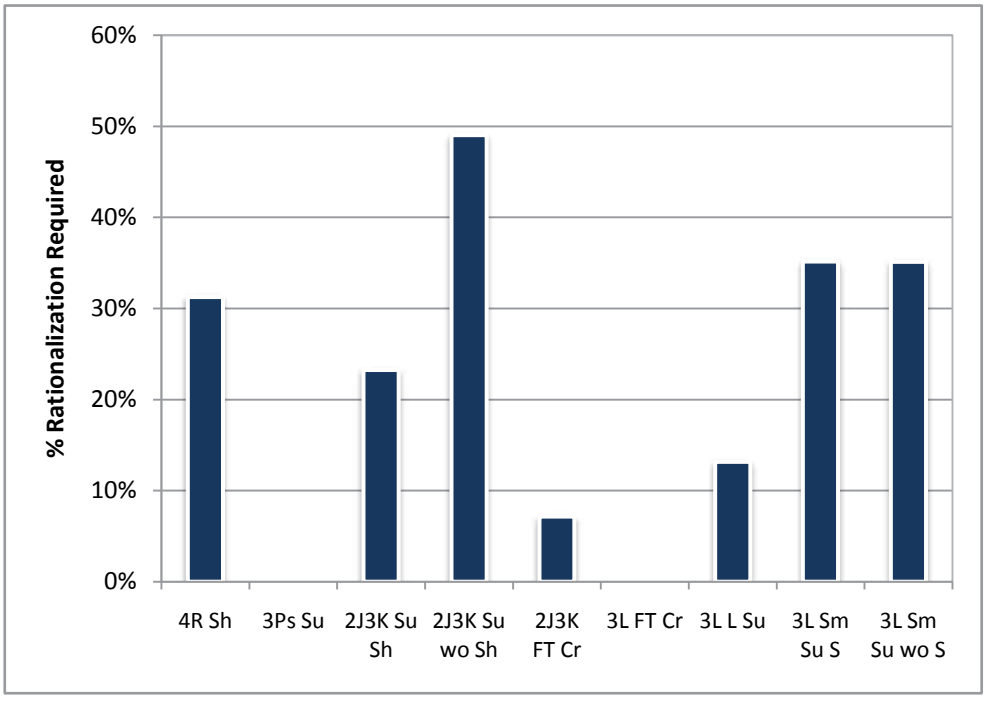
- Area 4R Shrimp (64 enterprises);
- Area 3Ps Supplementary (90 enterprises);

- Area 2J3K Supplementary with Shrimp (99 enterprises);
- Area 2J3K Supplementary without Shrimp (151 enterprises);
- Area 2J3K Full-time Crab (28 enterprises);
- Area 3L Full-time Crab (36 enterprises);
- Area 3L Large Supplementary (76 enterprises);
- Area 3L Small Supplementary with Shrimp (37 enterprises);
- Area 3L Small Supplementary without Shrimp (205 enterprises); and
- Other [3] (75 enterprises).

Under the terms of the FFAW proposal, the nearshore fleets would require between 0% and 49% rationalization, depending on fleet sector. The weighted average rationalization required for viability of the nearshore fleets is 25%. In total, approximately 214 of the nearshore enterprises in the NL nearshore fleets would have to be removed in order to meet the income and enterprise viability targets established by the HWG.

The region that would be most dramatically affected by this rationalization is Area 2J3K, which includes the southern region of Labrador and the northeast coast region of Newfoundland (i.e. north of Cape Freels). The highest levels of rationalization would be required in the 2J3K without Shrimp fleet (49% of 151 enterprises). In other words, on average, enterprises in this fleet would need to harvest roughly double their current volumes to meet the viability target. Areas 3L Full-time (36 enterprises) and 3Ps Supplementary (90 enterprises) do not, in general, require any rationalization to achieve viability as the established viability targets have, on average, already been met in these areas. Table 4.10 estimates the number of enterprises remaining by fleet in the nearshore sector post-rationalization under the four options analyzed. The overall average rationalization required across all nearshore fleet sectors ranges from a low of 25% under the FFAW terms to a high of 40% using commercial loan terms.

Figure 4.2 Percentage of Rationalization - Nearshore - FFAW



3. Note there were 75 enterprises in other fleet sectors, such as the small west coast seiner fleet, which could not be examined due to insufficient data.

Table 4.10 Comparison of Number of Enterprises Pre and Post-Rationalization – Nearshore Sector												
	4R Sh	3Ps Su	2J3K Su Sh	2J3K Su wo Sh	2J3K FT Cr	3L FT Cr	3L L Su	3L Sm Su S	3L Sm Su wo S	Other	Total	**Percent Remaining**
Enterprises Pre-Rationalization	64	90	99	151	28	36	76	37	205	75	861	**100%**
Enterprises Post- Rationalization												
1. FFAW Terms	44	90	76	77	26	36	66	24	133	75	647	**75%**
2. NL Inshore Shrimp Fleets Term	44	90	74	69	26	36	64	20	119	75	617	**72%**
3. Loan Guarantee	43	90	72	66	25	36	62	16	111	75	596	**69%**
4. Commercial Terms*	42	90	65	57	22	36	40	Unachievable	90	75	517	**60%**

Note: * Although the commercial option for 3L Sm Su S is unachievable, the HWG calculated the amount required to meet the income target, which resulted in 18 out of 37 enterprises remaining. As such, the total enterprises post-rationalization under the commercial terms include this number.

In concluding this section, a final cautionary note is warrented. The above analysis is based on "average" enterprise performance over relatively large fleet sectors. Within these sectors there could be a fair degree of variability. To illustrate, in area 3L there was high variability between the three bays (St. Mary's Bay, Conception Bay and Trinity Bay). As a result, on average the data was not representative of these individual fleets. While the Deloitte report noted that average enterprise revenue in 3L was $35,300, further analysis found that the average revenue per fleet in St. Mary's Bay, Conception Bay and Trinity Bay was $69,505, $44,575, and $27,337 respectively.

4.3 Benefits and Costs of Rationalization

FFAW noted in its rationalization proposal that "a reduction in the number of fishing enterprises would reduce peak landings, allow for a much better distribution of landings within the current operating season and a modest expansion of the operating season might be attainable in some species. Sufficient economic returns are required to allow owners/operators to reinvest in their enterprises, to be in a position to replace vessels, gear and equipment, as they need maintenance and eventual replacement." Rationalizing the industry should leave the remaining participants better off by improving enterprise efficiency. The most challenging aspect of the costing effort comes when attempting to attach a value to the various harvesting enterprises that operate in the 16 fleet sectors. As outlined earlier in this report, financial performance varies greatly by fleet, due in large measure to variances in catch rates and individual enterprise access to resources. The values assumed by the HWG for acquiring licenses/quotas were obtained from the FFAW proposal and are summarized in Table 4.11. These are the values used to determine the resource acquisition costs for rationalization, and are believed to be reasonably representative of current quota transfer values.

Table 4.11 Expected License Cost	
Species	**Cost ($/Pound)**
Crab	$5.00
Shrimp	$0.50
Groundfish	$0.32
Lobster	$9.05
Pelagics	Included above

The FFAW proposed rationalization in the magnitude of 30-40% to allow the remaining harvesters to have access to more resources. They requested financing in the range of $222.5 million to $292 million for industry buy-outs. Further analysis, based on the rationalization requirements by fleet, indicates total costs to achieve viability are closer to $190 million (75% grant and 25% loan). The benefits that accrue to those that remain would be influenced by the costs associated with rationalization. The total cost associated with the FFAW and shrimp fleet option terms are close, with a difference of $2.85 million (1.5%), although the total cost under the commercial financing option is 1.5 times greater than that of the FFAW ($89.6 million). Issues including who bears the risk (government/industry), the ability of the harvesters to provide the downpayment and their ability to obtain financing are major considerations when comparing these options for rationalization.

It is noteworthy to mention that the FFAW proposal does not include a provision for incidental costs for deckhands. Its proposal is based on a 10-year time period that is in line with the aging harvester demographics. As such, there are no costs included for displaced harvesters.

Table 4.12 Rationalization Costs under Various Options ($ Millions)

	Inshore			Nearshore			Total		
	Grant	Loan	Total	Grant	Loan	Total	Grant	Loan	Total
FFAW	70.0	23.3	**93.3**	72.2	24.1	**96.3**	142.2	47.4	**189.6**
Shrimp*	-	91.4	**91.4**	-	101.0	**101.0**	-	192.4	**192.4**
Loan Guarantee	-	105.9	**105.9**	-	123.4	**123.4**	-	229.3	**229.3**
Commercial	-	116.1	**116.1**	-	163.0	**163.0**	-	279.1	**279.1**

*Note: The Shrimp option includes interest subsidy of 3%. Compared to a commercial rate of 7%, the subsidy amounts to $75 million, which is not reflected in the table costs.

Consideration must be given to which party, government or industry, bears the financial risk of rationalization and to what degree. Given the dynamic nature of the industry, the ability of the harvesters to maintain a long-term loan payment would be compromised in declining resource scenarios, thus increasing the risk to government.

4.4 Governments' Role

Fish harvesting is an area of federal jurisdictional responsibility. Policy and management decisions over the past few decades have contributed to the industry's current structure. There were 3,200 snow crab licenses issued in the 1990s. The majority of these were located in the inshore sector (2,400). This number represents an enormous increase from the 70 licenses issued prior to the mid-1980s. The number of shrimp licenses peaked at approximately 360, up from just under 50 during the 1980s. The additional licenses were issued primarily to core enterprises in response to the collapse of the groundfish fishery. Unfortunately, there are insufficient resources to sustain the large number of licenses issued, as confirmed by the financial analysis completed during this MOU process.

During FIR, the Federal Government agreed to implement changes in its harvesting policies and regulations that supported self-rationalization of the harvesting sector. These changes included more flexible rules on combining and allowance for interested harvesters to move to larger vessels. DFO also committed to allowing licenses to be used as collateral, but later postponed implementation. Subsequent to this, a court decision in Nova Scotia known as the Saulnier decision set a precedent for licenses to be used as collateral under the *Personal Property Security Act*, in the case of bankruptcy. On the basis of the Saulnier decision, DFO has recently advised commercial banks of new policy arrangements that can provide sufficient security for banks to finance license acquisitions.

The province committed to include licenses as an eligible item in the FLGP during the FIR initiative. Although this has not yet been done due to the above-noted delays on the part of the Federal Government, the province made changes to the provincial FLGP, including:

- increasing the ceiling amount from $1.3 million to $2 million;
- providing a fixed payment option; and
- including refinancing of debt previously held with processors.

Since enhancements were announced in April 2007, there has been limited uptake on the FLGP. Approximately 279 enterprises exited the industry as a result of the combining of 575 licenses, all of which was achieved without the benefit of access to the FLGP. Additionally, buddy-up arrangements have existed in the inshore sector (<40' fleet) since 1996 (about 700 buddy-up arrangements existed in the inshore crab fishery in 2008).

In 2009, buddy-up arrangements also existed in 3K capelin, 4R lobster and 4R cod. The 2010 buddy-up policy was similar to the previous year (buddy-up included a maximum of two fishers and up to three individual quotas (IQs), factoring in combined quotas). In 2006, the buddy-up policy was extended to the nearshore sector (>40') for shrimp and crab; however, the policy in this instance is subject to stringent conditions. Consequently, enterprise combining is the principal approach to self-rationalization for this fleet sector.

In conclusion, the buddy-up and combining policies that exist have provided some degree of rationalization. That said, there is anecdotal evidence that suggests that the combining in some fleets has contributed to financial stress due to the loan burden for the acquisition cost of enterprises. Buddy-up relationships are limited to some species, and the policy has not enabled the permanent removal of enterprises from the fleet. Changes to the federal buddy-up policies could provide a mechanism to support a sustainable self-rationalization option for many fleet sectors, by allowing two or more buddy-up license holders to permanently consolidate their enterprises.

4.5 Summary of Findings - Harvesting Sector

The Federal Government should carefully consider the harvesting rationalization proposal to ensure that harvesters are not restricted by policies and regulations that discourage rationalization. Both levels of government must work together to ensure that any efforts at rationalizing and restructuring the harvesting sector are optimized by ensuring that their policies complement each other, do not discourage further self-rationalization on the part of interested harvesters, and provide the necessary flexibility for enterprises to respond to changes that will occur in the future.

Examination of the financial health of the harvesting sector indicates that some fleets are under severe financial distress, others require rationalization to be viable going forward, and some fleets are viable under current conditions. The question arises, for those fleets requiring intervention, to what extent would policy changes for buddy-up and combining arrangements affect the financial viability of the fleets? If the answer to this question is that modified policies would do little to improve the situation, then some form of financial intervention may be required, and in the most severe cases a buy-out of enterprises would improve financial results of the remaining enterprises, although perhaps not enough to achieve viability targets.

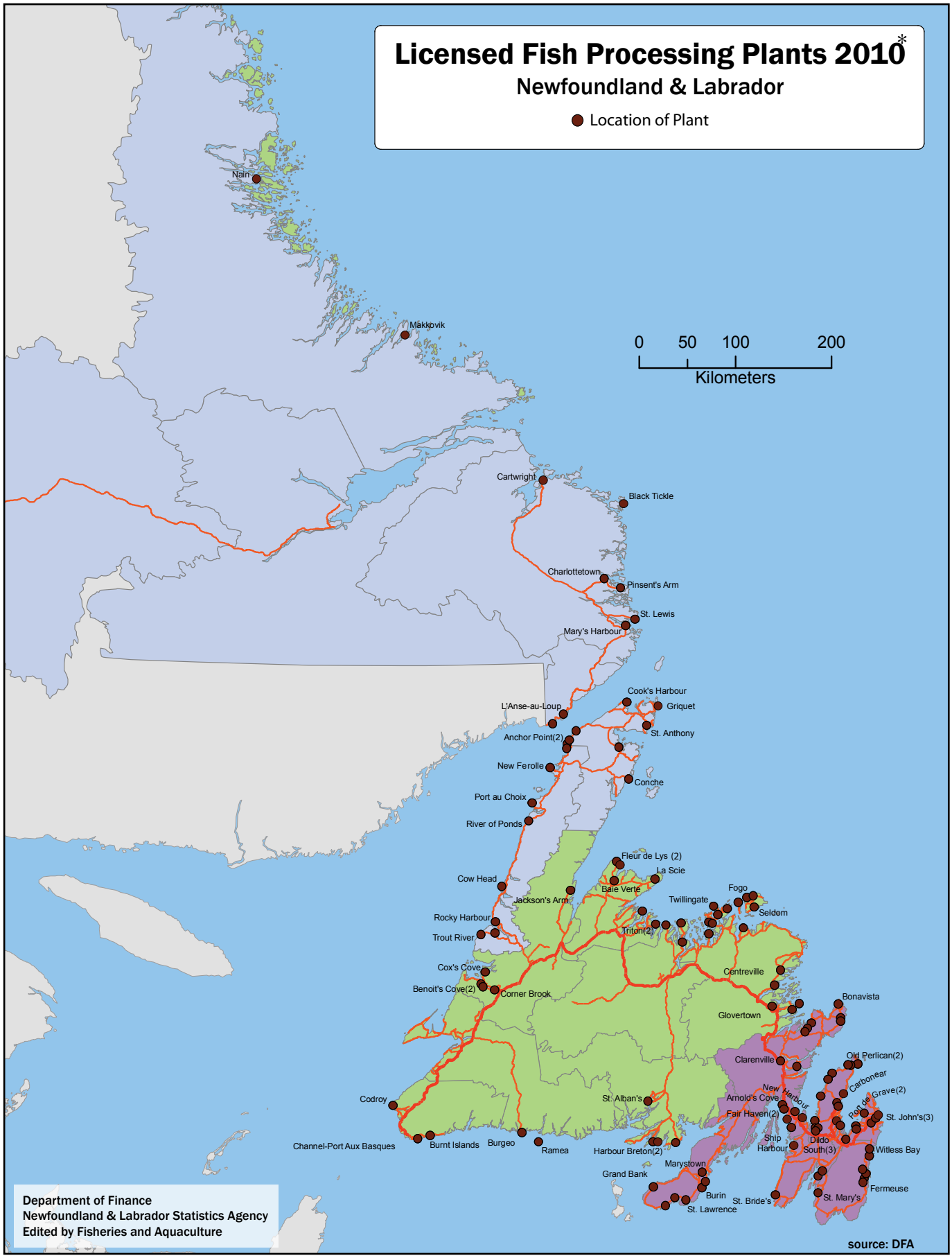
Overall, in excess of 50% of the current enterprises in the NL inshore fleet would have to be removed in order for the remainder to achieve viability. As defined by HWG, the highest levels of rationalization are required in areas 2J, 4R3Pn, 4R North and 3K of the inshore sector. On average, 71% of these four fleets must be removed in order for the remainder to be viable, for a total of 964 enterprises. A rationalization level of 71% essentially means about three-quarters of existing enterprises would have to be discontinued, and on average the remaining enterprises need to catch

roughly four times their existing volumes to meet the HWG viability target. This may not be realistically achievable given current structural impediments such as seasonality of resource availability and limited vessel mobility. By contrast, the lowest levels of rationalization are required in areas 3L, 3Ps Placentia Bay and 3Ps Fortune Bay West (45%, 42% and 32% respectively). These fleets require roughly a doubling of landings per enterprise, which may be realistically achievable through rationalization options proposed. These areas generally report somewhat lower levels of unemployment relative to those areas which will be most severely affected by rationalization.

There is quite a range in the degree of rationalization that is required in the inshore sector when one compares the fleet that requires the highest level of rationalization (area 2J) to the fleet that requires the lowest level of rationalization (Area 3Ps Fortune Bay West). What is obvious here is the financial impact that a longer fishing season, with a more diverse range of species being harvested, has on overall enterprise performance. In area 3Ps Fortune Bay West, enterprise owners can typically harvest five to six months per year, catching a variety of species including crab, shrimp, groundfish, lobster and capelin. Not surprisingly, these enterprises report higher than average earnings and incomes. By contrast, enterprise owners in the northern regions have shorter seasons and fewer species available for harvesting. Areas like 4R North and 2J experienced severe financial difficulties after the cod moratorium in 1991 and have never had adequate resource access to provide financial viability. The severity of the situation in the hardest hit fleet sectors would appear to dictate that high levels of rationalization (some form of buy-out) within these fleets may be the only option. In the more stable inshore fleet sectors, increased levels of rationalization under the current buddy-up option, an improved version of this option (increasing the percentage that avails of the buddy-up arrangement or allowing three or more individual enterprises to buddy-up as opposed to the current arrangement of two), may be a lower cost way to improve efficiency and overall enterprise performance. Such things, together with permanent combining, may serve to effectively achieve viability over time.

With respect to the nearshore sector, less than one-third of the current enterprises in the NL nearshore fleet must be removed in order for the remainder to achieve viability. The highest levels of rationalization are required in area 2J3K (without shrimp), with 49% and 54% of this fleet requiring rationalization under the terms of the FFAW and NL Inshore Shrimp Fleets proposals respectively. No other nearshore fleet sector requires more than 35% rationalization under the terms of the FFAW proposal, while Area 3L Small Supplementary Crab with Shrimp and Area 3L Small Supplementary without Shrimp require 46% and 42% rationalization respectively under the terms of the NL Inshore Shrimp Fleets proposal. No other nearshore fleet sector requires more than one-third rationalization under the NL Inshore Shrimp Fleets proposal.

Two nearshore fleet sectors (3Ps Supplementary and 3L FT Crab) do not, on average, require any rationalization at the present time and two additional fleet sectors require relatively low levels of rationalization, 16% in area 3L Large Supplementary and 7% in area 2J3K FT Crab. On average, the required levels of rationalization in the nearshore sector are higher, 10%-15%, under the commercial lending terms.



*Note - includes primary, secondary and aquaculture processing plants.

5.0 Processing Sector

In 2010, there were 102 licensed primary fish processing plants in the province, owned by close to 60 companies. Approximately 60% of the annual production in the NL seafood processing sector rests with the top four processing firms, and the remaining annual production is processed by the rest. In the snow crab sector, there were 35 processing plants in operation in 2010 that were owned by 25 arm's length processing companies. In contrast, the shrimp sector is characterized by 13 plants owned by 9 arm's length companies, although one plant (located in Jackson's Arm) did not operate in 2010.

The completion of a financial assessment of the fish processing sector on a species basis (particularly for snow crab and shrimp) was vital to understanding the challenging circumstances experienced by operators. Processing overcapacity, short operating seasons and the lack of supply dependability and timing have all contributed to the financial difficulties in this sector. This financial information was used by the PWG to develop a plan for industry rationalization. The PWG was asked to develop a plan that took overcapacity, an aging workforce, recruitment and retention, outmigration, and ongoing enterprise rationalization in the harvesting sector into account. These factors were to be considered in terms of the impact on processing operations and their ability to attract and retain processing workers. Other parameters were to include consideration of workforce issues, the resource outlook, economics and viability of the processing sector in order to serve as an economic driver in vibrant, rural regions. In addition, any proposals developed were to identify the potential impact on workers and propose measures to minimize these impacts. As such, a Worker Adjustment Subcommittee was established parallel to the work of the PWG. Proposals were to consider the potential impact on port market competition and services to harvesters. Any rationalization program proposed was to be designed in such a manner that any government funding would improve the viability of those who remain in the industry.

In 2010, market prices recovered from lows experienced in 2009, and industry performance improved in comparison to what was predicted by industry participants early in the year. However, because profitability is very sensitive to price factors, especially for crab and shrimp, marginal changes in market factors and exchange rates have a profound impact on profits. As Grant Thornton concluded, "the level of profitability in the NL processing industry is not sufficient for the NL processing sector, on average, to make a secure capital investment and achieve long-term viability." The improved performance in 2010 has removed some of the urgency for rationalization that existed in 2009. Nevertheless, the Grant Thornton financial analysis clearly indicated that the ability of the NL processing sector in general to withstand two or more consecutive years of poor results is questionable.

There were two proposals received for industry rationalization, including one from ASP and one from SPONL. Both proposals have been appended to this report. ASP proposes a 30% rationalization in the snow crab and shrimp sectors over a period of three years, funded by a government-backed loan guarantee at a 2.5% subsidized fixed rate of interest. Interestingly, the status quo is SPONL's suggested approach. Specifically, they requested a market-driven approach without government intervention. The focus of the analytical work completed by the PWG, and subsequently this report, is premised on ASP's proposal for an accelerated rationalization program in order to increase the economic performance and long-term sustainability of the province's fish processing industry. It is also worthy of note that both the ASP and SPONL proposals referenced the need for improve-

ments to the fish price collective bargaining framework as embodied in the *Fishing Industry Collective Bargaining Act* (FICBA) and the Standing Fish Price-Setting Panel. Both associations contend that the FICBA institutionalizes a fragmented and confrontational approach to price setting, and compromises the ability of the industry to achieve real viability improvements through rationalization and restructuring. However, collective bargaining was not an element of the MOU, and in any case its inclusion in the working group and steering committee processes would likely have served to perpetuate the level of mistrust and animosity which sometimes manifests during joint processes involving harvesters and processors when fish prices are at stake. Consequently, it was concluded that discussion of collective bargaining issues in the context of the MOU work would have been counterproductive and therefore was not pursued. Nevertheless, it is noteworthy that the Provincial Government has recently made changes to the FICBA and associated regulations. These changes were designed to improve the fish price collective bargaining framework for harvesters and processors.

Additionally, in ASP's proposal, they recommend a complete and effective restriction on new license entrants to the processing sector. Key aspects include: rationalized plants would have all processing licenses permanently removed; a freeze on all transfers or new processing licenses for a period of seven years; ownership of processing plants to exclude harvesters as long as the fleet separation policy is maintained; and an allowance for no new processing licenses on a go-forward basis. In contrast, SPONL recommends the elimination of processing licensing fees to assist in decreasing operating costs, thereby freeing up capital to invest in new technology and opportunities.

5.1 Financial Health of the Processing Sector

A thorough review of the financial performance of this sector was completed by Grant Thornton. The final report provided the following:

- a financial performance overview for the industry;
- a financial performance assessment based on four principal operations (snow crab, shrimp, groundfish and pelagics);
- an identification of areas where financial viability was impaired; and
- a cost revenue model.

This was then used in further analysis by the PWG in determining the levels of rationalization required in the snow crab and shrimp sectors to be viable and the benefits and costs associated with a 30% rationalization under the terms proposed by ASP.

5.1.1 Approach Taken to Determine Financial Health of Processing Sector

Grant Thornton obtained detailed, audited year-end financial results from processors for 2006 to 2008, and some preliminary results for 2009. The data obtained included financial statements, production reports by species, trial balances, breakdown of various revenue and expense amounts on a species basis, volume exported and species yields. Additional data was also sourced from DFA where possible, including data on industry production and employment. While there are over 40 different species processed by NL plants, for analysis purposes four principal types of processing operations were evaluated, including snow crab, shrimp, groundfish and pelagics. These collectively accounted for approximately 85% of the production value of the processing sector over the 2006-2009 period. The final survey results collected by Grant Thornton included data on 15 companies that represented

22 plants. All the companies that provided information on shrimp also owned snow crab plants. The sample provided good coverage of shrimp (7 of 13 plants) and crab (13 of 35 plants) production. In terms of value, the sample covered represented 50.9% and 49.7% of shrimp and snow crab production respectively. However, the companies/plants surveyed tended to be the relatively larger operations. As such, smaller plants were under-represented in the sample data. Although all smaller companies/plants were asked to participate, in general they were unable to do so for various reasons. Some did not have sufficiently detailed data readily available, did not have full-time accounting support, or were unable or unprepared to complete the survey due to the relatively short submission time frame. Coverage of groundfish and pelagic processing was also limited to those companies that own snow crab operations. In addition, the few larger, vertically integrated, or partially vertically integrated, groundfish and pelagic plants were not included as they operate under somewhat distinct financial circumstances. The size and structure of their operations, compared to others in the province, could distort overall findings. To summarize, Grant Thornton worked with an excellent sample of crab and shrimp data, and a very limited amount of groundfish and pelagic data, which under-represented the smaller groundfish and pelagic plants, as well as the large vertically integrated groundfish and pelagic plants.

Grant Thornton assessed various financial performance measures. Key measures included Gross Margin (GM); Return on Net Operating Assets; Return on Equity; and Return on Capital Employed (see Annex 19: Glossary of Terms, for definitions).

To this end, the PWG undertook to examine the financial model that was delivered by Grant Thornton, and subsequently refine the model they provided in order to develop three operating scenarios. This process included identifying and validating assumptions related to key model input variables, including market prices, raw material prices (prices paid to harvesters), resource projections, and fuel costs. Exchange rates were assumed to be factored into the market prices. It was understood that taking such an approach would allow the group to better understand the relative effect of each variable on overall performance and under a variety of possible outcomes. The Steering Committee reviewed and endorsed the assumptions, ensuring consistency with those used by the HWG in its analysis of harvesting sector rationalization options. Three scenarios were agreed upon (pessimistic, anticipated and optimistic) for the development of models in order to determine the costs and impacts of rationalization in the processing sector (see Table 4.8).

The sample data provided by Grant Thornton was grossed up to the aggregate industry level and subsequently analyzed on both an industry basis and on a species basis for the four principal types of processing operations. Adjustments were made to the producer selling, general and administrative costs (SGA) that were collected by Grant Thornton. Subsequent to receiving the Grant Thornton report, the PWG determined that allocating administrative and other overhead costs on the basis of revenue by species provides a more realistic estimation of relative profitability than does allocating on the basis of production volume per species, the approach Grant Thornton was asked to apply by the FAWG. As a result, the NL processor margins noted in the Grant Thornton report may be overstated for shrimp and pelagics and understated for snow crab and groundfish. This adjustment does not change the summary conclusions of either the Grant Thornton report or the report by the Chair of the MOU Steering Committee. However, it does serve to further highlight the magnitude of the challenge facing the seafood processing sector in NL, particularly with respect to GM performance.

5.1.2 Financial Results

Grant Thornton concluded that "from an overall perspective, the NL seafood processing sector is achieving some profitability in shrimp, crab and pelagic processing but is incurring losses on groundfish." The key financial indicators are provided in the following table for the Canadian Seafood Processing Industry and for the NL seafood processing sector. Financial results appear to be highly variable from year to year.

The summary conclusions of Grant Thornton's report are outlined below. In addition, the Executive Summary of the Grant Thornton report is appended (See Annex 15).

- The level of profitability is well below the Canadian seafood processing sector norms and is considered unacceptable. The profitability level is not sufficient for the NL processing sector on average to make secure capital investments and achieve long-term viability. Profitability is very sensitive to price factors (raw material price, market price and exchange rate shifts), especially for crab and shrimp processing, and very small changes in these price factors have a profound impact on net income. For example, a 5% change in the Canada/USA exchange rate in the case of snow crab (assuming no change in raw material price paid to harvesters) will have a $7.26 million impact on net revenue.

- In order for the NL seafood processing sector to be viable in the long term, processors must generate adequate returns. These returns must be sufficient to sustain current and future capital investment, while at the same time providing for a level of reward/return that would serve to compensate investors for the inherent risk associated with doing business in this sector. The serious deficiencies in the Return on Equity (ROE) in the NL processing sector suggest that:

    - the sector may in fact be unable to achieve a level of return that is sufficient to attract the necessary capital to maintain its operations in the long term;
    - if the processing sector can attract the kind of investment that is required, firms may have to pay a premium (i.e. higher interest) to attract such an investment; and
    - if the industry is not properly capitalized and its operations are not generating sufficient earnings (and cash flow) to provide for a reasonable rate of return on equity, the industry as a whole is not viable.

- The results of the GM and net profits indicate that the current GM compression that the industry is experiencing is a function of the increasing raw material costs (on a percentage basis) and lower market prices which, to a considerable extent, are affected by the exchange rate shifts. Together these factors are rendering the industry unprofitable in the short term and unsustainable in the long term. Improvements in these areas can be achieved through rationalization and restructuring. In order to effect real change, plants must attain a higher level of production which, in the absence of significant quota increases, may only be achieved through plant closures.

Table 5.1 Selected Financial Performance Indicators - Seafood Processing

	Canadian Industry 2005	NL Average 2006	Canadian Industry 2006	NL Average 2007	Canadian Industry 2007	NL Average 2008	NL Average 2006-2008	Canadian Average 2005-2007
Gross Margin - all species	13.2%	10.0%	13.7%	6.0%	13.3%	13.0%	9.8%	13.4%
Return on net operating assets	5.0%	-52.0%	5.0%	-4.0%	3.0%	16.0%	-13.0%	4.0%
Return on equity	8.0%	2.0%	6.0%	-57.0%	4.0%	-19.0%	-25.0%	6.0%
Return on capital employed	5.0%	4.0%	5.0%	-4.0%	3.0%	8.0%	3.0%	4.0%

The Grant Thornton report and associated model was provided to the PWG for further analysis. The sample data was grossed up for the industry and culminated in a financial statement for the NL industry (inclusive of shrimp, snow crab, groundfish and pelagics)*. The income statement is presented in Table 5.2. The GM was 12.1% for the industry for the 2006-2009 period. This compared to 9.8% GM calculated for the sample. This variance is due to the individual weighting of each species represented in the sample versus the actual volumes produced by industry. Further, the Grant Thorton results were for 2006-2008 only, and the adjusted information was for 2006-2009, including a volume adjustment for shrimp to 2008 levels as 2009 landings were not representative. In 2009, returns on shrimp were lower than prior years, but crab and groundfish returns improved modestly, and pelagic returns improved significantly.

Table 5.2 Income Statement - Newfoundland and Labrador Seafood Industry (Four-Year Average, 2006-2009)

		Total ($ Million)*	% of Net Sales
Sales	**Net Sales[1]**	**$ 591.6**	**100.0**
Variable Costs	Raw Material[2]	$ 389.3	65.8
	Direct Labour[3]	$ 57.6	9.7
	Packaging & Ingredients	$ 20.9	3.5
	Other Variable Costs[4]	$ 10.2	1.7
Total Variable Costs		**$ 478.0**	**80.8**
Contribution Margin (Sales less Total Variable)		$ 113.6	19.2
Plant Overheads[5]		$ 42.1	7.1
Gross Margin (Contribution Margin less Plant Overheads)		$ 71.5	12.1
Selling, General & Administrative[6]		$ 19.5	3.3
EBITDA (Earnings before interest, taxes, depreciation, and amortization)		$ 52.0	8.8
Interest, Depreciation & Amortization		$ 27.3	4.6
Earnings before taxes (EBT)		$ 24.7	4.2

* Figures may not add due to rounding.

1. Net Sales: Total sales revenue, less selling expenses. Selling expenses include freight-out for finished products, Export Development Canada (EDC) insurance, customer expenses, outside storage for finished products, brokerage and inspections, and commissions on sales.

2. Raw Material: This category includes the purchases of raw materials, dockside grading, discharging and wharfage, freight-in of raw materials, ice, fishermen's payroll and benefits, and finished goods purchased for resale.

3. Direct Labour: This category is comprised of direct processing labour and benefits.

4. Other Variable Costs: This category represents the grouping for all the other remaining direct production costs.

5. Plant Overheads: This category includes costs incurred for fuel, electricity, repairs and maintenance, municipal taxes, rentals, indirect plant labour and factory supplies. After various discussions with plant management, these costs were allocated as a percentage of species revenue. This was completed on a plant- by-plant basis.

6. Selling, General & Administrative: This category includes administrative salaries, office expenses, licenses and fees, consulting, legal and accounting fees, insurance and bad debts. Various sources of other income, including local sales, raw material sales, discharge/wharfage revenue, ice sales, interest income, unrealized and realized foreign exchange profit and loss, and miscellaneous income were deducted from the selling, general and administrative expenses. These costs were allocated as a percentage of species revenue. This was completed on a plant-by-plant basis.

*Note - this excludes vertically integrated operations.

5.2 Processing Rationalization Requirements

Since the moratoria, the number of processing plants decreased substantially with the number of processing workers following suit. During the 1990s, the number of snow crab and shrimp plants increased, although the number of crab plants has subsequently declined from a peak of 42 licensed operators. In 2010, there were 35 snow crab plants in operation, along with 12 shrimp facilities processing throughout the province. The production from these two principal types of operations represents the majority of industry production value (over 60% from 2006-2008). The large number of players currently sharing the limited amount of resource has marginalized the industry. This has contributed to the structural challenges and poor returns being experienced by the NL processing sector. In order to deal with the cyclical nature of prices and resource shortages, rationalization is required to improve industry viability.

5.2.1 Rationalization Options Involving Public Sector Intervention

The principal components of the ASP proposal include a 30% rationalization of the existing shrimp and crab plants (volume based) in NL, a 'reverse auction' as a mechanism to facilitate redistribution of available resources, and the establishment of an independent panel to review and approve offers. The rationalization of shrimp and crab plants would also have a beneficial impact on groundfish and pelagic operations to the extent that closure of a shrimp or crab plant would also result in elimination of any associated groundfish and pelagic processing capacity at that plant. The panel would be comprised of two members from both producers and government, along with an independent chair. The suggested buy-out values for plants would be based on historical production of raw material. Financing would be for 30 years at a 2.5% fixed rate of interest. Alternative financing terms were also analyzed, including a 15-year amortization period at 2.5% and 15 years at 7% (a proxy for the presumed prevailing commercial rate for processors).

The options evaluated included:

- A 30-year term with 2.5% financing (i.e. the ASP proposal);
- A 15-year term with 2.5% financing (to assess the impact of the financial term); and
- A 15-year term with 7% financing (to assess the impact of interest rate).

5.2.2 Approach Taken to Determine Rationalization Requirements

In light of the findings outlined in the Grant Thornton report, and in consideration of its mandate, the PWG set out to accurately determine (under a variety of potential scenarios using key variables) the level of rationalization that would be required to achieve processing sector viability.

One of the primary tasks facing the PWG, as it began its deliberations, was defining viability. The key measure of viability that was identified by the PWG was the GM. The reason this measure was chosen was twofold. Firstly, it was discovered that limited balance sheet data existed to be used to determine other measures of financial health, particularly on a species basis. Secondly, members of the PWG believed that using the GM as a target would protect the confidentiality of the data provided by producers (i.e. profitability percentages on a per species basis). Using the data and model obtained from Grant Thornton, the PWG focused on the achievement of a 20% average GM. This level was

chosen because working group members generally agreed this level is required to sustain the industry at profitable levels, with acceptable levels of return on equity, and is comparable to GM performance of other Canadian food manufacturing sectors. In order to be successful, companies must achieve a GM sufficient to cover operating expenses and provide adequate after-tax income. Failure to achieve the required GM percentage (and GM dollars) will make it difficult for a company to maintain the efficiency of its current operation or secure ongoing financing for future advancement and growth.

The level of rationalization required to reach the 20% GM target established by the PWG was determined for both the snow crab and shrimp sectors. The GM performance target chosen by PWG is relatively high compared to historical and industry margins. The national average in the seafood processing sector is 13.4% from 2005-2007, well below the 20% targeted by the PWG. However, NL represents about 20% of national seafood exports, so the national average would range from 14% to 15%, when adjusting for NL's influence on the overall average.

5.2.3 Rationalization Requirements by Principal Operation (Snow Crab and Shrimp)

An analysis of the level of rationalization that would be required to achieve viability reveals that the 20% GM target may be overly ambitious. In fact, a 64% rationalization would be required in the snow crab sector, while in the shrimp sector the 20% GM target cannot be achieved under any of the financing options analyzed. The difficulty in using the GM target is that when rationalization occurs, much of the benefit is realized by reducing average fixed overhead costs, which improves operational efficiency through economies of scale. Fixed overhead costs are shown on the income statement below the GM line. In other words, a significant portion of benefits from rationalization is not included in the calculation of GM.

Figure 5.1 Gross Margin by Species at 30% Rationalization

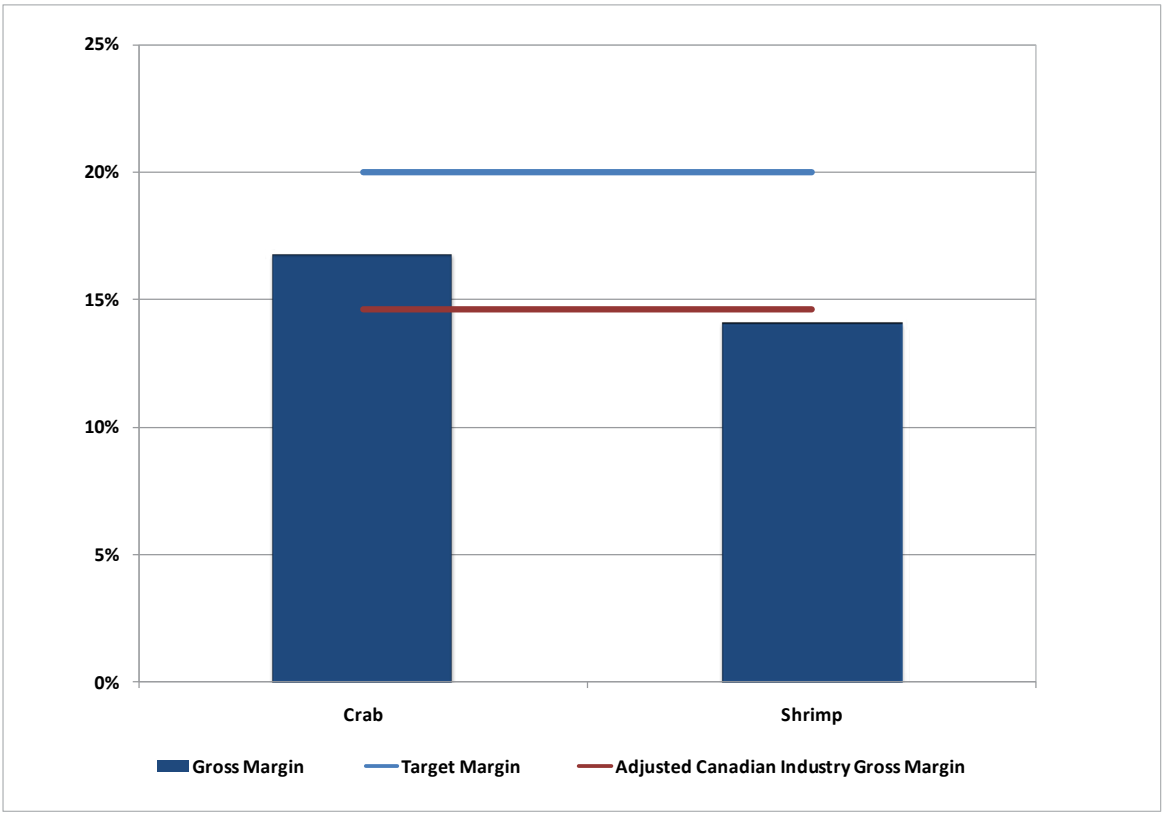


Figure 5.1 illustrates the GMs for crab and shrimp processing when the industry is rationalized at 30%, compared to the adjusted national average. The target GM rate of 20% is also included for comparison purposes.

A more reasonable GM performance target might be the achievement of a GM percentage that is consistent with the adjusted national average. There are no margins published on a species-specific or sector-specific basis for Canada. Therefore, the GM performance in the NL snow crab and shrimp sectors is being compared to a national average for all seafood (excluding NL). A 30% rationalization (proposed by ASP) in both sectors would achieve a GM in the range of 14 -18%. For shrimp, the GM would improve to 14-15%, which is consistent with the adjusted Canadian seafood industry average. A corresponding level of rationalization in the snow crab sector results in higher GM performance, between 14.5% and 18%.

5.3 Benefits and Costs of Rationalization

Rationalization alone will not fix the structural challenges in the processing industry and some excess capacity will likely remain. Nevertheless, a 30% rationalization of snow crab and shrimp plants can improve the economic viability of those species sectors. The supply of raw material available on a per plant basis will increase. In addition to improvements in GMs, there will be significant savings on SGA expenses, and interest on existing debt and depreciation (in the magnitude of $6 million annually). The incidental benefits to be realized in the groundfish and pelagic sectors would be marginal.

Based on the current rate of plant attrition, in five years the number of processing plants will have declined by an additional 20%, or two-thirds of the recommended rationalization level (30%). This of course assumes relatively steady market conditions during this period. As ASP has repeatedly noted and has been confirmed by recent industry performance (2009), many processors might not withstand two successive years like 2009. As we saw in 2009, a decline in prices or landings and increases in the value of the Canadian dollar relative to key foreign currencies can have a debilitating effect on this industry in a relatively short time frame. Similarly, other factors such as worker and resource availability can also contribute to further downsizing. In the absence of a move to rationalize the industry in the short term, the industry will continue to operate in a relatively vulnerable position until such time as self-rationalization through attrition can be achieved – likely seven or more years from now.

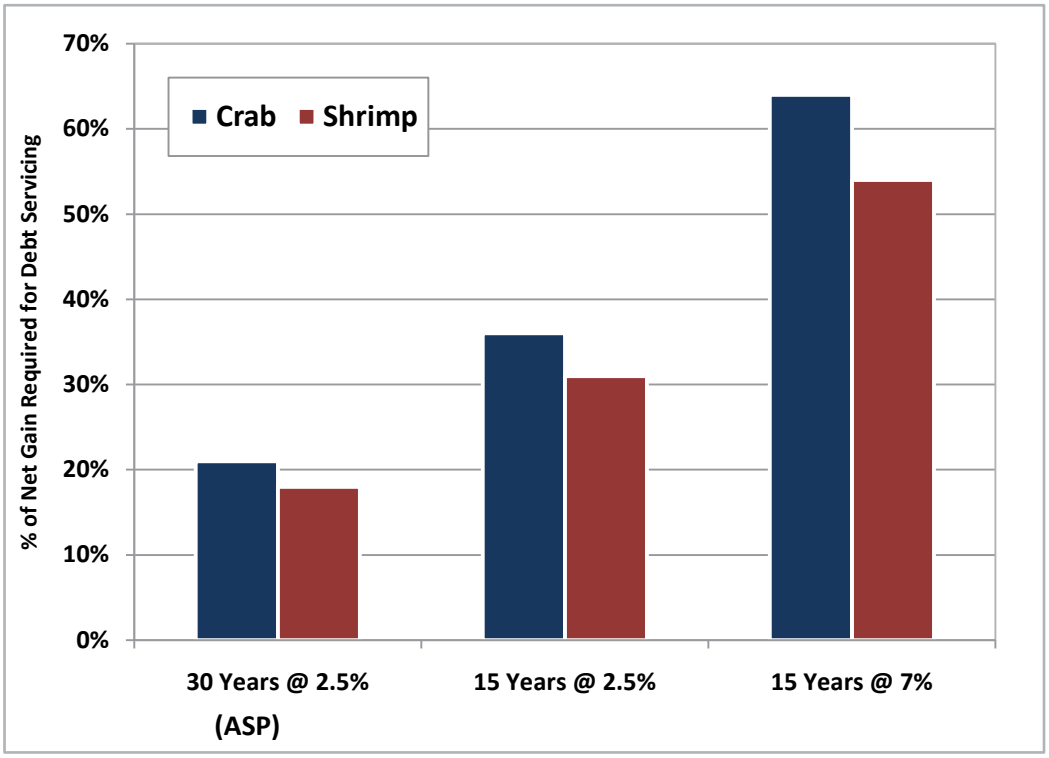
The projected costs associated with a 30% rationalization of the processing sector based on ASP's proposal were estimated by ASP as $80 million (loan requirement). This cost is based on a buy-out cost of between $1-$2 per pound for snow crab and $0.50-$1.00 per pound for shrimp. ASP based its costing on a volume of shrimp consistent with 2008 landings. The PWG based its analysis on the assumptions developed (refer to Table 4.8). This included a significantly lower volume of shrimp. As such, subsequent analysis suggests that the cost is closer to $70 million for the same level of rationalization (30%). The cost to government for subsidizing the interest rate (2.5% versus 7%) is approximately $69 million. Additional costs of rationalization would include displaced workers due to plant closures, and other negative spin-off impacts on communities regarding reduced demand for supplies and services. A further discussion of the workforce adjustment support requirements is provided in the next section of the report.

Financing options were evaluated to determine debt service costs (interest and principal). The cost of servicing debt is expressed as a percent of net margin gain required to pay the interest and principal. The following chart illustrates the cost for debt servicing based on three options for loan repayment terms.

These terms are outlined below:

- A 30-year term with 2.5% financing;
- A 15-year term with 2.5% financing; and
- A 15-year term with 7% financing.

Figure 5.2 Percentage of Earnings Before Taxes (EBT) Gain Required for Debt Servicing (Anticipated Scenario)



The amount of principal and interest required for debt servicing increases as the terms of the loan become more onerous. In the case of snow crab, the associated cost under ASP's proposed terms requires 21% of the net gain to be paid out for debt servicing. This compares to 36% under 15 years at 2.5% and 64% under 15 years at 7%. In the case of shrimp, 18% of the benefit is required for debt servicing under ASP's terms. However, 31% is required under 15 years at 2.5% and 54% is required under 15 years at 7%.

While net financial gains can be achieved through planned restructuring, it appears that the benefits depend significantly on the financial terms. In addition, if interest rates are not subsidized, it would not be feasible for the processing sector to finance self-rationalization at the assumed buy-out payments to those willing to exit the industry.

It is important to note that ASP's proposed rationalization scheme would have minimal influence on overcapacity challenges experienced in both the groundfish and pelagic sectors. Their current proposal recommends 30% rationalization of both the snow crab and shrimp sectors. Groundfish and pelagic species would be incidental.

5.4 Worker Adjustment

5.4.1 Worker Adjustment Subcommittee

Any rationalization in the processing sector, whether through market forces or through an accelerated plan as proposed by ASP, will impact processing workers. A Worker Adjustment Subcommittee of the PWG was formed as part of the MOU process. The primary objective of the committee is to examine alternatives to address the impacts of rationalization on plant workers.

The committee held two meetings during the MOU process. The first meeting was to discuss the terms of reference for the committee, and the second one reviewed the current status of the Processing Sector Rationalization Plan, its potential impact on workers, and the current Workforce Adjustment Framework established by the Provincial Government.

Presently, there are 2,089 shrimp plant workers in the province who average 652 hours (16.3 weeks) of work per year. With the 30% rationalization proposed by ASP, the number of workers is projected to drop to 1,462 (based on a proportional drop). This drop will serve to increase the number of available hours of work (for the remaining plant workers), to 932 from the current level of 652 (or 23+ weeks of employment annually). At the current average hourly plant worker wage of $11.70, this could potentially increase total annual earnings from fish processing by 43% (or $3,270 per worker).

In addition, there are 5,814 crab plant workers in Newfoundland and Labrador, who average 602 hours (15.1 weeks) of work per year. With the 30% rationalization proposed by ASP, the number of workers could drop (proportionately) to 4,070. This reduction in the number of workers could serve to increase the number of available hours of work for the remaining plant workers to 860 from the current level of 602 (or 21.5 weeks of employment annually). At the current average hourly plant worker wage of $11.20, this could increase total annual earnings from fish processing by 43% (or $2,889 per worker). Again, some of this gain may be offset by reduced EI benefits.

The impact on plant employment gains (increase in employment hours) on EI benefits is uncertain. The way in which the additional plant work manifests will influence total benefits received. For example, additional weeks of plant employment would reduce the number of weeks the worker would need to draw EI benefits prior to the next season, and the weekly benefit rate would not be affected. On the other hand, if the additional work manifested as additional hours worked per week, this would result in an increased weekly EI benefit. Most likely, some combination of more hours worked per week and more weeks worked in total would be the typical outcome.

5.4.2 Worker Adjustment Requirements

The overall level of rationalization proposed for the processing sector is in the range of 30%, which will dramatically reduce the number of processing plants currently in operation in Newfoundland and Labrador. In the processing sector, the 30% rationalization proposed by ASP would occur primarily in the snow crab and shrimp processing plants. According to the analysis undertaken during the MOU process, approximately 1,700 workers from 35 snow crab plants and 600 workers from 13 shrimp processing plants could potentially be displaced if this level of rationalization occurred.

Displaced workers are one of the anticipated outcomes of rationalization and capacity reduction in the industry. However, the impact of any rationalization is mitigated somewhat given the aging and declining workforce in the processing sector. Nevertheless, a set of worker adjustment programs is required to minimize any effects of processing restructuring on older and other affected workers.

In many rural communities in the province, the fish processing industry is a traditional and key component of business, and the rationalization in this sector would accelerate challenges already being experienced in these areas. The closure of individual plants under the ASP proposal would not be subject to government decree, but to a modified reverse auction. All proposals would be voluntary and all bids placed by producers would be ranked based on best value for money. A selection committee would then review the proposals and put forward final decisions. In this situation, the government would have little, if any, control of plant closures in rural communities where the fish processing sector plays an important role in the economy and employment. Any final comprehensive restructuring plan for the fishery should consider the potential impacts on rural communities, and contribute to the strategic development and long-term growth of the industry.

The benefits of rationalizing the processing sector are multi-faceted. The highly seasonal nature of the industry contributes to significant overhead burden. A reasonable increase in capacity utilization caused by the rationalization could readily reduce this investment on a per pound basis. As well, the fishing enterprises and processing plants can increase the period of employment for plant workers, thereby increasing the productivity of industry while improving individual annual earnings. According to a straight-line analysis completed during the MOU process, if the 30% rationalization takes place, the individual working hours per year would increase from 602 hours to 860 hours for snow crab plant workers and from 652 hours to 932 hours for shrimp plant workers. Based on a wage rate of $11.20 per hour in snow crab plants and $11.70 per hour in shrimp plants, this could mean an increase of $2,889 in the individual annual employment earnings for snow crab plant workers and $3,271 for shrimp plant workers, both of which could potentially be partially offset by reduced EI benefits. Additionally, there will be indirect and spin-off impacts on supplier industries.

5.4.3 Current Workforce Adjustment Framework

In June 2006, in direct response to challenges in the fishery, the Provincial Government announced a set of adjustment services for workers at fish plants designated as permanently closed. These measures were subsequently included in the FIR announcement in 2007. Departments collaborating on the worker adjustment framework are Municipal Affairs (MA) (responsible for overall coordination), Human Resources, Labour and Employment (HRLE), Innovation, Trade and Rural Development (INTRD) and DFA. Prior to devolution of the Labour Market Development Agreement (LMDA), Service Canada was also heavily involved with HRLE in joint delivery of the employment counselling component. The provincial and federal agencies work cooperatively to provide a range of supports to help displaced plant workers make a transition to other employment. The programs have assisted workers from communities where fish plants have permanently closed, such as Port aux Basques, Englee, Trouty and Gaultois, as well as those that have experienced major downsizing, notably Fortune and Marystown. Workforce measures for individuals who may require assistance include:

- Transition support services through HRLE to help displaced workers develop an individualized transition plan to include access to labour market information, retraining options, counselling on relevant provincial and federal programs concerning employment opportunities, resume writing,

job search, training, wage subsidies and self-employment supports. This also includes retraining through public, private and non-profit training institutions.

- Regional economic diversification through programs made available through INTRD. This includes wage subsidy to support transition to other jobs, through the Fish Plant Worker Employment Support Program (FPWESP) - Wage Subsidy component for Small- and Medium-sized Enterprises (SMEs) which provides new entrepreneurs and expanding small businesses with funding to employ fish plant workers negatively affected by the closure of a fish plant.

- Short-term job creation through the Fish Plant Worker Employment Support Program (FPWESP), which provides a short-term solution to help workers deal with their immediate financial needs. Eligible workers are employed by local governments and community organizations to work on projects that contribute to tourism development, economic development, community/municipal infrastructure or community services.

5.4.4 Insights from the Fortune Pilot – Implications for the Fishing Industry in 2011 and Beyond

In August 2005, the fish plant in Fortune was closed and as a result over 350 employees were left with no immediate source of related employment. Starting in June 2006, HRLE funded a series of interventions under the terms of the LMDA. This involved the establishment of a satellite office and the implementation of an Employment Assistance Services assessment and counselling service. By October 2006, 135 or 38% of the affected plant workers were participating in the counselling service, and 41 or 11% had participated in a skills development program. By July 2010, a total of 219 workers or 61% had used the labour market services at some point. While these numbers may seem low to the casual observer, they must be considered in the context of the workforce profile for the Fortune plant. Approximately 49% of the workforce in this plant was aged 50 or older and some individuals may have decided they were too old to begin a retraining program, while others who had easily transportable skills may have opted to find a job in the local, provincial or national labour markets. In fact, in the short term (to October 2006), approximately 40% of the plant workforce found employment elsewhere, while 49% were employed on the plant worker employment project established by MA. In comparison to the plant's overall workforce, individuals who found alternate employment in the local labour market were more likely to be male and more likely to be aged 45-54. Those plant workers who found work in the provincial labour market were also more likely to have been male and those affected plant workers who found work in the regular labour market outside NL were also more likely to be male and more likely to be aged 45-54. Conversely, those who entered the employment counselling program were more likely to have been female and more likely to have been aged 45 or over.

Early insights from the Fortune plant program suggested that it will take more time than was originally anticipated to build the kind of presence that is required in affected communities to foster relationships between transition officers and affected workers. To date, HRLE and MA officials suggest that they do not have sufficiently detailed data to make an informed opinion on the dynamics associated with individual worker adjustment behaviour. The data that has been gathered to date does suggest the need to pay attention to the behavioural patterns that individuals of different genders exhibit when directly affected by a loss of employment. Also of note, government messaging with respect to overcapacity in the fishing industry, the role of the transition office and the Plant Worker

Support Program appear to have been clearly communicated and well received – as evidenced by the program participation rate amongst those affected plant workers who could not find work immediately (215/229 = 94%).

More recently there have been plant closures in Port aux Basques, Englee, Trouty and Gaultois, as well as a reduction in the plant workforce in Marystown. Including the Fortune plant, in excess of 1,500 workers have been affected by the closure or major downsizing of operations over the past five years. At the present time, 578 (38%) of these workers have accessed transition services and approximately 800 worked on projects under the FPWESP. Expenditures by the Provincial Government on employment projects for workers affected at these plants have totalled $5.2 million ($6,800 per person).

While these results are indeed encouraging, it is important to note that the various governments involved in these initiatives have only had to deal with one or two such initiatives in any one year. Clearly, any large-scale reduction in the number of crab and shrimp plants in a shorter than expected time frame, would put additional strain on existing resources and on the ability of the local and provincial labour markets to absorb the increased number of workers that might be available for certain types of employment.

Given that the proposed rationalization program would result in a much higher increase in the rate of worker attrition over the next three years, it is clear that the current mix of program offerings and current staffing levels would be insufficient to meet the demands that would be placed on these departments. It is evident that although the current workforce adjustment program announced under the FIR initiative is due to expire this year, the ongoing processing sector rationalization trend which is expected to continue for the next five to ten years suggests that, even in the absence of an accelerated rationalization plan as proposed by ASP, continuation and possible enhancement of the workforce adjustment measures will be essential.

While this analysis leads to the conclusion that spreading the rationalization over a longer period or more would put less strain on the job market and the Provincial Government support network, it is important to note that the processing sector has repeatedly stated that extending the rationalization process over a three-year period will not allow for the kind of financial recovery that is required to materially affect the current financial positions of most firms, particularly those that are heavily in debt at the present time.

Clearly the parallel rationalization of the harvesting and processing sectors will serve to place additional pressure on government resources.

5.5 Governments' Role

The province has jurisdictional responsibility for regulating the processing sector. In a similar fashion to the overcapitalization of the groundfish sector in the 1980s, the collective response of government and industry to the groundfish collapse, and the increase in opportunities in shellfish in the 1990s, was to similarly overcapitalize the shellfish sector, both in harvesting and processing. For example, in response to increased volumes of snow crab, additional processing licenses were issued by the province in the mid-to-late 1990s. The number of snow crab processing licenses more than doubled, peaking at 42. Similarly, the number of shrimp processing plants increased from 2 to 13.

In recognition of the overcapacity in the processing sector, and its relative weakness in comparison to international competitors, government commissioned Mr. Eric Dunne to conduct a study of fish processing licensing policy in 2003. A new fish processing policy framework was implemented by the province in 2004 arising from recommendations contained in the Dunne Report. On the basis of these new policies, the number of snow crab processing licenses has declined to 37 in 2010, of which 35 had production, however, the number of shrimp processing licenses currently remains at 13, although one plant did not operate in 2010. There have also been significant reductions in the number of groundfish and pelagic licenses. In addition, all processing licenses are limited to only those species that had been actively processed in one of the two previous years, and any "inactive" species authorizations are eliminated. In total, more than 2,000 such inactive authorizations have been removed since 2004, leaving less than 400 that are considered to be "active" within the current primary processing plants.

In response to FIR, government announced enhanced processing policies in support of industry self-rationalization. The strengthening of provincial policies served to reduce capacity, while introducing a more rigorous and transparent licensing framework. During FIR, government also announced its Workforce Adjustment Program in aid of displaced workers from permanent plant closures. To date, the program has been administered in several communities. A more accelerated plant rationalization program beyond what the province has been experiencing would put increased pressure on the current program. There is no early retirement option or exit strategy available to those workers who are nearing retirement. In the past, the province has pursued an early retirement program with the Federal Government for those impacted by rationalization; however, the Federal Government has not been receptive to such proposals in recent years.

One of the primary challenges facing both levels of government when deciding to commit funds for industry rationalization initiatives lies in the ability of the government to assess the true need for such expenditures, including the assessment of potential outcomes should such an intervention not materialize. In the process of deciding to invest in such initiatives, governments must also assess the probability that such investments might be repaid over some reasonable period of time.

In the case of the proposed investment in the rationalization of the processing sector, there are a number of challenges associated with the current ASP proposal. First of all, the current proposal does not speak specifically to the potential outcome of the rationalization process with respect to the location of plant closures. In the absence of a controlled and orderly rationalization, the potential exists for further geographical imbalance with respect to the alignment of harvesting and processing resources and available labour supply. In addition, the current ASP proposal suggests that the funds advanced by government for the purpose of rationalization will be paid back over time by those entities that acquire the available quota – on a per species basis. These conclusions appear to be based on the assumption of the consistent availability of such quotas for an extended period of time, when recent evidence (shrimp quota declines) would suggest that this may not be the case. One of the more challenging aspects of such an intervention for government is the requirement for sufficient controls to ensure that those who benefit from rationalization in the short term have the ability to repay government in the face of declining quotas.

Another consideration when examining the ASP proposal relates to the ability of the remaining plants to process current landings (volumes) under the 30% proposed rationalization scenario. Figures 5.3 and 5.4 illustrate the current landing patterns (by week) for both snow crab and shrimp relative to existing capacity and also demonstrate revised capacity with 30% rationalization.

Figure 5.3 Snow Crab - Landings versus Production Capacity

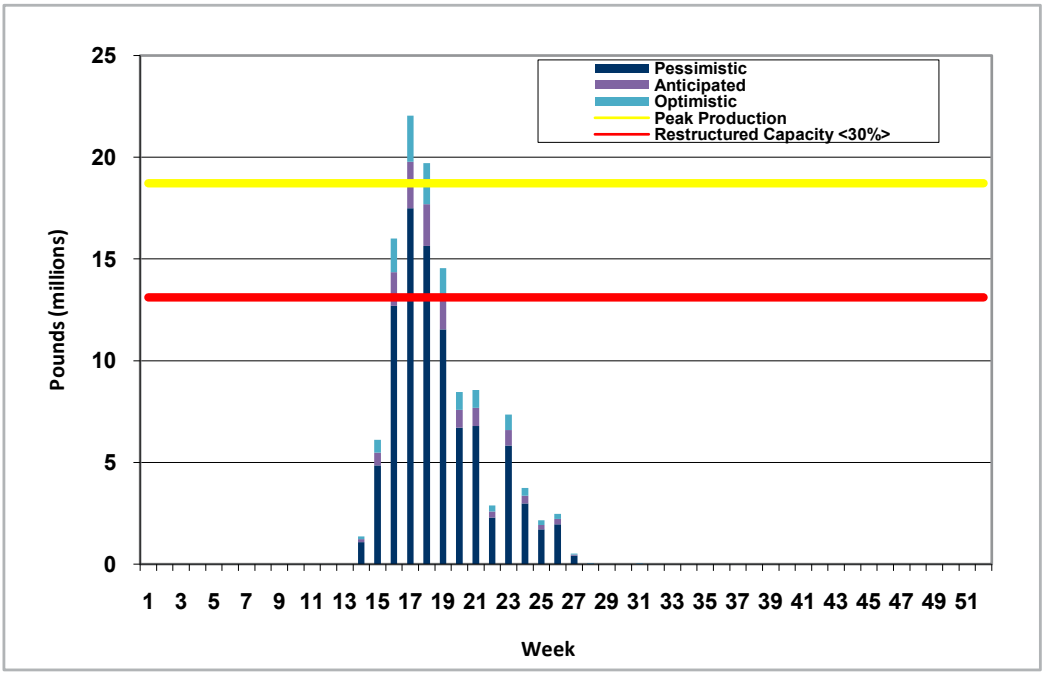
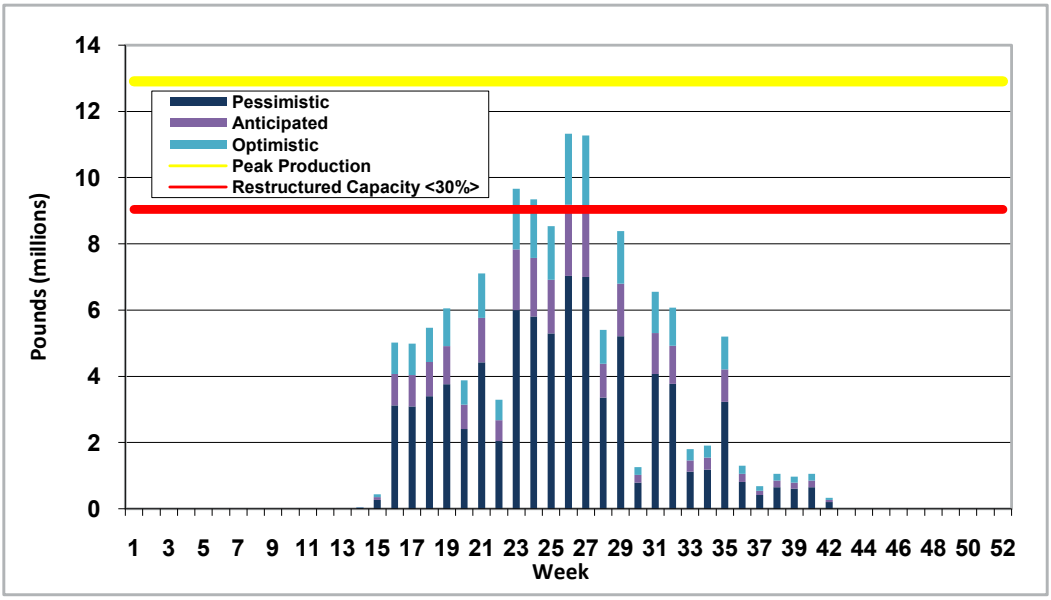


Figure 5.4 Shrimp - Landings versus Production Capacity



Under rationalization, assuming similar landing patterns and volumes, supply could potentially exceed capacity over a four-week period (for snow crab and shrimp). In each case, at least a portion of the supply could be processed in a subsequent week. However, production capacity will handle some oversupply as the above analysis was based on weekly capacity and daily capacity may not have been fully utilized. Therefore, the reduction in the number of crab and shrimp plants might not necessarily have a debilitating effect on overall production capability.

At the present time, and for the past ten years or so, the rates of decline in the harvesting and processing sectors have been proportionate to each other and more or less in balance, in the absence of any direct intervention by government. Failure to coordinate an orderly reduction in both harvesting and processing may result in a degree of imbalance and may put present productivity and supply capability (long-term supply relationships) at risk.

5.6 Summary of Findings - Processing Sector

One key finding related to the processing sector is that rationalization is required in order to ensure that the processing sector can achieve and maintain an adequate profit to support capital investment and permit a reasonable return on investment. To date, rationalization has occurred with only a modest level of government intervention, and will continue to occur in response to changes in raw material supplies, market price returns and demographic challenges related to labour supply. As Figure 3.8 illustrates, the number of plants is projected to decline to 94 by 2015. As such, left to their own devices, producers will likely respond to these challenges through plant closures; however, the pace and degree of rationalization will be less than if a planned approach and time frame are developed and implemented.

The cost of self-rationalization could be borne by the corporations that own the plants (asset abandonment), and possibly banks and other creditors if bankruptcies occur. These results may put additional financial burden on companies and, in turn, contribute to a continued lack of capital investment to modernize their operations and support product and market diversification. The impact on workers and communities will be uncertain.

Under ASP's proposed rationalization plan, financial health would quickly improve and the impact on workers and communities could be accelerated. The current proposal by ASP is for industry controlled buy-outs. This could potentially lead to outcomes (plant closures) that are contrary to the province's current policy objectives such as regional balance. The financial risk to government is relatively higher if the proposed plan is supported, particularly if resource or market conditions weaken, resulting in an inability by producers to support debt repayment obligations. Further, other public policy objectives have not been addressed in the proposal, so there is no assurance that issues such as worker attraction and retention and capacity reduction will be addressed. These uncertainties, coupled with the unknown impact to communities and displaced workers, further increase financial exposure for government.

As previously discussed, much of the snow crab and shrimp processing capacity is owned by multi-plant corporate entities. The proposed rationalization plan could permit these corporate entities to close some of their existing facilities and have these closures subsidized by government and remaining plant owners. This method of rationalization would bolster the balance sheets of these corporations and permit them to be the primary beneficiaries of rationalization through overhead cost reductions. In addition, those companies paid to close plants may move capacity to other facilities, thus providing little benefit to the industry as a whole.

Without some mechanism to ensure permanent capacity reduction in the processing sector, the benefits that could be realized by season extensions such as improved worker incomes might not be realized, and in fact attracting workers to the sector would remain difficult because the season would still be short and income levels would remain low.

The process of the reverse auction, and proposed conditions of ownership of purchased plants, should be strengthened if a government supported rationalization of the sector is to occur. There is opportunity for industry intervention in the auction process, so further mechanisms to ensure arm's length evaluation of proposals and determination of the values proposed should be implemented. In addition, plant sale proposal templates with a suggested range of values, based on returns times a multi-

plier, could be sent to stakeholders to ensure submissions are standard and values remain reasonable. Industry has proposed that a consortia be formed to take over and dispose of assets acquired under the rationalization plan. Therefore, industry has the opportunity to realize benefits upon the disposal of acquired assets. There should be some means to ensure that these benefits are used to reduce principal loan amounts immediately upon sale. Further, conditions regarding disposal of processing assets are needed to ensure that the assets are not sold to existing processing entities in NL. This would not eliminate the possibility of capacity expansion, but would ensure that existing equipment is not immediately transferred to increase existing capacity.

Though not examined specifically, there might be a tax benefit realized by the consortia, and possibly transferred to shareholders, for loss on disposal of assets. If these benefits were realized, they would reduce the cost of the acquisition with little risk being borne by the shareholders.

There are a number of operational issues that may prove to be challenging when attempting to act on the recommendations proposed by ASP. The mechanisms, if any, that can be established to control processing capacity post-rationalization are a fundamental concern. That is, what assurances can be made to prevent an increase in processing capacity in those plants that will remain post-rationalization? This question has been debated at the Steering Committee level. To date, there has been no solution identified. ASP proposed that loan payments to remaining operators would be based on a percent increase in production compared to some base amount. Issues associated with this approach include the financial ability of remaining plants to pay in the event of a dramatic decline in the resources. Also, issues of corporate concentration and concerns over port competition with a reduced number of players were highlighted by the FFAW. The most recent ASP response to these questions suggests that there are actions that could be agreed upon to mitigate at least some of these risks to government and other potential investors. However, there are a number of practical concerns that remain outstanding. In addition to those noted above, ASP's proposal recommended a 2.5% interest rate subsidy for repayment of loans for rationalization. Subsidies have been provided in other jurisdictions for rationalization schemes. These would not subsidize operational costs and therefore would not be countervailable.

While the Grant Thornton report and work of the PWG both suggest that a 30% rationalization in the number of shrimp and crab plants will allow processors to achieve significant improvement in GM performance and improved profitability in the short term, longer-term profitability and sustainability in this sector will likely require fundamental structural changes if the Newfoundland and Labrador processing sector is to achieve the objectives of the MOU which were identified during FIR and highlighted in Section 2.0 of this report.

As we have seen at numerous junctures in the analysis and review process, a significant change in one variable (i.e. a dramatic reduction in shrimp quotas) can have a potentially devastating effect on short-term performance and could potentially undermine any incremental improvements that have been contemplated herein. Regardless of whether or not a planned rationalization program is implemented, current trends suggest that the progressive decline in the number of processing plants will continue, and perhaps accelerate.

The cost-benefit ratio at commercial rates and terms (7% at 15 years) is likely inadequate for industry to finance self-rationalization without a subsidy.

While there would be benefits to processors from rationalization, impacts on worker incomes are marginal, and it is doubtful they would meet the FIR/MOU objective of attracting new workers. Therefore, the sector is unlikely to avoid a major labour shortage within the next five to ten years, if not sooner, regardless of whether an accelerated rationalization process is implemented. To address worker and community requirements, consideration of fundamental fisheries restructuring would have to be considered.

Worker adjustment will continue to be required as continued sector downsizing is likely, whether there is a planned rationalization or not.

6.0 Seafood Sales and Marketing

As was outlined in Section 2.0 of this report, one of the key platforms of the MOU involved the examination of a variety of issues surrounding the sales and marketing of seafood products by Newfoundland and Labrador seafood processors. To that end, in September 2009 the MWG was appointed. This group was mandated to make detailed recommendations for a new approach to seafood sales and marketing. The primary objective of the MWG was to carry out a comprehensive analysis of the options to more effectively and efficiently market Newfoundland and Labrador seafood and to make recommendations to the province's fishing industry and government to improve seafood sales and marketing.

The MWG members included representatives of ASP, FFAW, DFA and the Chair of the MOU Steering Committee. A representative from DFO attended all meetings of the MWG as an ex-officio member.

Any proposal that was to be developed by the working group was to take into account the timing of other measures developed under the MOU. Any proposed sales and marketing initiatives were to be complementary in nature to any other initiatives that were forthcoming under the MOU.

DFA, FFAW and ASP agreed that fundamental structural change to the sales and marketing of NL seafood products is essential to meet the objective of increasing the value of the NL fishing industry. It was also acknowledged that any change in sales and marketing would be required as part of overall structural change that might be contemplated within the industry (i.e., rationalization of the processing and harvesting sectors).

The MWG further agreed that any delay by the harvesting or processing working groups in developing proposals would not automatically or necessarily prevent the MWG proposal from proceeding. Certain members of the MWG were of the opinion that changes to the current approach to sales and marketing alone would not be sufficient to facilitate the type of improvement needed to stabilize the industry. In fact, they suggested that change should occur in all significant aspects of the fishery, including harvesting, processing, and sales and marketing.

6.1 Perspective

One of the most significant challenges facing the NL seafood industry has been the nature and intensity of the competition faced by NL seafood processors in the international marketplace. This competition has been manifested in the availability of low cost/high quality substitute species, shifting consumer tastes away from products that have been the mainstay of the NL fishery (e.g. salt cod), the availability of lower cost products from other regions, and improvements in the sales and marketing orientation of many of our direct competitors. As a result, participants in the NL fishery have to find new and improved ways to compete (collectively) in the international fish and seafood marketplace.

While to some degree, varying views still exist within the MWG as to the extent to which enhancements in our collective sales and marketing capability alone can optimize returns to participants in the NL fishing industry, the reality is that we must embrace change in order to be competitive in the international marketplace. If we don't embrace the kinds of changes that are advocated for herein, then we will continue to be at the mercy of an increasingly sophisticated market – one that is willing to wait us out and one that will constantly be trying to extract higher margins at other points in the seafood distribution channel, often at our expense.

In fact, it has generally been recognized that there are shortcomings in how industry players in this province deal with both the sales and marketing aspects of operations. To date, the processing sector has been consistent in its contention that its ability to facilitate change in the areas of sales and marketing has been negatively impacted by industry structure (i.e., overcapacity in harvesting and processing, the current inability to coordinate harvesting and processing activities within Newfoundland and Labrador, and seasonal instability which results in disruptions and/or delays during the relatively short processing season for most or all species). MWG members have recognized that the current industry structure is serving to restrict the ability of the industry to extract additional value from the international markets which it serves.

One of the most significant challenges associated with any attempt to refine the approach to sales and marketing in the NL seafood industry lies in the current distribution of production capacity and market share. At the present time, there are 102 active fish processing plants in the Province of Newfoundland and Labrador. These plants are owned by more than 85 firms, suggesting the potential for a somewhat disjointed approach to both sales and marketing. At the same time, 75% to 80% of the annual production in the Newfoundland and Labrador seafood processing sector rests with about a dozen processing firms. While there are relatively high levels of industrial concentration in what constitutes a significant block of the total production, the remaining 20% of the annual production rests with over 70 firms, less than 0.3% each, on average. As a result, one might reasonably expect the routes taken to market by this rather large and disparate group are many and varied. As noted by Sandy Roche (Roche) in 2008 and Roche and Brian Burke (Burke) in 2010, relatively little has changed in the interim. Roche and Burke (2010) concluded that these firms were engaged in sales relationships with at least 30 different sales agents in the past year. In the snow crab sector, there are 36 processing plants which are owned by 27 arm's length processing companies. In recent years, these entities have brought their products to market through as many as 15 to 20 different sales agents or brokers.

6.2 Sales Function

The potential negative effects that are sometimes associated with the absence of a coordinated approach to seafood sales and marketing in NL are most evident when poor market conditions exist. It is during these periods (when prices are low or sales are either slow or non-existent) that processing operations with low cash reserves and lower than average owner's equity become forced to sell products at lower prices than they would otherwise consider. This phenomenon, which has been often referred to as 'distressed' selling, has the potential to negatively affect sales for a particular species for an entire season for the entire industry, or at least until the supply of product that is available at the distressed price has been exhausted. In the absence of a coordinated approach to sales and marketing, industry may not be receiving maximum value for its production and the end result is that increased profits are taken further along the value chain and the NL industry portion is not optimized.

As was noted in Section 3.0 of this report, the relatively short production season in Newfoundland and Labrador also serves to further inflame this situation and quite likely increases the chance of such an event. This, coupled with the current overcapacity in the NL processing sector, results in an excess of companies going to market, many of whom are not dealing from a position of strength, and results in lower than average prices, thus lower than average gross margins. The end result of this is an industry that is underperforming relative to its potential. While the industry itself has to shoulder some of the responsibility for this, the good news here is that the industry, with some help, can also be an integral part of the solution.

The rationalization that has been suggested for the harvesting and processing sectors could go a long way to ensuring that the industry is financially sound and producing higher quality products for the various markets which it serves. However, in the absence of a coordinated approach to sales and marketing, the production output of the Newfoundland and Labrador seafood industry will continue to be undervalued.

6.2.1 Conclusions

It has been recommended by the MWG that a number of sales consortia be established. The MWG has suggested that the best approach to the early stage development of these sales consortia is to seek the 'voluntary' collaboration of 'like-minded' firms. The MWG has noted that it is of utmost importance that participants in a particular consortium feel comfortable with each other, especially given current practices in the processing industry, where overall collaboration and cooperation are limited.

While the decision concerning the correct number of sales consortia has been the subject of much debate, both within and outside the MWG, the general consensus is that three to five sales entities would appear to be the most practical number required to achieve the kind of critical mass (of production volume available for sale) necessary to facilitate a more structured and coordinated approach to selling. While it may be that the industry starts out with as many as five such entities, from a market coordination perspective the fewer the entities the better.

6.2.2 Benefits and Costs

Having a larger number of consortia (in the range of expected numbers) would allow for a wider choice of sales partners and increase the likelihood that individual firms would opt to participate. At the same time, it would still serve to dramatically reduce the number of NL seafood processing firms going to market, while increasing the level of consistency with which they approach these markets.

At this juncture in the MOU process, the NL processing sector supports a voluntary approach to the establishment of sales consortia. While there was a fairly broadly-based discussion amongst MWG members about the need for government-based incentives to encourage consortia membership or regulations to impose membership terms and conditions, in the end the consensus of opinion was that government should focus on an 'incentive-based' approach to encourage individual seafood processing firms to join one of the various sales consortia that may operate within the province. Members of the MWG who represent the FFAW were of the opinion that government should explore regulatory measures in the event that an incentive-based approach does not achieve the desired result. At the same time, representatives on the MWG from the processing sector felt quite strongly

that the type of increased coordination that would come from the establishment of sales consortia would be a positive move for the industry. They also concurred with an industry analyst who suggested that the mere establishment of sales consortia would not solve all of the sales and marketing challenges currently being faced by the NL seafood industry. As noted earlier, processors feel strongly that structural change needs to occur in both the harvesting and processing sectors, in conjunction with initiatives in the area of sales and marketing, before these collective initiatives can truly be effective.

Finally, the FFAW is of the opinion that a more coordinated approach to sales and marketing would help achieve better returns from the market. It also agrees that these returns would be more substantial if these initiatives were undertaken in conjunction with the structural changes that have been proposed in the processing and harvesting sectors.

Not surprisingly, the MWG was of the opinion that the sales consortia that are established should focus their initial efforts on the efficient sale of crab and shrimp, as these species are the dominant species currently being processed in Newfoundland and Labrador. Other species would be considered for inclusion as the consortia gain experience and as opportunities permit.

As the task of defining the corporate objectives of each sales consortium may differ, either by species, entity size, or region of representation, defining the exact structural nature of the consortium is quite challenging. However, regardless of its defining characteristics or regional representation, the MWG was of the opinion that the following key structural issues and challenges should be addressed when considering the development of a sales consortium.

- Does the establishment of this consortium serve to significantly reduce the number of companies selling into the market?
- Does the proposed sales consortium represent at least 15% of the production volume of the species being sold?
- Does the proposed sales consortium have dedicated in-house sales and marketing expertise?
- Does the proposed consortium have a well-defined quality assurance program?
- Is the proposed consortium a well-defined legally structured entity with formal governance and operating procedures, requiring multi-year participation commitments?
- Does the consortium have a mechanism to provide for an expansion in its membership base in the future?

The MWG has also proposed that provision be made for situations that may arise where individual firms do not agree to participate in one of the sales consortia that have been proposed herein. In such cases, the MWG suggests, with approval from the Steering Committee, that government should consider regulatory options within its power and jurisdictional responsibility to encourage participation and limit (in consultation with industry) the number of seafood product sellers going to market.

Finally, the MWG was of the opinion that greater transparency with respect to the sales and marketing effort and sales performance of each consortium would greatly enhance the level of cooperation between industry members.

To help facilitate the formation of these sales consortia, the MWG recommends that government should consider two forms of financial incentives:

1. The first would involve a funding program to offset initial incremental set-up costs for participants who are interested in establishing sales consortia. Some of the eligible costs that might be incurred by such consortia include legal costs related to incorporation and sales contract development, sales and market strategy and plan development.

2. The second would involve the establishment of a working capital guarantee program that could be accessed by sales consortia to enhance their inventory financing requirements. The Provincial Government should work with federal agencies (e.g., Export Development Canada (EDC)), commercial banks and sales consortia in a collaborative effort to assist in the provision of inventory financing arrangements.

The purpose of making available inventory financing to sales consortia, which is greater than that which would otherwise be available from commercial banks, is to enable consortia to have a greater ability to hold product in inventory for an extended period to allow for a more orderly release of product into the marketplace than is currently the practice in the industry.

Commercial banks provide working capital financing on the basis of a percentage of the value of a company's inventory and accounts receivable at points in time. The amount advanced once product is produced but not yet sold is normally about 50% of the actual cost of production. The amount advanced once the product is sold and its value converted to an account receivable is normally higher (perhaps upwards of 70%). As a result, to avail of more financing, there is a major incentive for companies to convert product into sales inventory as soon as possible. The working capital line of credit available to a company is also subject to maximums which banks set based on each bank's subjective consideration of such factors as the company's track record, its balance sheet, financial ratios, the bank's overall exposure in a particular industry, etc. It is also understood that a significant portion of small to medium sized companies may not meet the eligibility criteria of EDC programs.

Invariably, many seafood processors, especially in the crab sector, hit their maximum well before the season's production is finished. This is because their working capital requirements peak so high and so fast due to the compressed time frame during which crab production occurs. Hence these companies have an even greater need to convert inventory into sales.

Given the current industry structure, the only way to have commercial banks relax their guidelines and provide additional working capital resources to the industry would seem to be through the government providing deficiency guarantees to the banks. Such guarantees would constitute a contingent liability of the government and would only involve an actual cash outlay should there be a default. The deficiency guarantee would be made available only to sales consortia.

The amount of the deficiency guarantee(s) that may ultimately be required is difficult to quantify and would depend, of course, on the number and size of sales consortia actually formed. The crab sector would require the highest amount of working capital financing. The maximum amount of deficiency guarantee(s) outstanding at any one time can be estimated using certain assumptions, as follows:

1. The entire industry comes together into the desired number of consortia.

2. The amount of working capital financing needed to enable processors to be able to hold product in inventory and still be able to carry on production is 100% of the processor's direct cost of producing each pound of product. (In accounting terms, 100% of cost of goods sold, (COGS)).

3. The commercial banks will provide financing of 50% of the direct cost of production and the government deficiency guarantee will be required to enable the banks to extend a large portion of the remaining 50%.

4. No product is sold until after the full season's production is completed (i.e. the worst case scenario).

5. The estimated average unit direct cost of production for crab is $3.00/lb. and for shrimp is $2.70/lb.

6. Inventory financing may not be required for crab production going into the Japanese market because of the conventional terms of payment provided by Japanese buyers.

7. Using five-year averages, the total annual crab production is about 76 million lbs., of which about 65%, or 50 million lbs., is for the United States market.

8. Average shrimp production has been about 57 million lbs. over the past few years but given the expected reductions in shrimp quotas, a more realistic production volume is likely to be about 35 million lbs.

Based on the above assumptions, we can estimate the maximum amount of a government deficiency guarantee outstanding at any one time to be $75 million for crab (50 million lbs. @$3.00/lb x 50%) and $47 million for shrimp (35 million lbs. @ $2.70/lb x 50%) for a total of $122 million.

This, as stated, is a worst case scenario since it is unrealistic (and undesirable) to assume there would be no sales of crab or shrimp during the production seasons. Once a sale of product is made, an account receivable is created and this enables the bank to extend financing of 70% of the value of the receivable (and up to 90% if it is EDC insured) which thereby reduces the amount of government deficiency guarantee required.

A more likely scenario is that the peak amount of the deficiency guarantee will be in the range of $45 to $50 million for crab and $25 to $30 million for shrimp, for a total in the range of $70 to $80 million.

Assuming appropriate terms can be negotiated with commercial banks, there should not be a significant risk of default on the government deficiency guarantee. The spread between the cost of producing a pound of product and its final market value is normally enough to cover market price exposure as well as other more normal risks such as nonpayment, quality claims, etc. Additionally, the provision of the deficiency guarantee is in itself designed to increase overall returns from the marketplace and reduce volatility. Nevertheless, prudence would dictate that some provision for default be recognized.

These financial incentives to newly-established sales consortia should be made available for a minimum period of three years. It is crucial that any form of financial assistance from government should continue to be provided in compliance with domestic and international trade agreements. Costs associated with the establishment of seafood sales consortia over a three-year period are as follows:

Table 6.1 Seafood Sales Consortia Incentive Program Costs				
Funding Program				
	FY 2011/12	**FY 2012/13**	**FY 2013/14**	**TOTAL**
Government	$1,500,000	$1,200,000	$1,200,000	$3,900,000
Industry	$500,000	$800,000	$800,000	$2,100,000
	$2,000,000	**$2,000,000**	**$2,000,000**	**$6,000,000**
Deficiency Loan Guarantee Program				
	FY 2011/12	**FY 2012/13**	**FY 2013/14**	
Government	$80,000,000	$80,000,000	$80,000,000	

6.3 Marketing Function

The seafood industry, not unlike any other industry, is driven by consumers. The basis of successful marketing is having a consumer-focused approach. Failure to do this limits the ability to differentiate NL products from those of competitors, to project the important attributes of NL seafood products to consumers, and to fully achieve the benefits that normally accrue to a dominant supplier in the marketplace (e.g., crab and shrimp). Increasingly, competitors in other jurisdictions (e.g., Iceland, Alaska and Norway) have the benefit of industry-wide marketing support initiatives.

In the processing sector, few companies have any significant level of marketing expertise or fund marketing activities. As well, resource management regimes are not always aligned with marketplace realities (e.g., length of season, time of catch, and quality retention). The NL fishing industry needs to commit itself to a collaborative seafood marketing effort. In addition, insofar as nature permits, restructuring and rationalization in the harvesting/processing sectors must include market-oriented measures to extend operating seasons and maximize fleet/plant capability to produce the highest quality products and to extend the periods these products are available to the market.

6.3.1 Marketing Working Group Recommendations

The MWG strongly advocates that the Newfoundland and Labrador seafood industry commit itself to the development of a collaborative seafood marketing effort via the establishment of a Seafood Marketing Council (the Council). In particular, the MWG feels that the Council that was proposed in the Roche Report of 2008 should be implemented in consultation with industry. A vote to proceed with the Council (as was suggested in the Roche Report) took place in 2009 and the Council was narrowly rejected by the processing sector. Given that the Council recommendation is an integrated approach along with other recommendations for industry restructuring, the MWG feels that a vote is no longer necessary.

The organization described by Roche was structured to facilitate cooperation amongst industry participants to improve and enhance the marketing of NL seafood products. More specifically, the Seafood Marketing Council would have the following responsibilities incorporated in its mandate:

- Market Intelligence/Industry Collaboration: To collect and disseminate market intelligence and information to better enable processors to 'go to market' each season in a more coordinated manner and to better sustain that coordination throughout the processing season.

- Image Development and Product Promotion: To develop and promote the image of the province's seafood industry as a supplier of quality seafood and to augment company level marketing efforts with promotional campaigns in selected markets.

- Long Range Market Planning: To facilitate and encourage industry focus on proactive longer-range market planning.

- Public Relations: To become the industry vehicle for dealing with market relevant public relations issues and opportunities.

The MWG is of the opinion, and is supported by the MOU Steering Committee, that the staffing budget, funding, structure and governance model (including the composition of the Board of Directors) should be as outlined in the Roche Report (2008).

6.3.2 Benefits and Costs

The Council, as proposed, could also help with issues related to sales and market information sharing and, in so doing, build stronger relationships between industry participants, both on the processing and harvesting sides of the business. MWG members have also indicated a clear understanding of the need for privacy with respect to certain elements of corporate level sales and market related information. It is the opinion of the majority of MWG members that active participation of harvesters and processors on the proposed Council would facilitate greater transparency and trust. It is clear that in order for the proposed Council to be effective, processors and harvesters need to feel a sense of ownership in such an organization, thus it is crucial that all parties buy into the goals and objectives of the Council from the outset.

The MWG further recommends, with the support of the MOU Steering Committee, that the Newfoundland and Labrador fishing industry, in partnership with the Government of Newfoundland and Labrador, request financial support from the Government of Canada to establish and operate the Seafood Marketing Council. Table 6.2 provides costing information for a 3-year trial period.

Table 6.2 Seafood Marketing Council Costs

	FY 2011/12	FY 2012/13	FY 2013/14	Total for 3-Year Trial Period
Government	$2,000,000	$2,250,000	$3,000,000	$7,250,000
Industry	$ -	$750,000	$1,000,000	$1,750,000
	$2,000,000	**$3,000,000**	**$4,000,000**	**$9,000,000**

6.4 Summary Findings - Marketing

1. Seafood sales consortia should be established within the NL fishing industry.

2. Government should work on developing two forms of financial incentives: (1) offsetting incremental start-up costs to establish sales consortia; and (2) enhancing for a minimum three-year period the inventory financing capability of the consortia.

3. The Provincial Government, federal agencies (e.g., Export Development Canada), commercial banks and sales consortia should collaborate to assist in the provision of inventory financing arrangements.

4. Further details on industry assistance should be decided through discussions with industry participants. Financial assistance should be provided for at least a three-year period to establish and operate the sales consortia. It should also be incremental to the costs associated with current sales and marketing efforts. Assistance should be considered for activities such as legal requirements to establish the entities, as well as marketing strategy development and implementation.

5. It is crucial that any forms of financial assistance from government should continue to be provided in compliance with domestic and international trade agreements.

6. There should be flexibility in the criteria to establish the consortia, so as not to make it unreasonably difficult and onerous for companies to collaborate. The criteria as to what constitutes acceptable consortia will have to be developed more definitively but should address such questions as:

    - Does it significantly reduce the number of companies selling into the market?
    - Does it represent at least 15% of the production of that specie?
    - Does it have dedicated in-house sales/marketing expertise?
    - Does it have a well-defined quality assurance regime?
    - Is it a well-defined, legally structured entity with formal governance and operating procedures and requiring a multi-year commitment by its participants?
    - Does it provide for expanded membership in future?

7. All fishing industry organizations, as well as the provincial and federal governments, should collaborate to promote the merits of sales consortia within the industry.

8. The NL Seafood Marketing Council as recommended in the 2008 Roche Report should be established in consultation with industry.

9. The key activities of the Council as outlined in the report should be: market intelligence/industry collaboration; image development and product promotion; long-range market planning; and public relations.

10. The NL fishing industry, as represented by ASP and FFAW, in partnership with the Government of Newfoundland and Labrador, should request financial support from the Government of Canada to establish and operate the Council.

11. The priority with respect to establishing sales consortia and the Council should be on crab and shrimp products. However, efforts should be made as opportunities permit to include other species such as capelin, lobster and groundfish.

The successful implementation of sales consortia and a Seafood Marketing Council will require change in industry structure and substantial horizontal and vertical collaboration within the industry.

7.0 Conclusions

In conclusion, over the past 20 years the rates of decline in the number of plant workers, harvesters and harvesting enterprises in the NL fishery have been remarkably consistent with each other. In addition, these rates of decline are projected to continue for at least another five years. Further, the age profile of the existing (2010) and projected (2015) plant worker and harvesting workforce is now skewed towards older than average workers. In fact, more than half of harvesters and plant workers are currently over 45. Demographic evidence from the past 10 years also suggests that the vast majority (80% +) of harvesters and plant workers retire at age 65. As a result, one must conclude that unless action is taken to increase wages and incomes for plant workers and harvesters, there will, in all likelihood, be a significant decline in the number of available workers, particularly in remote areas.

The fishery, as it has been known in NL, appears to be coming to a turning point. So too, it seems, the age of self-reliance that was once a mainstay of outport life in rural areas, when a person could combine fishing, farming, wood cutting and other forms of seasonal work to build a balanced life, appears to be numbered. In fact, in certain geographic regions in NL, the revenues from fish harvesting or the wages derived from seasonal work in the local fish plant, are insufficient to allow the workers to achieve a reasonable income, or to allow the industry to retain or attract workers. These facts, coupled with the aging workforce, will in time create a situation where industry players may have to further explore options such as making structural changes, and/or look elsewhere to find workers, and/or place greater emphasis on finding solutions through new technologies.

In some geographic regions of the province, the fishing season is longer, the average value of the catch is higher and overall wages appear sufficient to allow the harvester workforce to be self-sustaining. While average revenues from harvesting are in decline in some areas, the overall value of the industry has increased from pre-moratoria levels, indicating that for at least some of those who remain, incomes from fishing have improved. Nevertheless, success, it seems, is fleeting. One need look no further than 2008, 2009 and 2010 to see the rather dramatic swings that can occur in this industry and the impacts they have.

Overall, the analysis of the financial health of the industry suggests that while the industry showed a reasonable recovery in 2010 relative to 2009, it continues to be in a rather volatile state and is perhaps one or two relatively poor seasons away from further economic misfortune. Action must be taken to solidify and improve the present economic position of the province's harvesters, processing operations and plant workers if the industry is to survive long enough to engage in the kind of meaningful restructuring that is required to achieve a self-sustaining, globally competitive industry, to meet the objectives of the FIR initiative.

The conclusions of the most recent round of industry analysis are summarized below:

- The NL fishing industry is very different today than it was prior to the early 1990s when the groundfish fishery dominated the industry.

- The fishery today is dominated by the catch and sale of shellfish and, as such, requires a different infrastructure, different harvesting capability and a different workforce and a different approach to sales and marketing.

- While the move to shellfish has benefitted some areas of the province, other areas have been much less fortunate.

- In the inshore sector, the level of rationalization that is required to allow fish harvesters to achieve a relatively reasonable average income (under the terms of the FFAW proposal) is significant. In the areas most dramatically affected by the shift to shellfish and the decline of the groundfish sector, as high as 80% of the current capacity must be rationalized in order for those who remain to achieve a viable income. The northeast and west coasts of Newfoundland and the southern coast of Labrador require the highest levels of rationalization. Enterprises in these regions will have to harvest as much as four times their current levels to achieve the income targets that have been set for them. This is probably not achievable given current structural challenges and seasonality.

- In these areas, some form of buy-out will likely be required as no other initiative would appear to have the desired effect on earnings potential. In this regard, the Atlantic Lobster Sustainability Measures Program (ALSMP) enterprise buy-back initiative could be quite beneficial, as it targets certain areas which have been shown to have limited prospects for viability in the inshore sector (i.e. west and southwest coasts), as referenced in the FFAW proposal.

- In all other inshore fleets, significantly less (40%) rationalization is required in order to allow those harvesters who remain to achieve the desired enterprise viability target. This could be achievable and feasible through an enterprise combining process.

- In the inshore sector, the weighted rationalization rate is approximately 54%, or 1,617 of the 2,972 inshore enterprises.

- The degree of rationalization that is required under the terms of the NL Inshore Shrimp Fleets proposal is not dramatically different from the FFAW proposal. The degree of rationalization that is required under a loan guarantee program or under commercial lending terms is higher than the FFAW or NL Inshore Shrimp Fleets proposal, due to higher debt servicing requirements.

- In the nearshore fleets, the level of rationalization that is required in order to allow those who remain to achieve the desired enterprise viability target is lower (0 to 49%) than experienced in selected inshore fleets.

- In the nearshore sector, the weighted average rationalization rate is approximately 25%, or 214 of the 861 nearshore enterprises.

- In other areas, such as 3L full-time crab and 3Ps, no rationalization is required at this time to achieve the target levels for average income and returns on investment.

- While rationalization would serve to reduce the volume of peak landings and allow for a better distribution of landings and a modest increase in the current operating season, it may not allow the harvesting and processing sectors to achieve the kind of fundamental restructuring that is required to permit participants to compete effectively in the global seafood marketplace in 2011 and beyond.

- On the processing side, while the value of production in 2010 has increased and again approaches $1 billion in value, lower than average gross margin performance may continue to impede the ability of the industry to attract the level of capital investment that is required to compete effectively in the international marketplace.

- Lower than average net incomes and weighted average cost of capital performance are also symptomatic of an industry that is underperforming financially, particularly one that is currently experiencing rationalization through market forces.

- While the targeted gross margin figure of 20% may not be achievable, the analysis suggests that plant rationalization at the 30% level will serve to increase overall gross margin performance to national seafood industry levels of 15%.

- The savings in the selling, general and administrative expenses that would accrue to the industry in the event of a 30% rationalization will also be significant, resulting in improved profitability.

- The benefits to plant workers that will arise from plant rationalization, while positive, are likely not sufficient to allow the industry to achieve income levels that will attract and retain workers.

- The current ASP proposal does not contemplate implementation details such as the plants that might be affected by planned closures and mechanisms to control capacity post-rationalization. The analysis shows that at commercial interest rates (7%) and a 15-year loan term, much of the benefit of rationalization would be required for debt servicing costs. Consequently, processing sector rationalization may be feasible only if an interest subsidy is available and the repayment period is protracted (i.e. 30 years), representing a public sector exposure of $80 million in loan guarantees and $60 million in interest subsidies, with high risk to the public sector. In addition, issues such as the ability of those plants that remain to finance their acquired quotas may diminish if the overall quotas for such species are subsequently reduced by DFO.

- It is clear that there is an ongoing process of downsizing which is occurring in the fish harvesting and processing sectors due to factors such as poor financial performance, low income levels, and aging demographic profiles. Over the past decade, the level of contraction of both the harvesting and processing sectors has been in the order of 20-30%, and this trend is likely to continue over the next decade, regardless of whether a funded rationalization program is forthcoming. To a large extent, the rationalization proposals examined will not set the course, which is already underway, but rather will serve to accelerate the pace at which the process unfolds.

- On the marketing side, a proposal has been advanced to establish a small number of sales consortia to help coordinate the sales activities of the disparate number of smaller processors who go to market in an infrequent and less structured manner.

- In conjunction with the establishment of sales entities, an inventory financing program would be required to enable the consortia to time the supply of product to market and to avoid distressed sales, thereby enhancing the market value to be extracted for the overall benefit of the NL fishing industry.

- It has also been recommended that a seafood marketing council be established so as to facilitate the gathering of market intelligence, the development of an improved image for Newfoundland and Labrador seafood products and undertake long-term market planning and public relations activities.

- The total costs of the harvesting, processing and marketing proposals are outlined in Table 7.1. In summary, the cost to government is close to $360.75 million (including direct financing and potential risk from loan guarantees) but excludes the associated interest cost to government (total interest subsidy of $80 million for processing rationalization at 2.5%) and ancillary adjustment costs for communities and industry workers.

Table 7.1 Financial Requirements by Sector ($Millions)

	Industry Cash Requirement	Cash Requirement from Government	Loan Guarantees	Total
Marketing	$ 3.85	$ 11.15	$ 80.00	$ 95.00
Processing	-	-	$ 80.00	$ 80.00
Harvesting	-	$ 142.20	$ 47.40	$ 189.60
Total	**$ 3.85**	**$ 153.35**	**$ 207.40**	**$ 364.60**

In reality, most of the initiatives that have been recommended herein fall within the domain of actions designed to rationalize the existing fishing industry, as opposed to initiatives designed to fundamentally restructure the industry. In fact, such an approach is not uncommon in Canadian industry and, in many respects, reflects the kinds of activities that were undertaken by the Canadian auto parts industry when it last underwent significant change. The approach taken in that industry was a two-stage approach, with the first round of change being associated with a downsizing of the industry and the second round being associated with more fundamental change to the actual structure.

Phase one, as it may come to be known in this exercise, is designed to allow the NL fishing industry to improve the current financial position of all participants, while simultaneously allowing industry participants sufficient time to contemplate the activities and structural changes that are required to allow the industry to achieve the remaining goals of the MOU, notably those goals associated with the retention and attraction of workers (if possible) and the continued improvement in compensation for those participants that remain post-rationalization.

Many industry participants appear to be preoccupied with survival in the short term and rationalization in the medium term. While at this juncture many key industry participants appear unwilling or unable to contemplate more fundamental restructuring initiatives, a cursory examination of ration-alization and restructuring activities in other industries and countries would appear to indicate that this phenomenon is not at all uncommon. What should be made clear to all parties, as evidenced by those governments that have supported such activities in other jurisdictions, is that initiatives designed to support rationalization alone will be insufficient to allow industry and government to achieve the kind of meaningful restructuring that is necessary. In order to compete effectively in the international marketplace, we must be as good as or better than our direct com-

petitors. We must achieve vertical integration (or, at least, an integrated industry approach to resource utilization and market development), advance technology, enhance quality and focus on other related initiatives that ensure that our product is easily differentiated from those of our competitors and in demand by highly valued long-term customers.

In the absence of such initiatives, we will be relegated to the status of the textile industry in the southeastern United States, the automobile industry in the United Kingdom, and the electronics industry in Germany, a collection of also-rans, each of which received significant amounts of government support and none of which managed to achieve the level of restructuring that was required to remain competitive in an increasingly competitive international marketplace. The availability of less expensive, qualified labour, in technologically advanced countries such as India, Korea and Japan, has served to render the aforementioned industries almost obsolete, in their respective countries.

For the province's fishing industry, the pursuit of an agenda that is defined by significant restructuring will involve a radical departure from the thinking and policies of generations past. It will also require the level of intensity, commitment and fortitude that has defined previous generations of Newfoundlanders and Labradorians.

Annex 1
Memorandum of Understanding (MOU) on Fishing Industry Restructuring

MEMORANDUM OF UNDERSTANDING

BETWEEN:

HER MAJESTY IN RIGHT OF NEWFOUNDLAND AND LABRADOR, as represented by the Minister of Fisheries and Aquaculture

(Hereinafter referred to as the "The Department")

AND:

FISH, FOOD AND ALLIED WORKERS (FFAW/CAW) duly incorporated under the laws of the Province of Newfoundland and Labrador

(Hereinafter referred to collectively as "FFAW")

AND:

ASSOCIATION OF SEAFOOD PRODUCERS duly incorporated under the laws of the Province of Newfoundland and Labrador

(Hereinafter referred to collectively as "ASP")

1 Purpose

1.1 The parties recognize the difficult economic circumstances facing the fishing industry in Newfoundland and Labrador and commit to seeking solutions to the current and long standing problems in the industry as referenced herein.

1.2 The problems in the industry relate to a host of structural, resource, market and policy issues that compromise the long term economic viability of the industry. The current economic environment has exacerbated these problems and the parties commit to seek means to resolve the issues.

1.3 This is a continuation of work that began under Fishing Industry Renewal ("FIR"). The current environment requires an accelerated process to respond to the global challenges.

1.4 The Parties will establish working groups that will develop proposals for key areas including demonstrating the financial state of the industry, developing a long term marketing strategy, developing a rationalization model for the harvesting sector and developing a rationalization model for the processing sector.

2 Conditions Precedent

1 The FFAW and ASP agree to utilize their best efforts to finalize an agreement on the shrimp fishery.

2 The Department agrees to bring forward all proposals that are developed by the working groups and presented to the Steering Committee for consideration by the Government of Newfoundland and Labrador.

3 The FFAW and ASP and their members agree to fully cooperate and disclose all information necessary for this work including financial and operational information.

4 The Working Group reports will be submitted to all parties as completed and the Steering Committee must report no later than December 15, 2009.

3 Elements of the Agreement

The Parties agree to a plan of action utilizing four working groups. These will include: a working group on financial analysis, a working group to develop a seafood marketing strategy, a working group to develop a rationalization model for the harvesting sector and a working group to develop a

rationalization model for the processing sector. Whenever possible, the working groups will work on a consensus basis and will be assisted by a Department facilitator.

The process will be directed and overseen by a Steering Committee consisting of two representatives each of the FFAW, the ASP, and the Department. An independent Chair will be appointed by government. As part of its role, the Chairperson will serve as liaison and facilitator to ensure that the work of the Working Groups proceeds on time and within the established terms of references.

A. The **Financial Analysis Working Group** will collect and analyze financial data from both the harvesting and processing sectors.

1. Members of the Working Group will include two representatives from each of the FFAW, the ASP, and the Department. Ex-officio members can participate by mutual agreement of all the parties.
2. A Terms of Reference and a Request for Proposals must be developed and approved by the Steering Committee.
3. For the analysis of the harvesting sector, the Working Group will prepare a plan to sample harvester costs and earnings on a statistically significant basis, including identification of the fleet/species/geographic breakdowns that are required. Time will be the constraining factor on the level of detail sought.
4. For the analysis of the processing sector, the Working Group will prepare a plan to sample processor costs and earnings on a statistically significant basis. Time will be the constraining factor on the level of detail sought.
5. Wherever possible, analysis to be based on audited financial statements.
6. Only aggregate information will be provided to the Working Group.
7. All individual information will be kept strictly confidential.
8. All the parties agree that this information is not for general disclosure.
9. An independent third party will be hired to undertake the reviews.
10. The financial costs of the reviews will be borne by the Department.
11. The Working Group will report its findings by October 1, 2009.

B. **The Working Group on Harvesting Rationalization** will develop a voluntary comprehensive cost-shared proposal on harvesting rationalization and any proposal developed must take into consideration the timing of other measures developed under this MOU and be complementary in nature.

1. Members of the Working Group will include four FFAW/CAW representatives and two Departmental representatives. It will be mandated to develop a voluntary, cost-shared fleet rationalization program and a strategy to continue to pursue federal participation. Officials of the Department of Fisheries and Oceans will be requested to participate in the work of the committee to ensure compatibility between any fleet rationalization plan and federal fisheries licensing policy. Other ex-officio members can participate by mutual agreement of the parties.
2. A Terms of Reference must be developed by the Working Group and approved by the Steering Committee.
3. The parties agree that fleet rationalization is of such critical importance to policy objectives in both the harvesting and processing sectors, the Harvesting Sector Working Group will develop a comprehensive proposal for a fleet rationalization plan cost-shared by harvesters and Governments. The parties recognize that harvesting is a matter of federal jurisdiction, and note that the Provincial Government continues to press the federal government on the principles of licence buyout that would be cost-shared on a 70/30 federal-provincial basis.
4. The parties agree to pursue all possible avenues to compel the Federal Government to meet its responsibility to cost-share a fleet rationalization program.
5. The Province has already demonstrated its policy commitment to rationalization through its commitments under FIR.

6. The parties agree that a fleet rationalization program would contribute, along with the other elements, towards achieving Fisheries Renewal policy objectives directly in the harvesting sector and indirectly in the processing sector.
7. Any proposal developed must clearly articulate the specific costs for governments and harvesters.
8. The parameters of a rationalization plan will be developed taking into consideration the demographics of the harvesting fleet, the resource outlook, and economics and viability of the fleet. For example, the parties might agree that over a ten year period, an adequately funded, properly designed rationalization program could remove as much as 50% of the enterprises in some fleets, and 25 to 33% overall.
9. The Working Group will be mandated to develop a strategy to ensure that fishing enterprises acquiring additional quota through rationalization are able to minimize the risk associated with using their existing enterprise assets as collateral against the incremental quota/access.
10. Any rationalization program developed would be retroactive to the FIR announcement on April 12, 2007 to ensure eligibility for any enterprises that have already combined.
11. Each party shall be responsible for the costs of its own representatives on the Working Group. The Department will fund the hiring of a qualified independent third party to develop detailed proposals and otherwise carry out the work of the Working Group.
12. The Working Group would be mandated to ensure that any rationalization program is designed in such a manner that any Government funding improves the viability of those who remain in the industry, and best efforts will be made to design a program that does not inflate the cost of acquiring licenses/quotas.
13. The costs and benefits of any options considered will be developed as part of the final report.

C. **The Working Group on Processing Restructuring** will develop a comprehensive rationalization model for the processing sector. Any proposal developed must take into consideration the timing of other measures developed under this MOU and be complementary in nature.

1. Members of the working Group will include four representatives from the ASP and two from the Department. Other ex-officio members can participate by mutual agreement of the parties.
2. A Terms of Reference must be developed by the Working Group and approved by the Steering Committee.
3. The parties recognize that overcapacity, an aging workforce, recruitment and retention, out-migration, and an ongoing rationalization in harvesting enterprises will continue to impact processing operations and therefore processing restructuring is required in order to revitalize the processing sector and enable it to attract and retain processing workers.
4. The parties recognize that processing is a matter of provincial jurisdiction.
5. The Province has already demonstrated its policy commitment to rationalization through its commitment to funds for Fishing Industry Adjustment and funding for its 30 percent share of an early retirement program.
6. The parties agree that a rationalization program would contribute, along with the other elements, towards achieving Fisheries Renewal policy objectives.
7. The parameters of a rationalization plan will be developed taking into consideration the demographics of the workforce, the resource outlook, and economics and viability of the processing sector so that it continues to serve as an economic driver in vibrant, rural regions.
8. Any proposal developed must identify the potential impact on workers and propose measures to minimize these impacts. Parallel or subsequent to this work, the FFAW, the ASP and the Department will develop a Workers Adjustment Program to help mitigate any effects of processing restructuring on older and other affected workers.
9. Any proposal developed must take into consideration the potential impact on port market competition and services to harvesters and propose a strategy to minimize these impacts.
10. The Working Group would be mandated to ensure that any rationalization program is

designed in such a manner that any Government funding improves the viability of those who remain in the industry.

11. Each party shall be responsible for the costs of its own representatives on the Working Group. The Department will fund the hiring of a qualified independent third party to develop detailed proposals and otherwise carry out the work of the Working Group.
12. The costs and benefits of any options considered will be developed as part of the final report.

D. The **Working Group on Seafood Marketing** will develop a comprehensive marketing strategy for the Newfoundland and Labrador Industry. Any proposal developed must take into consideration the timing of other measures developed under this MOU and be complementary in nature.

1. Member of the Working Group will include four representatives from ASP, two from the FFAW and two from the Department. It will make detailed recommendations for a new seafood marketing structure aimed at achieving a more coordinated and coherent Newfoundland and Labrador strategy in the marketplace and thereby optimizing returns from world markets. Ex-officio members may be added to the Working Group by mutual consent of the parties.
2. A Terms of Reference must be developed by the Working Group and approved by the Steering Committee.
3. DFA, FFAW/CAW and ASP agree that fundamental structural change to the marketing of our seafood products is essential to meet the objective of achieving optimal value from world markets and this change in marketing is required as part of overall structural change.
4. The Working Group will be mandated to propose a budget and implementation plan for the proposed new marketing structure.
5. The Working Group will be mandated to review the availability of federal programs, such as those under the marketing branch of the federal Department of Agriculture, which might be relevant to the development and funding of a new marketing structure.
6. A consultant with expertise in marketing will be hired to advise the group.
7. The costs of any options considered will be developed as part of the final report.
8. Any delay or failure in the harvesting or processing working groups from developing proposals will not prevent the marketing proposal from proceeding.
9. Each party shall be responsible for the costs of its own representatives on the Working Group. The Department will fund the hiring of a qualified independent third party to develop detailed proposals and otherwise carry out the work of this Working Group.
10. The Working Group will report its findings, including an estimate of the financial contribution required from the Provincial Government and the Parties, no later than October 1, 2009.

Timing

The Financial Analysis Working Group and the Working Group on Seafood Marketing will begin its work as soon as possible, with a deadline of October 1, 2009 to report its findings.

The Working Group on Harvesting Rationalization and the Working Group on Processing Restructuring will begin work at a time determined by mutual agreement of the parties and in any event no later than September 1, 2009. These Working Groups shall have a deadline of December 1, 2009 to report their findings.

The Parties agree that implementation of processing sector restructuring and harvesting sector restructuring are linked and one will not proceed without the other unless otherwise agreed by the parties. The objective of the Working Group is to develop restructuring proposals. The logical sequence would be that harvesting sector rationalization would commence before processing sector restructuring; however, the failure of one Working Group from developing a proposal should not be a barrier to the other proceeding.

4. General Terms

4.1 This Memorandum contains an outline of terms only and neither this Memorandum nor the negotiations conducted pursuant hereto are intended to, nor shall they create legally binding obligations on any of the parties except for the obligation of the parties as specified in 4.2-4.5. If a final agreement cannot be reached, no party shall be entitled to any form of relief whatsoever, including injunctive relief or damages, as a result of the failure to reach a final agreement. However, provisions 4.2 to 4.5 shall survive the termination of this Memorandum or the negotiations conducted hereunder and for greater certainty shall be legally binding upon the parties.

4.2 Each party shall keep any and all information disclosed to it by any other party, either to date or through the negotiations pursuant to this Memorandum, confidential, and shall not disclose same to any other person without the prior written consent of the disclosing party. This section shall not apply to information which:

4.2.1 was generally known to the public prior to disclosure to the recipient;

4.2.2 becomes generally known to the public other than as a result of disclosure to the recipient;

4.2.3 was or becomes available to the recipient on a non-confidential basis from a source other than the discloser, which disclosure is not in breach or violation of any law or any obligation;

4.2.4 is disclosed by the Province in accordance with the mandatory disclosure requirements of the Freedom of Information Act (Newfoundland and Labrador), as amended, or any similar statute repealing or replacing that statute (the "Act") or contained in a record, within the meaning of the Act, that is subject to disclosure under the Act; or

4.2.5 is disclosed pursuant to an order or direction of a court, board, commission or other tribunal or competent jurisdiction, or in connection with legal proceedings (by discovery, oral question, interrogatory, requests for information or documents, subpoena or similar process), to the extent required to be disclosed;

4.2.6 provided, however, that in any of the cases described in 4.2.4 and 4.2.5 where a recipient is required to disclose any portion of the confidential information, the recipient shall give notice of such requirement to the discloser as soon as is reasonably practicable after such requirement becomes known to the recipient.

4.3 Negotiations pursuant to this Memorandum may be terminated by either party upon notice to the others.

4.4 Each party shall bear all expenses it incurs in connection with this Memorandum.

4.5 Parties represent that they have the necessary power and authority to execute this Memorandum.

4.6 This Memorandum shall be construed in accordance with the laws of the Province of Newfoundland and Labrador.

IN WITNESS WHEREOF the parties hereto have executed this Memorandum at the places and on the dates hereinafter indicated.

DEPARTMENT OF FISHERIES AND AQUACULTURE

Tom Hedderson

MINISTER

Place: _____

Date: _____

FISH, FOOD AND ALLIED WORKERS (FFAW/CAW)

Place: _____

Date: _____

ASSOCIATION OF SEAFOOD PRODUCERS

Place: _____

Date: _____

Annex 2
Committee Members and Working Group Members

Steering Committee Members:

Tom Clift, Independent Chair of MOU Steering Committee
Alastair O'Rielly, Department of Fisheries and Aquaculture
Dave Lewis, Department of Fisheries and Aquaculture
Brian Delaney, Department of Fisheries and Aquaculture *(until January 2010)*
Earle McCurdy, Fish, Food and Allied Workers
Dave Decker, Fish, Food and Allied Workers
George Feltham, Fish, Food and Allied Workers
Karl Sullivan, Association of Seafood Producers
Greg Viscount, Association of Seafood Producers
Derek Butler, Association of Seafood Producers
John Collins, (ex-officio) Department of Fisheries and Oceans
Paul Martin, (secretary) Department of Fisheries and Aquaculture

Financial Analysis Working Group Members:

Dave Lewis, Department of Fisheries and Aquaculture
Wanda Wiseman, Department of Fisheries and Aquaculture
Brian Delaney, Department of Fisheries and Aquaculture *(until January 2010)*
Dave Decker, Fish, Food and Allied Workers
Bill Broderick, Fish, Food and Allied Workers
Gabe Gregory, Association of Seafood Producers
Randy Barnes, Association of Seafood Producers
Derek Butler, Association of Seafood Producers
John Collins, (ex-officio) Department of Fisheries and Oceans
Ken Carew, (ex-officio) Department of Fisheries and Oceans
Tom Clift, (ex-officio) Independent Chair of MOU Steering Committee
Paul Martin, (secretary) Department of Fisheries and Aquaculture

Harvesting Rationalization Working Group Members:

Dave Lewis, Department of Fisheries and Aquaculture
Wanda Wiseman, Department of Fisheries and Aquaculture
Brian Delaney, Department of Fisheries and Aquaculture *(until January 2010)*
Phil McCarthy, Department of Innovation, Trade and Rural Development (replaced by Peter Au)
Peter Au, Department of Innovation, Trade and Rural Development
Don Kavanagh, Department of Innovation, Trade and Rural Development
Dave Decker, Fish, Food and Allied Workers
Bill Broderick, Fish, Food and Allied Workers
George Feltham, Fish, Food and Allied Workers
Ken Carew, (ex-officio) Department of Fisheries and Oceans
Frank Corbett, (ex-officio) Department of Fisheries and Oceans
Tom Clift, (ex-officio) Independent Chair of MOU Steering Committee
Paul Martin, (secretary) Department of Fisheries and Aquaculture

Processing Restructuring Working Group Members:

Dave Lewis, Department of Fisheries and Aquaculture
Wanda Wiseman, Department of Fisheries and Aquaculture
Brian Delaney, Department of Fisheries and Aquaculture *(until January 2010)*
Martin Sullivan, Association of Seafood Producers
Derek Green, Association of Seafood Producers
Derrick Philpott, Association of Seafood Producers
Rose Buckingham, Association of Seafood Producers
Randy Barnes, Association of Seafood Producers
Derek Butler, Association of Seafood Producers
Jim Davis, Department of Fisheries and Oceans
Tom Clift, (ex-officio) Independent Chair of MOU Steering Committee
Paul Martin, (secretary) Department of Fisheries and Aquaculture

Worker Adjustment Subcommittee Members:

Bill Duggan, Municipal Affairs
Paul Martin, Department of Fisheries and Aquaculture
Joelle Aucoin, Department of Fisheries and Aquaculture
Greg Pretty, Fish, Food and Allied Workers
Allan Moulton, Fish, Food and Allied Workers
Greg Viscount, Association of Seafood Producers
Derek Butler, Association of Seafood Producers
Larry Weatherbie, Department of Innovation, Trade and Rural Development
Keith Mullett, Municipal Affairs
Gerard Dominic, Department of Human Resources, Labour and Employment
Paul Glavine, (ex-officio) Department of Fisheries and Oceans
Tom Clift, (ex-officio) Independent Chair of MOU Steering Committee

Seafood Marketing Working Group Members:

Mike Warren, Department of Fisheries and Aquaculture
Sean Barry, Department of Fisheries and Aquaculture
Earle McCurdy, Fish, Food and Allied Workers
George Feltham, Fish, Food and Allied Workers
Keith Sullivan, Fish, Food and Allied Workers
Blaine Sullivan, Association of Seafood Producers
Caroline Davis, Association of Seafood Producers
Gerry Donovan, Association of Seafood Producers
Paul Grant, Association of Seafood Producers
Gabe Gregory, Association of Seafood Producers
Derek Butler, Association of Seafood Producers
Jim Davis, Department of Fisheries and Oceans
Tom Clift, (ex-officio) Independent Chair of MOU Steering Committee

Annex 3
Terms of Reference - Steering Committee

Terms of Reference
Steering Committee - MOU (Industry Restructuring)

Introduction

On July 14, 2009, a Memorandum of Understanding was signed by the Minister of Fisheries and Aquaculture, the Fish, Food and Allied Workers (FFAW) Union, and the Association of Seafood Producers (ASP). The Parties recognized the difficult economic circumstances facing the fishing industry in Newfoundland and Labrador, which have been exacerbated by the current global recession, and the need for industry change and restructuring. This MOU is a continuation of work began under Fishing Industry Renewal ("FIR"). The current environment requires an accelerated process to respond to the global challenges.

The total value of all species in Newfoundland and Labrador is estimated to decline by approximately $200 million. Harvesting and processing costs have increased while market returns have declined due to changes in exchange rates and a softening of global seafood markets. Newfoundland and Labrador fish products must compete in a global market with an increasing world supply of aquaculture fish and with seafood products from other jurisdictions such as Iceland and Norway. The current "cost-price" squeeze created by factors such as exchange rates, market prices and fuel costs has highlighted the need for the province's fishing industry to become more internationally competitive.

These current economic difficulties have forced the fishing industry to confront long-standing internal structural challenges which are impeding international competitiveness. These include industry overcapacity, seasonality, and dependability and timing of supply. In addition to these structural issues, the fishing industry is facing significant labour challenges including an aging and declining population, significant out migration and an inability to compete with other parts of Canada for skilled labour. Industry change and restructuring is seen as the best opportunity for the fishery to be economically viable, internationally competitive and ecologically sustainable over the long term.

In light of these circumstances, the Parties agreed to establish working groups that will examine and develop proposals related to: the financial state of the industry; developing a long-term marketing strategy; developing a restructuring model for the harvesting sector; and, developing a restructuring model for the processing sector. Any proposal developed must identify the potential impact on workers and propose measures to minimize these impacts. Parallel or subsequent to this work the FFAW, the ASP and the Department will develop a Workers Adjustment Program. As such, a Worker Adjustment Working Group will also be established. The work of the Working Groups will be directed and overseen by a Steering Committee and an independent Chair, whose primary responsibility is to lead the Steering Committee in its work to implement the MOU.

Objective

The Steering Committee will support the implementation of the MOU and will oversee the establishment of four working groups (Financial Analysis Working Group, Working Group on Harvesting Rationalization, Working Group on Processing Restructuring, Working Group on Seafood Marketing) Parallel to this work a Worker Adjustment Program Committee will be established. These groups will complete the required work set out in the MOU. This will culminate in the submission of a final report to Government on industry restructuring.

Structure, Roles and Responsibilities

The entire MOU process will be directed and overseen by the Steering Committee consisting of two representatives each of the FFAW, the ASP, and the Department. An independent Chair will be appointed by Government. The Chair will serve as liaison and facilitator of the Steering Committee to ensure that the work of the four Working Groups proceeds on time and within the established terms of references. The Steering Committee members and their respective roles are:
Independent Chair – (Tom Clift)
The Steering Committee is responsible for delivering a Final Report containing a summary of the various Working Group findings to the Minister of Fisheries and Aquaculture. The Chair will be responsible for consolidating the recommendations of the four Working Groups and will not be expected to provide his/own recommendations at the conclusion of this process.

Members
The members at large are noted below and they are responsible for providing input into the MOU process to facilitate industry restructuring.

Alastair O'Rielly, DFA	Member (Facilitator)
Brian Delaney, DFA	Member
Earle McCurdy, FFAW	Member
Dave Decker, FFAW	Member
Karl Sullivan, ASP	Member
Greg Viscount, ASP	Member
Derek Butler, ASP	Ex-officio

SCOPE OF WORK

The Steering Committee will be guided by the following scope of work:

The Steering Committee will:
Review and approve the Terms of Reference/Work Plans for each of the Working Groups and all Requests for Proposals (to engage consultants) for each of the Working Groups.
Oversee and monitor the activities of the Working Groups and provide direction as required.
Resolve any conflicts within the Working Groups.
Ensure the work of the Working Groups is completed in a timely and efficient manner.
Work with the independent Chair in reviewing the submissions/reports of each of the four Working Groups.
Provide assistance and direction to the Chair, as he consolidates the Working Group reports into a final submission for presentation to the Minister of Fisheries and Aquaculture.

Methodology/Approach

The Steering Committee will meet on a regular basis (at least weekly) during the initial phases of this work and more frequently as the findings and reports of the various Working Groups are submitted for consideration by the Steering Committee. The comments and input from the Steering Committee will also be conveyed to the Chair for his consideration in preparation for the submission of the final report to Government.

SCHEDULE AND BUDGET

Work Schedule

July 30, 2009 - Consider appointment of Independent Chair.
- Commence reviews of Draft Terms of Reference and Draft Request for Proposals prepared by various working groups.

August 2009 - Consider and approve final RFP's prepared by WGs

September thru November. - Monitor activities of various WGs and consultants

November thru Dec.15, 2009 - Review and consider WG's findings and reports. Develop final submission to Minister, DFA.

December 15, 2009 - Final submission to Minister, DFA.

Budget

Each party will be responsible for the costs/expenses of its own representatives on the Steering Committee. The Department will fund the hiring of a qualified independent Chair to assist the Steering Committee in fulfilling its terms of reference.

Deliverables

1. The Steering Committee will monitor and oversee various elements of implementation of the MOU and develop the final report to be submitted to the Minister, DFA.

August 7, 2009

Annex 4
Terms of Reference - Financial Analysis Working Group

Terms of Reference

Financial Analysis Working Group

Overview

On July 14, 2009, a Memorandum of Understanding (MOU) was signed by the Minister of Fisheries and Aquaculture, the Fish, Food and Allied Workers (FFAW) Union, and the Association of Seafood Producers (ASP). The Parties recognized the difficult economic circumstances facing the fishing industry in Newfoundland and Labrador, which have been exacerbated by the current global recession, and the need for industry change and restructuring.

The total value of all species in Newfoundland and Labrador is expected to decline considerably this year. Harvesting and processing costs have increased while market returns have declined due to changes in exchange rates and a softening of global seafood markets. Newfoundland and Labrador fish products must compete in a global market with an increasing world supply of aquaculture fish and with seafood products from other jurisdictions such as Iceland and Norway. The current "cost-price" squeeze, created by factors such as exchange rates, market prices and fuel costs, has highlighted the need for the province's fishing industry to become more internationally competitive.

These current economic difficulties have forced the fishing industry to confront long-standing internal structural challenges which are impeding international competitiveness. These include industry overcapacity, seasonality, and dependability and timing of supply. In addition to these structural issues, the fishing industry is facing significant labour challenges including an aging and declining population, significant out migration and an inability to compete with other parts of Canada for skilled labour. Industry change and restructuring is seen as the best opportunity for the fishery to be economically viable, internationally competitive and ecologically sustainable over the long term.

In light of these circumstances, the Parties agreed to establish working groups that will examine and develop proposals related to: the financial state of the industry; developing a rationalization model for the harvesting sector; developing a restructuring model for the processing sector; and, developing a long-term marketing strategy.

Objective

In support of the objectives of the MOU, the objective of the Financial Analysis W/G is to carry out a comprehensive analysis of the financial health of both the harvesting and processing sectors. These are necessary steps for evaluating options for restructuring the fishing industry.

More specifically, the W/G will oversee the activities of a consultant(s) to carry out in depth analysis of the financial viability of the harvesting sector and the financial viability of the processing sector and produce financial contribution models for sensitivity analysis.

Structure, Roles and Responsibilities

The Financial Analysis W/G process will be directed and overseen by a Steering Committee consisting of two representatives each of the FFAW, the ASP, and the Department of Fisheries and Aquaculture and an independent Chair will be appointed by Government. Part of the Chairperson's role will be to serve as a liaison and facilitator to ensure that the work of the Financial Analysis Working Group, and other working groups, proceeds on time and within the established terms of references.

The Financial Analysis Working Group will include two representatives from ASP, two from the FFAW and two from the Department of Fisheries and Aquaculture. Ex-officio members may be added to the Working Group by mutual consent of the parties.

The Financial Analysis W/G members and their respective roles will be:

Dave Lewis, DFA	Member
Wanda Wiseman, DFA	Member
ASP	Member
ASP	Member
FFAW	Member
FFAW	Member

Key Considerations:

- Whenever possible, the working groups will work on a consensus basis and will be assisted by a Department facilitator.
- The Working Group will seek to ensure the views of processing companies not represented by ASP are taken into account.

SCOPE OF WORK

The Financial Analysis Working Group will collect and analyze financial data from both the harvesting and processing sectors.

- Requests for Proposals to be developed by the W/G and approved by the Steering Committee to seek Consultants to conduct the financial analyses.

- Monitor and direct the work of the Consultant in sampling harvester costs and earnings on a statistically significant basis.

- Monitor and direct the work of the Consultant in preparing a plan for the processing sector to sample processor costs and earnings.

- Where possible, financial information to be based on audited financial information.

- Only aggregate data to be provided to the group. As such, all individual information to be kept confidential.

- Financial costs of reviews borne by DFA.

Methodology/Approach

The W/G will develop RFP(s) for a financial analysis to be completed on both the harvesting and processing sectors, and will monitor and direct the work of the Consultants.

Schedule and Budget

Work Schedule

July 30, 2009	- Review Draft W/G Terms of Reference
	- Review Draft Request for Proposals for Financial Analysis of Harvesting Sector and Financial Analysis of Processing Sector
August 7, 2009	- Seek Approval of TOR and RFPs by Steering Committee
August 28, 2009	- Review Proposals
September 15, 2009	- Award contracts to Consultants

October 30, 2009 - Receive reports from Consultants

- Presents final report to Steering Committee

November 9, *2009* - Report to Steering Committee

Budget

Each party will be responsible for the costs of its own representatives on the Financial Analysis Working Group. The Department of Fisheries and Aquaculture will fund the hiring of qualified independent consultant(s) to assist the W/G to fulfill its terms of reference.

Deliverables

1. A study to be completed that will assess the financial health and viability of the various processing activities in the processing sector for the last two years, by reviewing company financials to determine the current state of this sector, and produce a cost-revenue model that will enable industry stakeholders to complete sensitivity analysis.

2. A study to be completed that will assess the financial health and viability of the various harvesting activities of enterprise owners (excludes offshore enterprises) to determine the current state of this sector and produce a cost-revenue model that will enable industry stakeholders to complete sensitivity analysis.

July 31, 2009

Annex 5
Terms of Reference - Harvesting Rationalization Working Group

Terms of Reference (DRAFT)

Harvesting Industry Rationalization Working Group

September 8, 2009

1.0 Introduction and Background

Introduction

The economic difficulties currently being experienced in the fishing industry have forced the fishing industry to confront long-standing internal structural challenges which are impeding international competitiveness. These include industry overcapacity, seasonality, and dependability and timing of supply. In addition to these structural issues, the fishing industry is facing significant labour challenges including an aging and declining population, significant out migration and an inability to compete with other parts of Canada for skilled labour. Industry change and restructuring is seen as the best opportunity for the fishery to be economically viable, internationally competitive and ecologically sustainable over the long term.

In light of these circumstances, DFA, the Union (FFAW) and the Association of Seafood Producers (ASP) agreed to establish working groups and examine and develop proposals related to: the financial state of the industry; the development of a rationalization model for the harvesting sector; the development of a restructuring model for the processing sector; and a long-term marketing strategy for the province's fishing industry.

The anticipated restructuring in the industry is intended to: provide an economic stimulus for communities in rural regions; provide attractive incomes to industry participants; and, retain skilled workers. This will support a sound and healthy harvesting sector and a vibrant processing sector both of which remain cornerstones for many rural economies.

The economic difficulties currently facing the fishing industry have also served to highlight long-standing internal structural challenges which are impeding the international competitiveness of the industry. Many of these challenges such as industry overcapacity, seasonality and dependability and timing of supply are complex.

Objective

In support of the MOU, the objective is to develop a comprehensive restructuring model for the harvesting sector, taking into consideration the timing of other measures taken under this MOU.

It was envisioned that this initiative will continue with the work undertaken under the Fishing Industry Renewal initiative and should result in a sustainable, economically viable, internationally competitive, and regionally-balanced industry which is able to:

- Adapt to changing resource and market conditions;
- Extract optimal value from world markets;
- Provide an economic driver for communities in vibrant rural regions;
- Provide attractive incomes to industry participants; and
- Attract and retain skilled workers.

Members

Members of the Working Group will include four representatives from the FFAW and two from DFA. Other ex-officio representatives can participate by mutual agreement of the parties.

Chair	- To be determined
DFA	- Brian Delaney
DFA	- Wanda Wiseman
Member	- Earle McCurdy
Member	- Dave Decker
Member	- Bill Broderick
Member	-
Ex-officio	- DFO, John Collins

Scope of Work & Key Considerations

As outlined in the MOU, the analysis and any proposals to be developed must take into account the following:

- The Harvesting Sector Working Group will develop a comprehensive proposal for a fleet

rationalization plan cost-shared by harvesters and Governments.

- The parties agree to pursue all possible avenues to compel the Federal Government to meet its responsibility to cost-share a fleet rationalization program.
- The parties agree that a fleet rationalization program would contribute, along with the other elements, towards achieving Fisheries Renewal policy objectives directly in the harvesting sector and indirectly in the processing sector.
- Any proposal developed must clearly articulate the specific costs for governments and harvesters.
- The parameters of a rationalization plan will be developed taking into consideration the demographics of the harvesting fleet, the resource outlook, and economics and viability of the fleet.
- The Working Group will be mandated to develop a strategy to ensure that fishing enterprises acquiring additional quota through rationalization are able to minimize the risk associated with using their existing enterprise assets as collateral against the incremental quota/access.
- Any rationalization program developed would be retroactive to the FIR announcement on April 12, 2007 to ensure eligibility for any enterprises that have already combined.
- Each party shall be responsible for the costs of its own representatives on the Working Group. The Department will fund the hiring of a qualified independent third party to develop detailed proposals and otherwise carry out the work of the Working Group.
- The Working Group would be mandated to ensure that any rationalization program is designed in such a manner that any Government funding improves the viability of those who remain in the industry, and best efforts will be made to design a program that does not inflate the cost of acquiring licenses/quotas.
- The costs and benefits of any options considered will be developed as part of the final report.

Methodology/Approach

The Working Group will develop a comprehensive proposal for a fleet rationalization plan cost-shared by harvesters and Governments. The analysis undertaken by the Financial Analysis Working Group will be used as a basis for proposal development. Any proposal requiring government funding will be presented cost-shared on a 70/30 federal-provincial basis. Any proposal developed must clearly articulate the specific costs for governments and harvesters.

The parameters of a rationalization plan will be developed taking into consideration the demographics of the harvesting fleet, the resource outlook, and economics and viability of the fleet.

The Working Group will develop a strategy to ensure that fishing enterprises acquiring additional quota through rationalization are able to minimize the risk associated with using their existing enterprise assets as collateral against the incremental quota/access. Any rationalization program developed would be retroactive to the FIR announcement on April 12, 2007 to ensure eligibility for any enterprises that have already combined.

The Working Group will ensure that any rationalization program is designed in such a manner that any Government funding improves the viability of those who remain in the industry, and best efforts will be made to design a program that does not inflate the cost of acquiring licenses/quotas.

The costs and benefits of any options considered will be developed as part of the final report.

The methodology and approach will entail the development of a work plan that will take into consideration working group discussions; targeted research and review of past reports/studies. This will also include a general review of work undertaken in other jurisdictions.

The results of the financial analysis working group for harvesting will be used as a guide to aid in proposal development. This will include using the financial analysis model to test scenarios. A broad range of options should be tested ranging from the status quo to cost-shared restructuring programs.

An overview of the current situation facing the harvesting sector and the operating environment will be prepared. This will require the consideration of the resource and market outlooks that will be faced by the sector. Also required will be the preparation of an overview of demographic trends by region identifying areas of greatest change.

Proposals developed by the Working Group will identify the impacts, costs and benefits associated with each proposal prepared. Internal and external impacts will have to be considered using cost-benefit analysis techniques.

The participation of the Federal Government is an important component of successfully implementing a rationalization model. A strategy must be developed that encourages federal participation in any proposal that may be developed.

Schedule and Budget

Work Schedule

September 28, 2009 - First Meetings of Working Group.

October 1, 2009 - The Working Group will report its findings

December 1, 2009 - Submit complete package for recommendations.

Budget

Each party will be responsible for the costs of its own representatives on the Working Group. If required, the Department of Fisheries and Aquaculture will fund the hiring of a qualified independent consultant(s) to assist the Working Group to fulfill its terms of reference.

Deliverables

The Working Group will prepare a comprehensive report and plan to for consideration by the Government of NL, the Government of Canada, and NL fishing industry participants. The plan will quantify the need for a program and include financial requirements and cost-sharing arrangements.

Develop a proposal taking into consideration the following:

1. Assessing the need for a restructuring model for the harvesting sector.

2. Identifying possible models with input of Financial Analysis Working Group report.

3. Assessing costs/benefits of each model.

4. Prepare a cost estimate of implementation of any proposal including the anticipated federal and provincial sharing.

5. Develop a strategy to compel federal participation.

6. Presenting recommendations for consideration

September 30, 2009

Annex 6
Terms of Reference - Processing Restructuring Working Group

Terms of Reference (DRAFT)

Processing Industry Restructuring Working Group

October 16, 2009

Introduction

The economic difficulties currently being experienced in the fishing industry have forced participants and Government to confront long-standing internal structural challenges which are impeding international competitiveness. These include industry overcapacity, seasonality, and dependability and timing of supply. In addition to these structural issues, the fishing industry is facing significant labour challenges including an aging and declining population, significant out migration and an inability to compete with other parts of Canada for skilled labour. Industry change and restructuring is seen as the best opportunity for the fishery to be economically viable, internationally competitive and ecologically sustainable over the long term.

In light of these circumstances, DFA, the Union (FFAW) and the Association of Seafood Producers (ASP) agreed to establish working groups and examine and develop proposals related to: the financial state of the industry; the development of a rationalization model for the harvesting sector; the development of a restructuring model for the processing sector; and a long-term marketing strategy for the province's fishing industry.

Objective

The objective of the Working Group is to develop restructuring proposals. It was envisioned that this initiative will continue with the work undertaken under the Fishing Industry Renewal (FIR) initiative and should result in a sustainable, economically viable, internationally competitive, and regionally-balanced industry which is able to:

- Adapt to changing resource and market conditions;
- Extract optimal value from world markets;
- Provide an economic driver for communities in vibrant rural regions;
- Provide attractive incomes to industry participants; and
- Attract and retain skilled workers.

Members

Members of the Working Group will include five representatives from ASP, and two from DFA. Other ex-officio representatives can participate by mutual agreement of the parties.

DFA - Brian Delaney

DFA - Wanda Wiseman

Member - Phil Barnes

Member - Rosemary Buckingham

Member - Derek Green

Member - Derrick Philpott

Member - Martin Sullivan

Ex-officio - Derek Butler

Ex-officio - DFO

Chair - To be determined

Scope of Work and Key Considerations

As outlined in the MOU, the analysis and any proposals to be developed must take into account the following:

- other elements of the MOU;
- the achievement in general of other Fishing Industry Renewal policy objectives;
- the demographics of the workforce, the resource outlook, and economics and viability of the processing sector, so that it continues to serve as an economic driver in vibrant, rural regions;
- the potential impact on workers and proposed measures to minimize impacts;
- a Workers Adjustment Program that will be developed in parallel or subsequent to this work;
- the potential impact on port market competition and services to harvesters and a proposed strategy to minimize these impacts;
- a recommended program be such that any government contributions towards it improves the viability of those who remain; and,
- determine the costs and benefits of any options considered.

The Working Group will seek input from all producers, including ASP and non-ASP members. The Working Group will give oversight to the drafting of a restructuring model and develop a proposal(s) for government consideration.

Methodology/Approach

The scope of work will entail the development of a work plan that will take into consideration working group discussions; review of past reports/studies; and meetings with all producers. This will also include a general review of work undertaken in other jurisdictions.

The results of the financial analysis working group for processing will be used as a guide to aid in proposal development. This will include using the financial analysis model to test scenarios. A broad range of options should be tested.

An overview of the current situation facing the processing sector and the operating environment will be prepared. This will require the consideration of the resource and market outlooks that will be faced by the sector.

Also required will be the preparation of an overview of demographic trends by region identifying areas of greatest change. The demographic analysis will draw on existing resources and will be used as an information tool for the Worker Adjustment Sub-Committee.

The terms of reference for the Worker Adjustment Sub-Committee will be prepared by the Steering Committee. The Sub-Committee will consider the issue of worker adjustment along with other proposals put forth by the Processing Restructuring Working Group. The Sub-Committee will recommend mechanisms to respond to the challenges taking into consideration the need for both levels of government to participate in adjustment programming.

Proposals developed by the Working Group will identify the impacts, costs and benefits associated with each proposal prepared. Internal and external impacts will have to be considered using cost benefit analysis techniques.

The work of past studies will be reviewed to determine their relevance for the current operating environment. This will include, the 1996 Fishing Industry Renewal Board, the Task Force on Incomes and Adjustment in the Atlantic Fishery, the Dunne Commission Report, The Panel on Corporate Concentration, the Report of the Inshore Shrimp Panel, the Cashin Review of the RMS system and the 2007 Fishing Industry Renewal Initiative. As well any other available information will be used to guide the work of the Working Group.

It may be necessary to engage a consultant to assist in the work.

Schedule and Budget

Work Schedule (TO BE REVISED)

Week of September 28, 2009	Finalize Terms of Reference, send to Steering Committee for August 27th
September through November	Meet with other producers, consider other models, develop proposal, meet with other producers, seek input.
December 23	Working Group to complete its work and report to Steering Committee.

Budget

Each party will be responsible for the costs of its own representative on the Processing

Restructuring Working Group. The Department of Fisheries and Aquaculture will, if required, fund the hiring of a qualified independent consultant(s) to assist the Working Group fulfill its terms of reference.

Deliverables

Develop a proposal taking into consideration the following:

1. Assessing the need for a restructuring model for the processing sector.

2. Identifying possible models with input of Financial Analysis Working Group report.

3. Assessing costs/benefits of each model.

4. Assessing the impact of any models on employment and communities and developing appropriate responses.

5. Presenting recommendations for consideration.

October 16, 2009

Annex 7
Terms of Reference - Seafood Marketing Working Group

Terms of Reference
Newfoundland & Labrador Working Group on Seafood Marketing
Draft: September 22, 2009

1.0 Introduction and Background

The total landed value of all species in Newfoundland and Labrador is expected to decline this year. Harvesting and processing costs have increased while market returns have declined due to changes in exchange rates and a softening of market prices due to the worst world recession since the Depression of the 1930s. These global realities combined with other more recent changes in exchange rates, market prices and fuel costs highlight the need for changes in industry structure. This must happen if the Newfoundland and Labrador fishing industry is to become more competitive and economically sustainable in the global seafood market, and contribute to better incomes and vibrant coastal communities.

As part of the Fishing Industry Renewal Strategy announced in 2007, the province identified an enhanced marketing element, valued at $3 million over a three year period. The primary activity under this element was the creation of a NL Seafood Marketing Council. Based on a report from the Marketing Review Panel, chaired by Sandy Roche, recommendations were made concerning the organization, structure, and priorities for a Marketing Council, but the concept of a council was not approved in a vote by seafood processors. From comments at the time, a number of processors indicated that the response may have been different if it had been part of an overall restructuring initiative. Given the increasingly difficult market situation in 2009, and the integration of marketing as part of an overall restructuring plan, it would be appropriate to re-visit the idea of a marketing council, plus other approaches to improve the marketing of NL fish and seafood.

On July 14, 2009 the Association of Seafood Producers (ASP), the Fish, Food and Allied Workers Union (FFAW) and the Government of Newfoundland and Labrador signed a Memorandum of Understanding (MOU) to help build a more viable, stable, and internationally competitive industry. This MOU identified a plan of action based around four government-industry working groups: a working group on financial analysis, a working group to develop a seafood marketing strategy; a working group to develop a rationalization model for the harvesting sector; and a working group to develop a rationalization model for the processing sector. This ToR will direct the Working Group on Seafood Marketing in the development a comprehensive marketing strategy for the Newfoundland and Labrador fishing industry.

2.0 Objective

In support of the objectives of the MOU, the objective of the W/G on Seafood Marketing is to carry out a comprehensive analysis of the options to more effectively and efficiently market NL seafood; and, using this analysis, to make recommendations to government and the province's fishing industry on ways and means to improve seafood marketing.

3.0 Structure, Roles and Responsibilities

The W/G process will be directed and overseen by a Steering Committee consisting of two represen-

tatives each of the FFAW, the ASP, and the Department of Fisheries and Aquaculture. An independent Chair will be appointed by government. Part of Chairperson's role will be to serve as a liaison and facilitator to ensure that the work of the Marketing Working Group, and other working groups, proceeds on time and within the established terms of references.

The Working Group will include five representatives from ASP, three from the FFAW and two from the Department of Fisheries and Aquaculture. Ex-officio members may be added to the Working Group by mutual consent of the parties. The Working Group will develop a Terms of Reference which will be approved by the Steering Committee.

The W/G members and their respective roles will be:

Mike Warren, DFA	Chair/Facilitator
Sean Barry	Senior Analyst.
Caroline Davis	ASP Member
Paul Grant	ASP Member
Blaine Sullivan	ASP Member
Robin Quinlan	ASP Member
Gerry Donovan	ASP Member
Earle McCurdy	FFAW Member
Keith Sullivan	FFAW Member
George Feltham	FFAW Member

Key Considerations:

DFA, FFAW/CAW and ASP agree that fundamental structural change to the marketing of our seafood products is essential to meet the objective of achieving optimal value from world markets and this change in marketing is required as part of overall structural change.

The Working Group will be mandated to propose a budget and implementation plan for the proposed new marketing structure.

The Working Group will be mandated to review the availability of federal programs, such as those under the marketing branch of the federal Department of Agriculture and Agrifoods, which might be relevant to the development and funding of a new marketing structure. Consideration will be given to timely application for funding applications, such as lobster funding under the recently announced ACOA, Community Development Fund.

The costs of any options considered will be developed as part of the final report.

Any delay or failure in the harvesting or processing working groups from developing proposals will not prevent the marketing proposal from proceeding.

Whenever possible, the working groups will work on a consensus basis and will be assisted by a Department facilitator.

ASP has agreed to seek the views of processing companies not represented by ASP.

4.0 Scope of Work

The W/G will be guided by the following scope of work:

Industry Scope: the examination and consideration of marketing issues leading to a comprehensive marketing strategy for the province , with particular emphasis on the development of structures to market NL seafood products including, - but not limited to - single desk marketing , marketing consortia, etc.

Species/Fishery Scope: all major species in the NL fishery. Priority will be given to shellfish fisheries (crab, shrimp and lobster), groundfish (cod, yellowtail and turbot), and pelagic fisheries (capelin and herring). Other important NL fisheries such as the lumproe fishery will be included in the W/G work. Aquaculture species i.e., Atlantic salmon, steelhead, and Blue mussels will not be included.

Market Scope: The W/G will focus its efforts on the major global seafood markets in Canada, the US, EU, Russia, and Asia.

5.0 Methodology/Approach

The W/G's work, supplemented by research and advice from a qualified marketing consultant(s), will include:

Review and update of marketing issues, challenges and opportunities identified by Mr. Sandy Roche in his report – Seafood Marketing Review Panel, Report of the Chairman. To accomplish this, an industry forum on seafood marketing with Mr. Roche, involving selected industry participants, will be organized. This event will also help to further refine the W/G's terms of reference.

Consideration of the factors which contributed to the 'no' vote in the Seafood Marketing Council initiative, and an assessment of the commitment of processors to joint marketing efforts/structures.

Review the necessity/requirements for 'quality seafood' standards associated with various marketing entities such as single desk marketing, marketing consortia, or marketing boards.

Conduct an analysis of how seafood and similar products (notably seafood and other food proteins) are successfully marketed globally and how the NL seafood industry can learn from this success (with specific reference to approaches in other jurisdictions, particularly Iceland, Norway and Alaska). In addition, review the impact of the global economic downturn on these approaches.

Review the NL place and perception within the global seafood market place. NL is a relatively small player in global seafood markets in all but a few key species. Markets have also been shown to be unpredictable when it comes to supply/pricing issues. For example, cod has now been replaced by lower cost tilapia and pangasius in many markets, and warm water shrimp has been substituted for cold water product in some European markets.

Consider the impact of structural issues, competition for raw material, producer size (small, medium, large), and/or financial wherewithal (undercapitalization, etc) on the ability of NL processors to work cooperatively in international marketing.

6.0 Schedule and Budget

Work Schedule

September 2, 2009 - Finalize W/G Terms of Reference.

September 18, 2009 - Develop Terms of Reference for marketing study

November 2, 2009 - Hire marketing consultant.

January 15, 2010 - Complete marketing study.

January 29, 2009 - The Working Group will report its findings, including an estimate of the financial contribution required from the Provincial Government and the Parties.

February 1, 2010 - Implement recommendations.

Budget

Each party will be responsible for the costs of its own representatives on the Working Group. The Department of Fisheries and Aquaculture will fund the hiring of a qualified independent consultant(s) to assist the W/G to fulfill its terms of reference.

7.0 Deliverables

The Working Group will prepare a comprehensive report and plan to enhance the marketing of NL fish and seafood products, for consideration by the Government of NL, the Government of Canada, and NL fishing industry participants. The plan will include financial requirements and cost-sharing arrangements.

Draft: Sept 22, 2009

Annex 8

Average Vessel Ages of 35- 64 ft. Core Fleet as of Dec. 31, 2006

Average Vessel Ages of 35- 64 ft. Core Fleet as of Dec. 31, 2006

Fleet Sector	No. of Enterprises	Average Vessel age
Full-time Crab – 2J3K	30	11.4
Full-time Crab – 3L	36	10.3
Large Supplementary Crab – 3L	79	10.1
Gulf Shrimp – 4R	57	22.4
Supplementary Crab – 2J	31	16.9
Supplementary Crab – 3K	240	14.7
Other Northern Shrimp License Holders (no crab)	15	23.9
Small Supplementary Crab – 3L	246	12.6
Small Supplementary Crab – 3Ps	100	12.6
Commercial Crab – 4R	17	21.3
Other Inshore Crab	130	25.2
Other (Non Crab/Shrimp)	23	20
Total	1004	15.6

Annex 9
Harvesting Rationalization Working Group Work Plan

A WORK PLAN/PROCESS FOR THE HARVESTING RATIONALIZATION WORKING GROUP

1. INTRODUCTION

This document is intended as a guide to assist in completing the final report of the Harvesting Rationalization Working Group (WG) established under the MOU on industry restructuring. This working group is mandated to: "prepare a comprehensive report and plan for consideration by the Government of NL, the Government of Canada, and NL fishing industry participants. The plan will quantify the need for a (fleet rationalization) program and include financial requirements and cost-sharing arrangements."

The WG is expected to develop a proposal that covers the following:

- An assessment of the need for a restructuring model for the harvesting sector.
- Identification of possible models with input of the Financial Analysis Working Group report.
- Assessment of the costs/benefits of each model.
- A cost estimate of implementation of any proposal including the anticipated federal and provincial sharing.
- A strategy to compel federal participation.
- Recommendations for consideration by the MOU Steering Committee.

In July, 2009, DFA, the Union (FFAW) and the Association of Seafood Producers (ASP) agreed to the MOU process because of the economic difficulties facing the fishing industry. The MOU established working groups to examine and develop proposals related to: the financial state of the industry; the development of a rationalization model for the harvesting sector; the development of a restructuring model for the processing sector and a long-term marketing strategy.

The complex, long-standing internal structural problems in the Province's fishing industry impede its ability to compete internationally. These include overcapacity, seasonality as well as dependability and timing of supply. The fishing industry is also facing significant labour challenges including an aging and declining population, out-migration and an inability to compete nationally for skilled labour. Industry change and restructuring is necessary for the fishery to be economically viable, internationally competitive and ecologically sustainable over the long term.

The current MOU process is a continuation of the joint federal/provincial Fishing Industry Renewal initiative that was finalized in April 2007. At that time both governments announced "a number of policy changes and new investments that will strengthen the province's fishing industry." These included federal licensing policy changes to permit combining, more flexible vessel replacement rules, measures to curtail "trust agreements" and to facilitate the use of licenses as collateral. Provincial measures included revisions to processing licensing policy and an enhanced loan guarantee program to assist those taking advantage of the federal licensing changes. A central consideration in the mandate of the Working Group on Harvesting Rationalization is that take-up on the new federal licensing measures has been low and has stopped almost completely since early 2009. The existing loan guarantee program does not apply to financing acquisition of quotas/licenses. Consequently, and also because of depressed industry conditions, needed fleet rationalization has not occurred to the extent generally viewed as needed.

More broadly, the MOU process is intended to "result in a sustainable, economically viable, internationally competitive and regionally-balanced industry which is able to:

- Adapt to changing resource and market conditions;
- Extract optimal value from world markets;
- Provide an economic driver for communities in vibrant rural regions;
- Provide attractive incomes to industry participants; and
- Attract and retain skilled workers."

This is the overall context in which the final report of the Harvesting Rationalization Working Group must be completed. The following sections will present a work plan or process to guide and facilitate completion of that document. The various sections that follow will include some directed commentary on a variety of issues relevant to fleet rationalization intended to guide the deliberations of the Working Group. Most sections will also include specific questions that should be addressed in determining possible models or approaches, assessing current proposals and arriving at the final conclusions to be presented in the Working Group's report to the MOU Steering Committee (and both levels of government).

2. SOME ESSENTIAL FACTORS/CONSIDERATIONS

This section will review a number of factors that the MOU process specifically identified as basic requirements for any fleet rationalization measures. Also, several industry conditions that have been identified as impacting any plan to restructure fishing fleets are covered.

MOU Objectives

The Terms of Reference of the Harvesting Rationalization Working Group requires the following be taken into account:

- Cost sharing of fleet rationalization by industry and government.
- Identification of specific costs to government and harvesters.
- Minimization of risk to harvesters from using existing licenses as collateral when acquiring additional quotas/licenses.
- Viability of those remaining must be improved.
- Minimization of increases in the cost of acquiring quotas/licenses.

The issue of cost sharing will need to be addressed by the WG in the context of its Terms of Reference which call for any proposal for government funding to be shared 70/30 federally/provincially and for the contribution of harvesters to be clearly shown. In this cost sharing context the following questions are suggested for consideration by the WG:

Cost Sharing:

- *How should the involvement of the federal government be pursued at this time?*
- *What is an acceptable timeframe for determining whether the federal government will participate?*
- *Can fleet rationalization proceed without federal financial involvement?*
- *What should be the government-industry sharing arrangement if the federal government does not participate?*
- *If there is government cost sharing in a buy-out program, what is the effective cost to harvesters who acquire re-distributed licenses/quotas?*

The following questions are suggested in the case of minimizing risk to harvesters:

Minimization of Risk:

- *What are some measures that could be adopted to minimize the risk to harvesters from using existing licenses as loan collateral?*

- ✓ *What arrangements are possible with the banks in this context?*
- ✓ *Can a provincial loan guarantee program limit required collateral?*
- ✓ *Are the federal licensing policy measures in respect of using licenses as collateral clear and effective?*
- ✓ *To what extent can incorporation of fishing enterprises help in this regard?*
- ✓ *Are there other measures available?*

The issues of future viability and controlling the costs of acquiring licenses/quotas will be dealt with below at page 8 and in Section 3.

Harvesting/Provincial Demographics

The WG's Terms of Reference require an assessment of the effects of demographic changes on fleet rationalization efforts. This assessment will need data on the age profile of the harvesting populations as well as regional demographic trends. This assessment should be conducted at the individual fleet level using the fleet groupings developed in the Deloitte Report on Financial Assessment of the Fish Harvesting Sector in Newfoundland and Labrador (Deloitte). The data on harvesters' demographics can be obtained from the Professional Fish Harvesters Certification Board.

These data will show an overall aging of the license holder population and a younger age profile for professional crewmembers. This may indicate a need to increase entry to the license holder population so that older harvesters are replaced by younger qualified professional fish harvesters. The only way this is possible is through the takeover of existing enterprises by qualified professional fish harvesters. This will involve more costly transactions than the acquiring of additional quotas/licenses by existing enterprises because the complete enterprise must be purchased by the new entrant.

An analysis of the demographic data for each fleet segment would determine if any have an age profile different from the overall fish harvester population. This will indicate if fleet rationalization is more urgent in some areas than in others. It might also identify fleets where rationalization may be more difficult to achieve.

The age profile of the various area fleets, delineated by Deloitte, can be assessed in the context of the regional demographic profiles that have been prepared for major areas of the province. These profiles show where past population changes have taken place and project the future trends in population by area. These data should be analysed to determine the effect of demographics on fleet rationalization plans for different areas of the province. Conversely, an assessment should also be made as to how the projected area population trend might affect plans for fleet rationalization.

The following are some of the questions that should be considered in this context:

- *What priority should be given to increasing the rate of new entry to the enterprise owner category?*
- *What particular measures should be adopted to advance the entry of younger new entrants to the enterprise owner category?*
- *In what way should identified area population trends be taken into account in designing fleet rationalization plans?*
- *Can fleet rationalization plans play a role in changing an area population trend?*
- *Or will the reverse be true?*
- *Does the demographic analysis suggest any considerations for regional balance in the fishery?*

Resource Outlook (Short and Long Term)

Some understanding of the resource situation facing different fleets is crucial to gauging the degree of rationalization that might be needed or possible. The resource situation facing the various fleets varies by stock area and license portfolio. All area fleets do not face the same resource situation or outlook. It is essential, therefore, to acquire an assessment of the resource outlook for each fleet in both the short and long term. This can be obtained from various assessment reports produced by DFO and through some directed questions. Indeed, some of these outlooks are already known, in general terms, to the members of the various fleets. This, in conjunction with other forecasts described below, would help the WG develope more tailored and realistic fleet rationalization proposals. It is almost definite that the resource outlooks will indicate varying levels of fleet reductions are warranted or necessary.

The following are some pertinent questions to be addressed in this context:

- *What role should short-term versus long-term resource outlooks play in the design of individual fleet rationalization plans?*
- *How should the level of resource projections be factored into assessment of the need for fleet reductions?*
- *Should varying resource outlooks influence the level of rationalization funding made available to different fleets?*
- *How should any forecast resource declines be factored into fleet rationalization plans?*
- *What are the implications for fleet rationalization of a major decline in one of the main inshore fleet resources?*

Market Outlook (Short and Long Term)

The seafood market short- and long-term outlook for the main species fished by various inshore fleets is another significant factor that should be assessed. For example, the

short-term dismal outlook for crab may not be the one facing the industry in the longer term. In the case of groundfish, a long-term continuation of recent market conditions may well be likely. These sorts of details should be determined and factored into the design of individual fleet rationalization plans. This approach will indicate whether there is a need to vary the fleet rationalization plans for different fleets or give different program priority to some fleets. A major market research effort is not considered necessary for this purpose. Adequate planning indications can be assembled with input from seafood marketing reports and specialists.

The following questions are suggested for consideration by the WG in applying market outlook information to the design of fleet rationalization plans:

- *What role should short-term versus long-term market outlooks play in the design of individual fleet rationalization plans?*
- *How should the level of long-term market uncertainty be factored into assessment of the scale of fleet reductions?*
- *Should the varying market outlooks facing different fleets influence the level of rationalization funding made available to them?*
- *What marketing measures can be taken to reduce the level of fleet reductions that would otherwise be needed?*

Costs of Acquiring Quotas/Licenses

In broadest terms, the price paid for a license/quota is determined by the buyer's perception of the likely revenue stream to be obtained from it over time. This is a combination of the buyer's view of the revenue being earned by the current holder and expectations that he will fare as least as well after acquiring the license/quota. Such an assessment made in good fishing times is likely to be more optimistic than one made when fishery earnings are depressed. Similarly, more buyers are likely to exist when times are good than when earnings in the fishery are declining. The supply of licenses/quotas for sale is influenced by similar factors.

In addition to the valuation a seller places on exiting the fishery, the expected numbers of potential buyers will influence the asking price. The number of these is likely to be higher in good times and when expectations about the future are positive. Sellers faced with more buyers will likely demand, and obtain, a higher price than those selling in adverse conditions. Also, a perception by sellers that buyers are willing, or able, to pay a higher rather than a lower price will raise the price demanded. There is a concern that this latter situation will prevail in any fleet rationalization program that involves some form of government assistance. If buyers are viewed by sellers are being more likely to purchase a license/quota in such circumstances, asking prices will be higher than otherwise.

The WG is mandated to ensure best efforts are made to design a program that does not inflate the cost of acquiring licenses and thereby negatively impact the viability of those who remain in the fishery. Therefore, some ways and means of achieving this must be

addressed. The following questions are suggested to assist in considering this matter:

- *To what extent might each of the following measures ensure fleet rationalization programs do not unduly increase the price of license/quotas:*
  - ✓ *Reverse Auction (in buy-outs)?*
  - ✓ *Limit on available funding assistance for any individual acquisition?*
    - *Based on some average of recent license/quota acquisitions?*
    - *Specified Maximum Price?*
  - ✓ *Internal fleet purchase and redistribution only (would require federal concurrence for a re-sale arrangement if they are not involved directly)?*
  - ✓ *Are there other measures?*
- *Will the current federal licensing system measures to curtail "Trust Agreements" lessen upward pressure on selling prices of licenses/quotas?*

3. SOME NOTES ON VIABILITY OF HARVESTING OPERATIONS

The MOU refers to viability in several different instances and contexts. Therefore, the following directed commentary is intended to properly define this concept for use in the design of fleet rationalization plans. These comments will be a further elaboration on the Deloitte report in this matter.

Economic vs. Financial Viability

It is useful to understand the basic differences between viability/profitability in economic and accounting terms. In the latter instance, profitability is calculated as the difference between all expenses and total earnings. If the result is positive, a profit is earned, if negative, a loss occurs. This approach does not consider or specify what the owner of the business should receive as his income or what return he should get on the capital he has invested in the operation. Economics includes these two "required returns" as costs that must be covered by total earnings before the business can be considered viable. Economics, furthermore, stipulates the level of these required returns as that which the owner and his capital could receive from the next best alternative use. These levels of returns are what are just sufficient to keep the owner and his capital engaged in that particular endeavour. To receive less means, in economic terms, that the enterprise is not fully viable and the owner and his capital should engage in another activity.

The owner of a viable fishing enterprise should, therefore, cover all his fixed and variable costs and receive, as his own compensation, the amount that he could earn in his next best alternative occupation or what is sufficient to keep him in the fishery as an owner/operator. The capital he invests in his fishing enterprise also should earn a return at least equal to what it could receive if used or invested in the next best alternative.

The difficulty in determining the viability requirement is the value assigned to these two required returns. It is somewhat less difficult to determine the level of required return to capital than that to the owner's time and effort. A generally accepted proxy for the required return to capital would be the best available return if the capital were invested in a relatively safe commercial instrument. The normal rate can be increased by some level of premium to account for the extra risks of using capital in the fishery. There are higher likelihoods of physically losing capital assets in this industry; and assets acquired for fishing purposes have little, if any, other immediate alternative use. Therefore, the normally acceptable return for capital invested in fishing would be the going commercial return plus a premium of several percent. The rates of return on investment suggested by Deloitte seem to meet this criterion.

The required return to the enterprise owner for his time and effort can be a little more problematic. Fishing is a risky business where not all individuals aspire to, or can, become enterprise owners/operators. The return to the owner/operator that is necessary to keep him engaged in that activity can be difficult to gauge or estimate. Because of the financial and personal risk involved and the overall effort and skill required, the adequate proxy for this return should be more than the average wage from employment (less EI earnings) as suggested by Deloitte. It probably should be, at a minimum, closer to the cost of engaging an alternative skipper. An added complication in this regard is

that this approach is likely to produce different results for different size of enterprises. Therefore, in the final analysis, no single level of required returns to owner's labour will cover all the fleets that need rationalization.

The WG must consider which level of (or proxy for) required returns should be used to calculate the viable size of various fleets. In this context, the following questions are suggested for consideration:

- *What level of wage compensation for enterprise owner/operators should be used in estimating viable fleet sizes:*
  - ✓ *Average Provincial wage from employment?*
  - ✓ *Average Provincial wage from employment, less fishing EI?*
  - ✓ *10 percent of gross enterprise earnings?*
  - ✓ *Compensation paid to replacement skippers?*
  - ✓ *Average paid to enterprise crewmembers plus 25%*
  - ✓ *Wage level ($52,875) at which EI clawback starts?*
  - ✓ *Other income proxy?*
- *Should these required returns be varied by fleet segment?*
- *If so, how and on what basis?*
- *Which of the rates of return on investment proposed by Deloitte is most suitable for capital invested in fishing enterprises?*

Attaining Fleet Viability

There are a variety of ways in which fleet viability can be attained or the viable fleet size reached. Essentially, the latter is the number of vessel/enterprises that can, on average over their economic life, cover all costs, including the specific required returns to owner's labour and his capital, from the total gross earnings available to the fleet. In simplest terms, this is determined by dividing the total available fleet revenue by the average total required returns, thus giving the number of vessels in the particular fleet that might attain viability under those circumstances.

The total gross earnings available to any fleet are determined by the resources it can exploit; or more precisely, by the quotas for which it members are licensed. Since fewer and fewer competitive fisheries exist, fleet viability (with a few exceptions) is now determined mostly by individual quota allocations for each fleet. Two factors can affect the total gross earnings of a fleet; one is a change in available allocations and the second is a change in prices received for catches. The first comes from changes in the resource or in allocation policy and the second from changes in market returns. When one or both of these are in a positive direction a larger number of viable vessels might be supported and a smaller number when these changes are negative. On the gross revenue

side, therefore, changes in the average level of gross earnings are the primary determinant of the number of viable operations that can exist in a given fleet.

Individual enterprise viability can also be influenced, or affected, by some factors other than changes in total potential earnings. Individual enterprises can become (more) viable by increasing total revenues more than total costs; reducing total costs while keeping total revenues constant, or some combination of these. Total revenues can be increased by acquiring additional quota or obtaining more revenue from existing allocations through improved quality of catches or from improvements in final product prices. Costs can be reduced or controlled by improving operating practices that increase catch rates or otherwise decrease cost per unit of catch. Costs can also be positively affected by reducing or limiting debt burden, disposing of and/or replacing expensive or inefficient assets etc.

The relevance for fleet rationalization is that enterprise revenues must increase more than total costs as a result of removing operations from the fishery. Those that remain must achieve higher individual earnings that provide all the required returns discussed above. Fleet rationalization, in this context, must therefore produce higher average net returns than existed before fleet restructuring. If this cannot be achieved with the current numbers of operations, a smaller number of more efficient enterprises must be achieved. Even then, individual enterprise viability cannot be guaranteed across the board for all existing operators. Some will not achieve this goal because of individual lack of ability, poor business decisions or simply bad luck. As well, viability cannot and should not be gauged on the basis of a single year's performance. It is best considered a state of affairs that must prevail, on balance, over a much longer period. A suitable guideline would be the economic life of the enterprise's vessel. This could be a 15 to 20 year period over which the enterprise should meet all required returns.

The following are some suggested questions to focus Working Group deliberations in this area:

- *In what cases is fleet viability possible without fleet reduction?*
- *What role should fleet reduction play in industry restructuring?*
- *How quickly can fleet reduction be achieved?*
- *To what extent should fleet rationalization be directed to fleets where the greater improvements in viability can be achieved?*
- *Are there any real alternatives to fleet reduction in the short-term? In the long-term?*
- *Are there some fleets where viable operations are not possible?*

4. REQUIRED DEGREE OF FLEET RATIONALIZATION

If fleet rationalization is to be properly pursued, the degree to which various fleets must be reduced has to be determined. Deloitte provides a listing of individual fleets and the cost data for calculating the necessary level of reduction. Some imaginative analysis will need to be carried out for the few fleet sectors for which Deloitte did not provide data. The use

of data from adjacent or similar fleets in other areas may be an adequate proxy.

The number of withdrawals necessary in each fleet segment can be calculated using the following simplified "economic break-even analysis" approach:

- Prepare a tabulation of average pro-forma operating and fixed costs based on the data provided by Deloitte for each fleet. These include the following: CCA, Repairs and Maintenance, Fuel, Bait, Crew/Wages and Insurance.
- Add in the "required return" selected for the owner's compensation and for his capital investment.
- Divide that total into the 5 or 10 year average gross landed value for the fleet. These averages will smooth out some of the more severe year-over-year fluctuations.
- The result is the "first order of "magnitude" rationalized fleet size target. The difference between that number and the current fleet size is the number of enterprises that must be removed.
- This number can be refined by applying sensitivity analysis to assess the effects of the additional operating and fixed costs the remaining enterprises might incur in acquiring and then fishing larger allocations. The result of this sensitivity analysis will likely be a smaller numbers of enterprises than arrived at in the "first order of "magnitude" calculation.
- This refinement of the "first order of "magnitude" numbers will vary depending on the which rationalization approach is examined (i.e. buy-outs vs. loan financing)
- These calculations will produce more realistic reduction targets for each fleet than simply adopting an across-the-board percentage.
- Exact precision is not really necessary as these are targets not definitive numbers that must, or even can, be reached precisely.
- Fleet rationalization, as envisaged at this point, is voluntary; there is no guarantee the exact calculated required number will actually exit the fishery.
- This calculation of the viable fleet sizes should be carried out periodically as conditions change significantly in the fishery.

The following additional question is suggested for consideration:

- *How should the resource and market trend forecasts be factored into the results obtained from this exercise, i.e. should the calculated number of withdrawals be increased or decreased depending on the direction of the forecast trends?*

5. FLEET RATIONALIZATION OPTIONS

There are a number of possible approaches or models for achieving fleet rationalization ranging from allowing the current licensing provisions to operate to a completely government funded license buy-out. A brief qualitative review of the most obvious pros and cons of these various options is presented in this section to help the WG focus on the real alternatives.

Status-Quo

Under this model no government financial intervention would take place. The current federal licensing provisions for combining, vessel replacement and "buddying-up" would apply to those who wish to acquire additional licenses/quota allocations or increase their vessel size.

❖ Pros

Some of the positive points advanced for the status-quo fleet rationalization model would include the following:

- ✓ No direct government intervention means individual commercial decisions will be made.
- ✓ Allows "self rationalization" to take place in each fleet for which combining and/or "buddy-up is permitted.
- ✓ No additional cost to the public purse.
- ✓ Should have success in IQ fisheries especially.
- ✓ More efficient operators will remove the less efficient ones.

❖ Cons

Some of the negative aspects of the status quo model include the following:

- ✓ Fleet rationalization will be too slow.
- ✓ Will not work in depressed economic conditions.
- ✓ Might lead to increased and unsustainable debt loads.
- ✓ Does nothing for the viability of those who do not wish to combine.
- ✓ Does not facilitate new entrants to the enterprise head category.
- ✓ Limits on combining may not produce sufficient reduction in some smaller boats fleets because of low IQs.

Buy-out 100% Funded by Governments

This is the approach where governments pay the full costs of removing licenses held by

those who wish to exit the industry. The removed licenses would be cancelled and the remaining quotas divided among the fewer remaining enterprises. In IQ fisheries, increased individual allocations could occur immediately. In competitive fisheries, fewer operators would then compete for the available quotas.

❖ **Pros**

Some of the positive points regarding this approach include the following:

- ✓ No cost or debt increases for those who remain in the fishery.
- ✓ Improved economic conditions are immediate.
- ✓ With the widespread existence of IQs reduction of effective effort is guaranteed.
- ✓ Average returns of those remaining should immediately increase.

❖ **Cons**

Some of the negative aspects of this approach are claimed to be the following:

- ✓ Significant costs for governments.
- ✓ Has not removed effective capacity in the past.
- ✓ Does not reduce the total numbers of individuals in the fishery.
- ✓ Past attempts have been "one-size-fits-all" that produced exit only by less efficient entities.
- ✓ Might lead to inflated cost of acquiring licenses/quotas if sellers perceive funding program as encouraging buyers to purchase licenses/quotas.

Governments/Industry Cost-Shared Buy-out

In this model both governments share the costs of removing licenses with those license holders that remain in the industry. The industry share of the costs would be covered by re-purchase of the removed licenses/quotas.

❖ **Pros**

The arguments for this approach include all those in the previous case, plus:

- ✓ There is a reduced cost to the governments.

❖ **Cons**

In this case all the claimed negative aspects of the previous example apply.

Province/Industry Cost-Shared Buy-out

In this case, only the Province and the harvesting sector would share the costs of license buy-out on some agreed basis. The industry share of the costs would be covered by re-purchase of the removed licenses/quotas.

❖ **Pros**

The arguments in favour of this approach would still include all those from the previous examples.

❖ **Cons**

The negative arguments would be the same as previous options plus:

- ✓ Costs to the Province and harvesters would be higher.
- ✓ Federal concurrence/agreement would be needed for the removal and redistribution of licenses/quotas.

Enhanced Financing of Combining/Acquisitions

This is the enhanced government loan guarantee program model that would provide financing for acquisition of licenses/quotas at some favourable rates, terms and collateral requirements for the purchase of licenses/quotas. These acquisitions would take place by individual harvesters in accordance with existing licensing policy provisions.

❖ **Pros**

Some of the positive aspects of this approach include the following:

- ✓ Would lessen the financial burden currently faced by enterprises in acquiring licenses/quotas.
- ✓ Would increase the use of the existing combining provisions.
- ✓ Could be viewed as "self rationalization" by fleets with decisions being made on the basis of individual enterprise financial capabilities and objectives.
- ✓ Provincial financial costs would be limited to the interest differential

and any defaults on loans.

- ✓ Could be extended to assist emerging enterprise owners to acquire an available enterprise.
- ✓ Would support independence of inshore fleets.

❖ **Cons**

Some of the negative aspects of this approach include the following:

- ✓ Might not restructure financially stressed fleets in current depressed economic conditions because both willing buyers and sellers are required.
- ✓ Financial exposure for government could be substantial if a high percent withdrawal of enterprises is needed in most fleets.
- ✓ Might lead to inflated cost of acquiring licenses/quotas if sellers perceive lending program as an incentive to buyers.
- ✓ Some of the less profitable or efficient fleets might not afford this approach.

Suggestion Questions for Consideration:

- ❖ *Are there other arguments for or against each of these models/approaches to fleet rationalization?*
- ❖ *Which of these approaches best meets the agreed overall objectives of the Harvesting Rationalization?*
- ❖ *Which of these approaches is the most feasible in terms of government involvement and ability/willingness to commit to funding?*
- ❖ *Would a different option be selected if economic conditions in the fishery were better?*
- ❖ *Could the current combining provisions and related licensing provisions be changed to further encourage fleet rationalization?*
- ❖ *Are there any another options in addition to those outlined?*

6. PROPOSED FLEET RATIONALIZATION PLANS

Proposals for fleet rationalization plans have been submitted by the FFAW, the NL Shrimp Committee Chairs and the NL Independent Fish Harvesters. The FFAW submission is a comprehensive set of proposed approaches that effectively covers the points made by the other two groups. An assessment of the FFAW document will therefore cover all the approaches to fleet rationalization that have been proposed in the MOU exercise.

The FFAW proposal expresses a preference for a completely government funded buy-out but proposes a fleet-designed, government/industry-funded buy-out program for those fleets and areas not covered by their Lobster buy-out proposal under the Atlantic Lobster Sustainability Measures Program (ALSMP). Also proposed is an enhanced loan guarantee program for those fleets that do not opt for the cost-shared buy-out arrangement. Some key features of the FFAW approach are the following:

- **A Cost-shared Buy-out Program**
  - ✓ Cost-shared: 50% federal, 25% province and 25% harvesters
  - ✓ Would apply to those fleets not covered by the Lobster buy-out proposal under ALSMP.
  - ✓ Harvesters' share would come from re-purchase of licenses/quotas.
  - ✓ Individual fleets would design specific rationalization plans against assigned 10 year budgets.
  - ✓ Each fleet budget would be determined by its share of total removals proposed or deemed necessary.
  - ✓ The buy-out would be based on four main species licenses: crab, shrimp, 4R seiners and groundfish.
  - ✓ This proposal is costed on a "transaction price" approach for valuing the amount of quota that would be purchased at 30% and 40% target reduction levels.
  - ✓ The Deloitte Report data would be used to determine if other levels of reduction are more appropriate.
  - ✓ Combining transactions undertaken since April 12, 2007 could be reversed through the buy-out program.
  - ✓ Program must meet all the other various MOU objectives such as minimizing costs of acquiring licenses/quotas, reducing collateral exposure of harvesters etc.

- **An Enhanced Loan Guarantee Program**
  - ✓ To finance the take-over of existing enterprises by qualified professional fish harvesters, acquisition of replacement vessels, gear and equipment as well as the financing of combining transactions for those fleets that might opt for that approach.
  - ✓ Combining transactions back to April 12, 2007 would be eligible for re-financing under this program.
  - ✓ The basic term at least 15 years.

- ✓ The interest rate fixed at 3.0% for the life of loan.
- ✓ A maximum 10% downpayment by applicants.
- ✓ The annual principal re-payment covered by an assignment of catch provision.
- ✓ Only the quota/license being acquired in the financed transaction to be used as collateral.

The FFAW envisages individual fleets deciding on, and designing, the type of rationalization plan they will adopt.

The cost of removing 30% of the enterprises (852) not covered by the Lobster Buy-out is estimated at $222.6 M; while removing 40% (1,537) would cost $292.0 M. The estimated total cost of the lobster buy-out is $23.7 M. Costing was not provided by FFFAW for the loan guarantee program.

The submission by the Shrimp Committee Chairs was for an enhanced loan guarantee program only. The terms and conditions are virtually the same as those in the FFAW proposal. It was proposed only in the context of financing acquisitions of licenses/quotas by NL shrimp fleets under the federal combining provisions. It did not specifically include enterprise takeovers, but indicated this type of financing program could be extended to other fleets that might be interested. The estimate of interest rate cost was $47.1 M based on a 30% take-up, or 110 combinations, in the shrimp fleets over five years. The maximum financial exposure of government for the same transactions was estimated at $99 M.

The one page of input from the NL Independent Fish Harvesters essentially echoes the points of the FFAW and Shrimp Chairs proposals regarding retroactivity and loan financing applying to all fishing assets while calling for outlawing trust agreements and removing restriction on outside buyers.

The rationalization models proposed by FFAW and NL Shrimp Chairs claim the following main benefits will be created:

- ❖ An increase in average income levels of those enterprises (and individuals) that remain in the fishery.
- ❖ Reduced number of landings during peak summer times resulting in a higher quality product.
- ❖ Corresponding improvements in the viability of fishing operations enabling them to compete in the globally-based seafood industry.
- ❖ Extended fishing activities of fleets and processing seasons for certain species.
- ❖ Improved earnings of processing workers.
- ❖ Stabilize the workforce and economic base of rural communities.

- Generate economic spinoffs in rural Newfoundland and Labrador from more efficient harvesting and processing.

These proposals need to be assessed against the criteria and other conclusions flowing from the issues and questions covered in Sections 2 to 5 and those below. The Steering Committee must then be advised of the selected and recommend options. The next section will outline the steps and actions that will need to be taken to properly accomplish this.

Suggestions Questions:

- *What other costing approaches could be used to calculate the funding needed for buy-outs and of loans for acquisitions?*
  - ✓ *Some average of recent transactions?*
  - ✓ *A set amount for each type of license/quota acquisition?*
  - ✓ *An "indicative" reverse auction to test demand?*
  - ✓ *Other?*
- *How should any MOU license buy-out program be offered in those areas covered by the FFAW"s submission to ALSMP?*
- *Should the selected rationalization approach be based on species or enterprises?*
- *Is the listing of claimed benefits of fleet rationalization complete?*
- *Can these claimed benefits be quantified? If so how?*
- *Are there any trade implications from the proposed loan guarantee program and the cost-shared buy-out models?*

7. PREPARATION OF FINAL REPORT OF HARVESTING RATIONALIZATION WORKING GROUP

The following steps are suggested as a pathway to completion of the final report of the Harvesting Rationalization Working Group to the MOU Steering Committee and the Governments of Newfoundland and Labrador and of Canada. These are given in a sequential order that seems most logical in arriving at the various decision points that must be passed. The suggested sequence of events is, then, as follows:

1. In Working Group session, address the various questions that are posed throughout this document.
2. Make the various decisions that these questions require.
3. Obtain the demographic data on the fishing population in each area fleet (as outlined by Deloitte).
4. Undertake the comparison of the demographic profile of the various fleets with that of the provincial area population trends. Document the findings in terms of the possible effects on fleet rationalization.
5. Assemble the short- and long-term resource outlooks for the main species fished by the various area fleets. These would include crab, shrimp, groundfish, capelin, lobster and small pelagic. Document the findings in terms of the possible effects on fleet rationalization plans.
6. Do likewise for the short- and long-term market outlooks for the same species. Document the findings in terms of the possible effects on fleet rationalization.
7. Conduct the estimation of necessary fleet reductions (other than those covered by the proposed lobster buy-out) as outlined in Section 6.
8. Calculate the costs of buying out the necessary reductions by fleet using the FFAW pricing approach and the one developed as an alternative in the Suggested Questions of Section 6.
9. Contrast that with the costs of an enhanced loan guarantee program for the same purpose.
10. Conduct an estimation of financing take-over of existing operations by qualified professional fish harvesters.
11. Compare the relative costs of buying-out versus financing self- rationalization.
12. Decide on the major terms and conditions that would apply to each fleet rationalization approach
13. Present the Steering committee with a final report that documents the expected costs, impacts, outcomes and major terms of conditions of one or more recommended fleet rationalization models.

Listing of Suggested Questions

***Cost Sharing*:**

- *How should the involvement of the federal government be pursued at this time?*
- *What is an acceptable timeframe for determining whether the federal government will participate?*
- *Can fleet rationalization proceed without federal financial involvement?*
- *What should be the government-industry sharing arrangement if the federal government does not participate?*
- *If there is government cost sharing in a buy-out program, what is the effective cost to harvesters who acquire re-distributed licenses/quotas?*

Minimization of Risk:

- *What are some measures that could be adopted to minimize the risk to harvesters from using existing licenses as loan collateral?*
  - ✓ *What arrangements are possible with the banks in this context?*
  - ✓ *Can a provincial loan guarantee program limit required collateral?*
  - ✓ *Are the federal licensing policy measures in respect of using licenses as collateral clear and effective?*
  - ✓ *To what extent can incorporation of fishing enterprises help in this regard?*
  - ✓ *Are there other measures available?*

Harvesting Demographics

- *What priority should be given to increasing the rate of new entry to the enterprise owner category?*
- *What particular measures should be adopted to advance the entry of younger new entrants to the enterprise owner category?*
- *In what way should identified area population trends be taken into account in designing fleet rationalization plans?*
- *Can fleet rationalization plans play a role in changing an area population trend?*
- *Or will the reverse be true?*

- *Does the demographic analysis suggest any considerations for regional balance in the fishery?*

Resource Outlook

- *What role should short-term versus long-term resource outlooks play in the design of individual fleet rationalization plans?*
- *How should the level of resource uncertainty be factored into assessment of the need for fleet reductions?*
- *Should varying resource outlooks influence the level of rationalization funding made available to different fleets?*
- *How should any forecast resource declines be factored into fleet rationalization plans?*
- *What are the implications for fleet rationalization of a major decline in one of main inshore fleet resources?*

Market Outlook

- *What role should short-term versus long-term market outlooks play in the design of individual fleet rationalization plans?*
- *How should the level of long term market uncertainty be factored into assessment of the scale of fleet reductions?*
- *Should the varying market outlooks facing different fleets influence the level of rationalization funding made available to them?*
- *What marketing measures can be taken to reduce the level of fleet reductions that would otherwise be needed?*

Costs of Acquiring License/Quotas

- *How might each of the following measures ensure fleet rationalization programs do not unduly increase the price of license/quotas:*
  - ✓ *Reverse Auction?*
  - ✓ *Limit on available funding for an acquisition (could vary by fleet, buyer could still pay more)?*
    - *Based on some average of recent license/quota acquisitions?*
    - *Specified Maximum Price?*
    - *Internal Fleet purchase and redistribution only (would require federal concurrence for a re-sale arrangement)?*
  - ✓ *Are there other measures?*
- *Will the current federal licensing system measures to curtail "Trust Agreements" lessen upward pressure on selling prices of licenses/quotas?*

Economic vs. Financial Viability

- *What level of wage compensation to enterprise owner/operators should be used in estimating viable fleet sizes:*
  - ✓ *Average Provincial wage from employment, less fishing EI?*
  - ✓ *Average Provincial wage from employment?*
  - ✓ *10 percent of gross enterprise earnings?*
  - ✓ *Compensation paid to replacement skippers?*
  - ✓ *Average paid to enterprise crewmembers plus 25%*
  - ✓ *Wage level ($52,875) at which EI clawback starts?*
  - ✓ *Other income proxy?*
- *Should these required returns be varied by fleet segment?*
- *If so, how and on what basis?*
- *Which of the rates of return on investment proposed by Deloitte is most suitable for capital invested in fishing enterprises?*

Fleet Viability Criteria

- *In what cases is fleet viability possible without fleet reduction?*
- *What role should fleet reduction play in industry restructuring?*
- *How quickly can fleet reduction be achieved?*
- *To what extent should fleet rationalization be directed to fleets where the better improvements in viability can be achieved?*
- *Are there any real alternatives to fleet reduction in the short term? In the long term?*

Degree of Fleet Rationalization

- *How should the resource and market trend forecasts be factored into the results obtained from this exercise, i.e. should the calculated number of withdrawals be increased or decreased depending on the direction of the forecast trends?*

Fleet Rationalization Options

- *Are there other arguments for or against each of these models/approaches to fleet rationalization?*
- *Which of these approaches best meets the agreed overall objectives of the Harvesting Rationalization?*

- *Which of these approaches is the most feasible in terms of governments' involvement and ability/willingness to commit to funding?*
- *Would a different option be selected if economic conditions in the fishery were better?*
- *Could the current combining provisions and related licensing provisions be changed to further encourage fleet rationalization?*
- *Are there any another options in addition to those outlined?*

Fleet Rationalization Proposals

- *What other costing approaches could be used to calculate the funding needed for buy-outs and of loans for acquisitions?*
  - ✓ *Some average of recent transactions?*
  - ✓ *A set amount for each type of license/quota acquisition?*
  - ✓ *An "indicative" reverse auction to test demand?*
  - ✓ *Other?*
- *How should any MOU license buy-out program be offered in those areas covered by the FFAW"s submission to ALSMP?*
- *Should the selected rationalization approach be species or enterprise based?*
- *Is the listing of claimed benefits of fleet rationalization complete?*
- *Can these claimed benefits be quantified? If so how?*
- *Are there any trade implications from the proposed loan guarantee program and the cost-shared buy-out models?*

Annex 10
Executive Summary of Deloitte Report

Executive summary

Key aspects of the assessment

The Government of Newfoundland and Labrador, the Department of Fisheries and Aquaculture, the Association of Seafood Producers and the Fish, Food and Allied Workers Union are parties to a Memorandum of Understanding concerning the difficult economic circumstances facing the fishing industry in the province and the need for industry change and restructuring.

Deloitte was engaged to assess the financial health and viability of the harvesting activities of various fleet sectors for 2008 and to complete a limited analysis for 2009. The main outputs of the assessment included a final report and a financial model. This document comprises the final report. The financial model will enable users to look at various scenarios to determine the impact of various economic and environmental shocks on enterprise profitability and viability. The analysis may form the basis on which future work around harvesting rationalization will be undertaken.

Data gathering approach

Deloitte used multiple data sources to gather financial and catch and effort data on the more than 3800 fishing enterprises in the province. Critical to the financial assessment was the gathering of actual financial information from fish harvesting enterprises and supplementing this information with catch and effort data from the Department of Fisheries and Oceans. Deloitte utilized an on-line survey that enabled enterprise owners to provide financial, landings and operational data in a secure and confidential manner. The survey period extended from November 26 – December 7, 2009. Various meetings were held with enterprise owners to explain the survey and promote the importance of providing information to Deloitte. Additional enterprise-level data, primarily financial in nature, was provided by an accounting firm, contracted to Deloitte, through the same on-line survey.

A total of 471 on-line surveys were completed. Only 108 responses were provided by individual enterprise owners with the remainder being provided by the accounting firm noted above. Following review and analysis, 361 responses were deemed useable, including only 30 from individual enterprise owners. The useable responses were supplemented with catch and effort data to allow for the assessment of profitability and viability.

The 361 responses which were included in our analysis equated to a 9.4% overall response rate which we were generally pleased with, notwithstanding that we expected a higher level of interest and participation from harvesters given the importance of this exercise to the future of the industry and the endorsement of union leadership and other stakeholders. It must be noted that when the responses are broken down into individual fishing areas/regions, the sample size is reduced, and our confidence in relying on the data is reduced. Furthermore, there was a great deal of variability in the data within regions and we make the following conclusion with which the Working Group understands and agrees. *The data presented in this report reflects survey results only, supplemented by certain Department of Fisheries and Oceans data. It may or may not be entirely representative of the population of fish harvesting enterprises across the province.*

At the highest level, two separate fleet sectors, inshore and nearshore, were analyzed. Initially each sector was divided into seven separate fishing areas/regions. Unfortunately, there was one region in each overall fleet sector that had fewer than 5 responses and we were unable to report on it. This left 6 regions within each overall sector to be analysed.

The inshore fleet is comprised of vessels of less than 40 foot length, while the nearshore is comprised of vessels greater than or equal to 40 feet in length.

Observations

In compiling and analyzing the data it is clear that there are both common characteristics as well as substantial differences between and within the fleets and between and within specific fishing areas/regions within those fleets. Some high level observations include:

- Virtually all enterprises operating in the nearshore are incorporated, while virtually none in the inshore are incorporated.
- Enterprise owners are quite homogeneous in the sense that virtually all have been in business for about 30 years, regardless of whether they fish inshore or nearshore.
- Nearshore: enterprises, on average, are less profitable (as a percentage of revenue).
- Inshore: enterprises reported very little debt (the highest being in 3PS Placentia Bay) and modest investments in equipment (the highest being 2J).
- Inshore: more than 50% of the enterprises, according to DFO statistics are engaged in buddy-up arrangements, yet only 13% of the sample are indicated to be high-revenue enterprises and/or engaged in combined and/or buddy-up arrangements; a significant underrepresentation of this group of enterprises in the sample we analysed.
- Nearshore: only 25% of the enterprises, according to DFO statistics are engaged in buddy-up arrangements but 30% of the sample we analysed are indicated to be high-revenue enterprises and/or engaged in combined and/or buddy-up arrangements, a higher representation in this group of enterprises.
- Inshore: most do not have insurance.
- The average revenue in the sample for both inshore and nearshore fleet sectors is higher than the Department of Fisheries and Oceans Catch and Effort average revenue. Part of this variance may be explained by the prevalence of high-revenue enterprises, buddy-up and/or combining arrangements in certain fleet sectors and regions. Finally, DFO revenues include only the paid price for landed fish and do not include any bonus revenues.
- Nearshore: average fuel expense, as a percentage of revenues, varies greatly from 6% to 24%; average crew/wages, as a percentage of revenues, also varies significantly from 19% to 35%; average profit, as a percentage of revenues, vary from 14% to 31%; average Net Book Value varies greatly with over $1 million variance between the highest and lowest;
- Inshore: looking at the sector from the perspective of averages, there is less variability when compared to nearshore, however, fuel expenses range from 6% to 15%, crew/wages from 24% to 31%, and profit from 14% to 37%, Net Book Value ranges from $27,500 to $46,500 with a variance of only $19,000.

Analysis and financial viability

Deloitte was asked to assess the profitability and financial viability of the various fleet sectors that comprise the harvesting sector in the province. We attempted to design measures of viability that would allow not only for reasonable compensation, including employment insurance, for the skipper/owner (including an option that tied wages directly to revenue) but would allow for a reasonable return on the investment required to operate an enterprise. We believe that both of these components are critical if the harvesting sector is to be viable and sustainable in the long term.

Analyses were completed for nearshore and inshore fleet sectors. Significant differences in viability were noted among harvesters both between and within the inshore and nearshore sectors.

The report suggests four alternative measures of viability.

Alternative Viability Measure #	Owner Compensation (including employment insurance of $14,169)	Owner Compensation (excluding employment insurance)	Return On Investment
1	10% of revenues (using a proxy of replacement skipper share)	10% of revenues	11%
2	$20,000	$5,831	9%
3	$25,000	$10,831	10%
4	$30,300 (using proxy of average employment income in the province)	$16,131	11%

% Viable by Fishing Area/Region

	Alternative Viability Measure			
Region	**#1**	**#2**	**#3**	**#4**
Inshore	**63%**	**57%**	**41%**	**21%**
- 2J	50%	33%	17%	0%
- 3K	59%	53%	38%	21%
- 3L	73%	68%	50%	22%
- 3Ps Fortune Bay and West	66%	63%	44%	25%
- 3Ps Placentia Bay	43%	50%	36%	21%
- 4R North of Pt. Riche	38%	23%	8%	8%
Nearshore	**50%**	**73%**	**65%**	**60%**
- 4R Shrimp	22%	44%	33%	33%
- 3Ps Supp Crab	14%	43%	14%	14%
- 2J3K Supp Crab with Shrimp	60%	79%	79%	77%
- 2J3K Supp Crab without Shrimp	54%	71%	64%	57%
- 3L Small Supp Crab without Shrimp	50%	71%	64%	50%
- 3L Large Supp & F/T Crab	50%	100%	80%	70%
Total	**59%**	**62%**	**48%**	**33%**

Notwithstanding the conservative threshold of viability, based on survey data Deloitte concludes that only between 33% and 62% of fish harvesters are viable (or alternatively, 38% to 67% are not viable), depending on the definition of viability used. While viability between the fishing areas/regions varies significantly depending on the viability measure used, the survey data suggests that generally nearshore regions are more likely to be viable than inshore.

In the inshore fleet sector, most of inshore enterprises are not viable under options 3 and 4. Furthermore, 3Ps Placentia Bay and 4R North of Pt. Riche are not viable under any option and 2J and 4R North of Pt.

Riche are the weakest under options 2, 3 and 4 (when owner compensation is highest). Finally, inshore viability is strongest for option 1, where owner compensation is based on a percentage of revenues as opposed to a defined value (resulting in a very low owner compensation number which may be unsustainable).

In the nearshore fleet sector, viability is the also quite variable with all areas/regions except for 4R Shrimp and 3Ps Supplementary Crab being viable, on average, under all four viability measures. Furthermore, nearshore enterprises tend to be less viable under option 1 as the owner compensation grows proportionally to the revenue and can represent a significant expense. Nearshore enterprises have a better than 50% of viability, on average, in each of the four viability measurements while the level of viability gradually declines with an increase in the rate of return on investment and owner compensation. This is more likely due to the level of investment rather than the minimal increase in owner compensation.

Limited analysis of 2009 fishery

As only 53 respondents answered our questions relating to the 2009 fishery and all but 1 of them were from the inshore fleet sector, we cannot draw any definitive conclusions. We can state that based on the responses we did receive, that virtually all experienced a decline in revenue that was primarily driven by a decrease in raw material prices. In addition, most harvesters experienced static or increasing expenses and few made changes to vessels and licenses.

Annex 11
Fish, Food and Allied Workers Fleet Rationalization Proposal

FFAW Fleet Rationalization Proposal

Basic Premises/Objectives

Our proposed approach to rationalization of the Newfoundland and Labrador inshore fleets has the following basic premises/objectives:

- Fleet rationalization must create conditions that provide satisfactory economic returns to enterprise owners (and their crewmembers) and the ability to re-invest in their capital assets as needed over time.
- It must take account of the specific and different economic circumstances and needs of the various fishing fleets in the Province. There could be at least 16 different fleets distinguished by main-species licence and area of operation.
- It must provide for inter-generational change so that future enterprises heads are not burdened with an unsustainable debt load.
- It must deal with the current lack of access to affordable capital and individual needs to acquire quota/licences at reasonable prices.

Special Requirements

There are a number of special circumstances or conditions that any successful and acceptable fleet rationalization plan must include:

- Fleet rationalization must be cost-shared between harvesters and governments.
- The needs of the following licence holders in the various fleets must be provided for:
  - ✓ Those who have combined enterprises since the April 12, 2007 announcement,
  - ✓ Those who may be interested in combining or acquiring additional quota in the near future,
  - ✓ Holders of single (un-combined) enterprises who do not intend to combine,

- ✓ Potential new entrants to the enterprise head category, i.e., the professional fish harvesters who have reached the required professionalization level to take over an existing enterprise.

- The different economic circumstances and requirements for viability of various fleets prelude "an one-size-fits-all approach".
- Members of each fleet must be given the option of choosing the type of fleet rationalization approach that best suits their economic circumstances and requirements for achieving viability.
- The risk of acquiring additional quota must be minimized in respect of the existing assets of an enterprise.
- Any rationalization plan must be retroactive to April 12, 2007 to cover those who have already combined.
- Government funding must be used in a manner that promotes economic viability of those who remain in the industry while not unduly inflating the cost of acquiring licences/quotas.
- More effective product marketing and competitive port markets must be essential complements to any rationalization effort.

The Fleet Rationalization Proposal:

Our overall province-wide fleet rationalization proposal has three components:

- The Lobster Conservation and Sustainability Program which covers most of the under 40 ft fleets from Fortune Bay west and north to Cape Norman.
- Direct fleet reduction programs for other fleets that are cost-shared between Governments and harvesters.
- An improved loan guarantee program to cover individual quota acquisition through take-over or combining of enterprises.

The Lobster Conservation and Sustainability Plan (LCSP) has just been presented to the Atlantic Lobster Sustainability Measures Program (ALSMP). It includes an enterprise buyback initiative that would be funded jointly by lobster harvesters and both levels of governments. This buyback program is intended to

reduce fishing effort, increase economic viability and avoid increasing the debt load of those who remain in that fishery. It is intended to accommodate the exit of up to 400 lobster enterprises and re-inject 30 percent of the pot entitlements held by them. This level of fleet reduction is expected to remove 60 percent of enterprises earning less than $40,000 annually and 35 percent of total effort. The average gross revenue of those remaining is estimated to increase by $13,200 annually from a total redistribution of fishing income of $10 million. The licences would be bought out through a reverse auction process and 30 percent of the pot entitlements would be resold in small allotments; all overseen by two Lobster Sustainability Boards. The total cost of this effort reduction program is $23.7 million over four years, with lobster harvesters contributing $5.9 million (25%).

Direct Fleet Reduction Program

The most effective and straightforward method of achieving fleet reduction and the ensuing economic benefits is a licence buyout program totally funded by governments. This is truer now than when such programs were last operated in the 1990s. Most significant species fisheries are now managed under an IQ approach; therefore licence (enterprise) removals would effectively remove real capacity and immediately increase the IQ allotment of those remaining. There would be no need for re-distribution, or re-sale, arrangements; licence withdrawals would immediately benefit the remaining IQ holders in proportion to their individual percentage share of the overall quota. And, most importantly in the current economic conditions, it would avoid imposing additional financial burdens on severely stressed enterprises. Finally, such an approach would benefit fleets in those parts of the Province that cannot avail of the present rationalization approach through combining because they do not have IQ systems. In their case, it would improve the balance between fleet capacity and the all too scarce resource availability.

The above notwithstanding, and not abandoning that position, the second-best approach is to develop cost-shared licence buyout approaches, that would be tailored by the individual fleet themselves, to suit their own financial and resource

availability conditions. We, therefore, propose that such fleet reduction programs be made available to those fleets not covered by the LCSP proposal with the following specific parameters:

- Funding would be: Federal – 50%, Province – 25% and Harvesters – 25%.
- The harvesters' contribution would come from purchase of re-injected quota allotments.
- The buy-out would be based on four main species licences: crab, shrimp, 4R seiners and groundfish; other licence holdings would be disposed of by the departing enterprise head in accordance with existing licensing policy.
- This proposal is costed on the basis of fleet reduction options of 30% and 40%. If the financial analysis prepared by Deloitte for the Financial Analysis Working Group permits, analysis could be conducted to identify any fleets for which a lower percentage of fleet reduction would be sufficient to give remaining enterprises a reasonable chance for viability.
- The fleet budgets (costs) for removals would be related to the value of the percentage effort reduction needed in each fleet and area (costings will follow below).
- Each fleet would be required, within some specified time after establishment of such a program, to submit a fleet rationalization buy-out proposal within their assigned budget and in line with the essential principles of the overall fleet reduction program.
- The fleet budgets would be for a 10 year period.
- If necessary to stay within budgets, pay-outs from the assigned budgets for purchase of quotas/licences could be made over the 10-year life of the program.
- The program design for each fleet plan must also include the following specific MOU principles:
  - ✓ Enterprises that have already combined must be offered the option of re-selling their combining transaction under their fleet's reduction program.
  - ✓ Inflating the cost of acquiring licences/quotas must be kept to a minimum. (Obvious possibilities include the

reverse auction approach and a rolling multi-year average index based on lowest recent transactions in the given fleet.)

- ✓ Risk from collateral exposure to banks must be minimized.
- ✓ The viability of those who remain in the industry must be achieved or improved.

- An administrative structure representing the three entities funding these initiatives would be required. Possible examples are the Lobster Sustainability Boards proposed in our submission to the ALSMP and the Fishing Industry Renewal Board that administered the last licence buy-out programs under NCARP and TAGS.

Enhanced Loan Guarantee Program

In addition to the direct fleet-specific rationalization approach outlined above, we also propose that the current loan guarantee program be enhanced to include the take-over of existing enterprises by qualified professional fish harvesters. This is a vital requirement as they are the future of the fishing sector with an average age much below that of current enterprise heads. This enhanced loan guarantee program should also be extended to cover acquisition of vessels, gear and equipment as required by the enterprises of the future. It should also cover the financing of combining transactions for those fleets that might opt for that approach.

The essential elements of such an enhanced loan guarantee program would include the following:

- Combining transactions undertaken back to April 12, 2007 would be eligible for re-financing under this program.
- The basic term of the financing would be for at least 15 years.
- The interest rate would be fixed at 3.0% for the life of loan.
- There would be a requirement for a maximum 10% downpayment by applicants.

- The annual principal re-payment would be covered by an assignment of catch provision to guarantee principal repayment.
- Only the quota/licence being acquired in the financed transaction would be used as collateral; not the total holdings of the enterprise.

The intention to extend the current loan program to cover combining transactions was announced by the Provincial Government in 2007.

The Costs of Fleet Reduction

There are two approaches to estimating the cost of the fleet reduction proposal outlined above. The first is based on current "transaction prices" for transfers of quotas held by the main-species licences proposed as the basis for fleet reduction. The second is to use recent asking prices for different types and sizes of fishing enterprises that are being offered for sale in various areas.

Transaction Price Method In this case the cost of reducing a fleet by any given level is arrived at by multiplying that volume of quota by the current transaction price for purchasing the given species quota. Removal of that much quota should also reduce the number of enterprises by a corresponding amount

The table below shows the estimated cost of removing two amounts of quotas (30 and 40%) in crab, shrimp and groundfish. No estimate is given for removals from the 4R seine fleet because of the low numbers involved. The estimated costs of removing the indicated amounts of quota are the total 10-year budgets that would be available to the various fleets as referenced on p. 4. The provision of funds for buyback of groundfish licences would significantly improve the success of fleet rationalization. This is difficult to cost on an unit-of-quota basis, hence the lump sum of $25 million. The allocation of budget to each fleet would be based on their share of the total species quotas.

1. Estimated Costs of Fleet Reduction by Quota Transaction Price

Quota/Cost	Crab	Shrimp	Groundfish	Totals
Total Quota	52,550 mt[1]	80,049 mt[2]		
Transaction Price	$5/lb/ ($11,023/mt)	$0.50/lb ($1102/mt)		
40% Reduction				
-Amount	21,020 mt	32,020 mt		
-Cost	$231.7M	$35.3M	$25.0M[3]	$292.0M
30% Reduction				
-Amount	15,765 mt	24,014 mt		
-Cost	$173.8M	$26.5M	$22.2M	$222.5M

Notes: 1. Excludes 3Ps Area 11 and 3Pn4R
2. Inshore allocations in 4R, Area 6 and 7.
3. This is an imputed amount that is proposed for removal of GF licences province wide. .

Market Price Method This cost estimation approach requires data on the numbers of Core enterprises in each fleet and the average asking price of different sizes and types of fishing enterprise licences offered for sale (without a vessel). The cost estimation removing any number of core enterprises (under and over 40 ft) can then be calculated by NAFO Division. However, an adequate amount of realistic and useable data on asking prices for species licence/quotas is simply not available to properly cost fleet reductions by this method.

Numbers of Core Enterprises The table below shows the number of core enterprises by size category and by NAFO Division, excluding the core lobster enterprises in LFA 11-14 that would be covered by the LCSP submitted to ALSMP. It also shows the two possible levels of removals. It is the numbers of enterprises that remain after fleet reductions that will determine the extent to which average gross earnings can be improved. This alone does not necessarily mean

that such increases are sufficient to create viable operations as total annual costs including those of acquiring additional quotas/licences must be provided for.

2. Possible Fleet Reduction, Based Numbers of Core Enterprises, by Division

	2J	3K	3L	3Ps	3Pn4R	Totals
Under 40 ft						
Total	97	634	788	441	84	2,044
Less 40%	39	254	315	176	34	818
Less 30%	29	190	236	132	25	612
Over 40 ft						
Total	30	238	346	96	91	801
Less 40%	12	95	138	38	36	319
Less 30%	9	71	104	29	27	240
All fleets						
Total	127	872	1,134	534	175	2,845
Less 40%	51	349	453	214	70	1,137
Less 30%	38	261	340	161	52	852

Summary of Proposed Fleet Reduction Programs

The summary parameters of the three fleet reduction programs being proposed by FFAW are shown in Table 3 below. This table shows the numbers of enterprises that are expected to exit the industry if these programs are established. It also indicates the total estimated costs and the shares of them proposed for governments and harvesters. Finally, it shows the relative improvements in average gross enterprise earnings for each reduction initiative.

3. Summary of FFAW Fleet Reduction Proposals

	Lobster Cores LFA11-14		All other Core Enterprises		Totals
			Under 40 ft	Over 40 ft	
	< 40 ft	> 40 ft			
Cores 2009	918	70	2044	801	3833
Reductions					
30 Percent					
-Numbers			612	240	852
-Total 10 yr. Costs			$66.8M	$155.7 M	$222.5 M
-Federal Share			$33.4 M	$77.9 M	$111.3 M
-Provincial Share			$16.7 M	$38.9 M	$55.6 M
-Harvesters Share			$16.7 M	$38.9 M	$55.6 M
40 Percent					
-Numbers	400[1]		818	319	1,537
-Total 10 yr. Costs	$23.7M[1]		$87.6 M	$204.4 M	$315.7 M
-Federal Share	$11.8M[1]		$43.7 M	$102.2 M	$157.9 M
-Provincial Share	$5.9M[1]		$21.9 M	$51.1 M	$78.9 M
-Harvesters Share	$5.9M[1]		$21.9 M	$51.1 M	$78.9 M
Change in Average Gross Income					
-30% Reduction			+42%	+42%	+42%
-40% Reduction	+53%[1]		+66%	+66%	+57.5%[2]

Notes: 1. Breakdown under and over 40 ft not estimated.
2. Arithmetic average only, a weighted average would be higher.

Cost of Enhanced Loan Guarantee Program

Quantification of the overall costs of the proposed extensions to the Loan Guarantee Program cannot be carried out until fleets decide which approach to fleet reduction they will adopt. The costs to government will consist of the interest relief (difference between the commercial rate and the proposed rate of 3%) and any loan defaults that may need to be covered. The exposure of government would

be related to the amount of financing in place at a given point in time. Some of this could be lessened by tangible and intangible assets being used as security.

Economic Results of Fleet Reduction Program

The direct economic effects of this fleet reduction plan will be two-fold. The first will be the increase in average income levels of those enterprises (and individuals) that remain in the fishery as well as corresponding improvements in the viability of fishing operations. This will enable owners to operate, maintain and re-new their enterprises without public assistance or government intervention. The second will be the positive effects on processing operations from the extended fishing activities of the fleets that will benefit from the removal of excess and inefficient capacity.

The income effect will vary somewhat by fleet depending on the extent to which earnings of the removed enterprises will be totally recouped by those remaining. Any such shortfall is most likely to be minor, mainly resulting from decisions not to pursue some clearly low-productivity fisheries. The effects of this on the estimation of overall income effects are insignificant. Otherwise, if 40% fleet reduction is achieved, recouping/redistribution of the total revenues earned by the departing enterprises would increase the average incomes of those remaining by 66% (100% of total landed values divided by 60% of original fleet size, i.e., 1.0/.60=1.66). Similarly, if a 30% reduction is achieved average incomes of those remaining will increase by 42%. It must be stressed that these are average gross earnings and do not imply that a corresponding level of net returns will result. There remains the question as to whether the increased costs associated with acquiring and fishing additional quotas will be adequately provided for.

The absolute magnitudes of these changes are shown in the following table for all Core enterprise fleets, exclusive of those that would be covered by the lobster proposal to ALSMP for LFAs 11-14. The five-year (2005-2009) average total landed values were adjusted by the annual amount ($23.5M) estimated as accounted for by the 988 Core lobster enterprises in LFA 11-14. Likewise, the total numbers of Core enterprises are adjusted for the Core lobster enterprises of LFA 11-14.

4. **Income Effect of Fleet Reductions, excld. Lobster In LFAs 11-14**

	Under 40 ft	Over 40 ft
Current		
-Total Core Enterprises	2,044	801
-Landed Values ('05-'09)	$73,215,000	$229,055,000
-Average Gross Earnings	$35,819	$285,961
After 40% Reduction		
-Total Core Enterprises	1,226	481
-Average Gross Earnings	$59,719	$476,205
After 30% Reduction		
-Total Core Enterprises	1,430	561
-Average Gross Earnings	$51,199	$408,298

The values shown in this table represent only the overall average enterprise picture and are not meant to indicate that these are adequate improvements in net income. No data are currently available to precisely evaluate the net incomes that are now earned but they are clearly well below all the average gross enterprise earnings shown in Table 4. From these gross earnings a variety of annual variable and fixed costs must be covered before the enterprise owner can make loan payments and, indeed, pay himself. In some cases, payments necessary to retain crewmembers now range as high as 40% of annual gross stock. Other major expenses such as fuel, gear, licences, general repair and maintenance, insurance and debt servicing can easily account for most of the remaining annual gross income. This would leave little or nothing to re-invest in the enterprises, leaving loan principals unpaid and nothing to set aside for future vessel or equipment replacement.

Fleet rationalization will improve the financial condition of the enterprises remaining in the fishery and cause some other benefits to flow their fishing activities. The longer fishing seasons that will occur in certain fisheries will extend processing seasons for certain species. That will improve the earnings of processing workers from longer hours of work. This is difficult to quantify across all cases. However, intuitively, reductions of 40% in fishing capacity would result in a similar relative increase in the number of fishing trips for the remaining enterprises, thereby extending processing times by a corresponding amount. This is most likely in fisheries such as shrimp and crab where significant volumes are available for harvesting and processing.

These fleet reductions will also stabilize the workforce and economic base of communities in rural Newfoundland and Labrador. There are currently some 11,300 positions in the harvesting sector that are often difficult to fill because inadequate wages is a disincentive to finding suitable candidates. The improved incomes resulting from fleet reductions will mean improved incentives for employment in the fishery sector. Finally, there will be economic spinoffs generated in rural Newfoundland and Labrador from the more efficient harvesting and processing operations that will result from these fleet reductions. These spinoffs, which come from the multiplier effect of primary production, will be more sustainable activities with a greater net overall economic impact than that generated by industry sectors crippled by over-capacity.

Annex 12
Inshore Shrimp Fleets Proposal

FLEET RATIONALIZATION FUNDING PROPOSAL

NL INSHORE SHRIMP FLEETS

Presented to:
Hon. Clyde Jackman
Minister of Fisheries and Aquaculture

January 18, 2010

2. THE PRESENT SITUATION

While the overall licensing and associated policy frameworks necessary for fleet rationalization are in place (and have been since early 2008), little progress is been made on rationalizing the Over 40 ft fishing fleets in Newfoundland and Labrador. Forty three (43) combinations have taken place in the various shrimp fleets in the past two years, most of them in 2009. Some of those may have been cases where operators had already acquired a second enterprise and then chose to combine it into one. Others may have resulted from the revised policy that severely restricted the continuation of "buddy-up" arrangements, especially when within families. For many enterprises that availed of the economic benefits of this provision, reverting to two operations was not a viable option. In most of these cases, severe personal financial burdens were undertaken to continue combined operations.

Other policy changes, effective April 17 2007, required licence holders with controlling trust agreements to end them within seven years to gain access to the new Independent Core status. This has created an additional need for individual financing. If these operators do not attain Independent Core status, they are not eligible for any new licences that may become available, nor can they acquire additional licence/allocation entitlements through combining.

Several factors together have caused this lack of progress in using the combining provisions to create more efficient, viable and competitive enterprises. These include the following:

- The current provincial loan guarantee program only applies to vessels and equipment and re-financing of loans obtained from fish processors before April 2007. The normal commercial interest rate and other terms and conditions apply.
- In some cases, in order to finance combining of enterprises, personal property has had to be mortgaged to cover security requirements of lending institutions.
- The last (December 2009) response by DFO to the Supreme Court ruling in the Saulnier vs. the Royal Bank case may still not be wholly satisfactory for lending institutions to readily use licences as collateral. It appears specific formal legal actions (under bankruptcy/receivership or performance of a

security interest) will be required by a lending institution before it can request the Minister to approve (at his/her discretion) disposal of the licence used as security to another eligible individual.

- An added concern for enterprises pursuing normal commercial financing for a combining arrangement would be that the newly combined licence might have to be provided as security when only acquisition of the entitlements from the second enterprise are being financed.
- The effective ending of "buddy-up" arrangements forced many enterprises to find emergency financing for combining enterprises, often at severe personal financial risk. The licensing status incentives to end, or avoid, controlling trust agreements will be an added financing pressure on certain operators over the next several years.
- This fleet sector has suffered a significant decline in total earnings since combining was first permitted in 2007. Landed values of the NL 35-65 ft vessels have never recovered to the levels reached in 2004/05. In 2009, the value of landings by this vessel size class was at the lowest level for the overall decade.
- Certain fishery management decisions have recently diminished, and will continue to diminish, the earnings opportunities of some parts of the NL shrimp fleets. These include the Coral Protected Area closure on the SW Grand Banks and reduced by-catch allowances in the turbot, monkfish, skate and hake fisheries.
- Landed values are a measure of gross earnings; net earnings have likely declined even more over the last decade when operating costs are considered. These have generally gone in the opposite direction to port and final product market prices, more especially in recent years.
- These earnings trends have greatly impaired the ability of fishing enterprises to finance the acquisition of the additional licences/allocations that are needed to achieve fleet rationalization, even though it has been permitted since 2007. This has occurred in a period when the virtual elimination of "Buddy-up" arrangements for over 40 ft vessels would have been expected to drive combining of enterprises.

- Some of the recent indications of negative resource changes, especially in some shrimp areas, will be an added impediment to fleet self-rationalization when, and if, they materialize.

These circumstances have created severe traumatic pressures on the enterprise heads, crewmembers and families involved. Many of them have suddenly found their livelihood in jeopardy because of financial commitments they were obliged to make to maintain their fishing enterprises. Much of this is because of policy changes that were implemented with little or no adjustment or phase-in period and the continued lack of financing that was first alluded to in April 2007.

All of these factors are negatively impacting self-rationalization of the predominant fleet in the Newfoundland and Labrador inshore fishing sector. The fleets represented by the five Shrimp Committees account for:

- A total of 369 fishing enterprises in the 40-65 ft category, all but 62 of which hold both shrimp and crab licences.
- These enterprises hold total allocations of 73,053 mt of shrimp and 20,310 mt of the 41,841 mt of crab available to all 40-65 ft vessels in NL.
- These total approximately 80% of the crab and shrimp allocations of all 40-65 ft vessels in Newfoundland and Labrador.
- Landings by the entire fleet of 40-65 ft vessels account for approximately 90% of the 73,053 mt of shrimp and the total allocation of 54,000 mt of crab in the province.

As a consequence of these factors, the achievement of significant rationalization in this fleet will have widespread positive economic impacts on the fishing sector itself, the owners and crews involved as well as the rural communities from which they operate and where they reside. These impacts will include all the economic results that flow from efficient, viable and competitive operations. These are improved incomes for those engaged in these fleets and extended landings of improved raw material for processing with the consequent spin-offs to the communities where these activities take place. It is not possible to fully quantify these impacts in a document such as this. However, the contributions of viable

enterprises to general economic activity always outweigh those produced by a weak and inefficient harvesting sector.

6

3. THE FLEET RATIONALIZATION FUNDING PROPOSAL

All these adverse economic circumstances have created an urgent need for more realistic and directed financing arrangements to get this fleet on the road to a more efficient, viable and competitive state of affairs. Such financing would enable fleet restructuring to proceed under the self-rationalization measures that have been available to these operators since 2007. This is presently not possible because of the economic conditions in which these enterprises have operated for the last several years and will face for the foreseeable future. As well, the expected financing arrangements for enterprise combining alluded to in the April 2007 announcement of FIR decisions,(and mentioned again in the November 2007 loan guarantee program announcement), have not been implemented.

This financing proposal will jump start restructuring in this fleet (and any others that might want to avail of such measures) and thus will meet the intentions and objectives of the MOU on Industry Restructuring. It will require a financial contribution from fleet members as well as government, but will contribute to the creation of more efficient fishing enterprises while lessening the financial risk associated with purchasing additional quota/licence access.

The essential elements of the proposed financing arrangement are as follows:

- This loan guarantee program would provide directed financing to fishing enterprises for the acquisition of additional quota/access only.
- Such transactions undertaken back to April 2007 would be eligible for re-financing under this program.
- The maximum level of each acquisition to be financed would be based on the average of such transactions in the specific fleet over the three years prior to the individual application.
- The basic term of the financing would be for at least 15 years.
- The interest rate would be fixed at 3.0% for the life of loan.
- There would be a requirement for a maximum 10% downpayment by applicants.
- Annual principal re-payments would equal that percentage of the enterprise's annual gross revenue that would be expected to retire the amount borrowed over 15 years. This percentage would be estimated

at the time of application based on the amount borrowed and the enterprise's recent average (3 years) annual gross earnings.

- That percentage of annual gross revenue would be covered by an assignment of catch provision to guarantee such annual principal repayments.
- The annual total principal repayment would fluctuate with annual gross revenues.
- If these repayment provisions do not pay off the loan in 15 years, an additional repayment time period would be necessary. This would happen only if the enterprise's annual gross earnings over 15 years averaged less than that calculated at the time of application.
- The enterprise would be required to pay the annual interest charges over and above the principal repayment that is covered by the assignment of catch.
- Only the quota/licence being acquired in the financed transaction would be used as collateral; not the total holdings of the enterprise. In the case where the loan is in the name of an individual fish harvester, only the quota/licence being acquired can be used as collateral. It must be stipulated in the bank loan (securities) that any existing quota/licence cannot be used as collateral. This is to meet the intent of the MOU in minimizing the risk to licence holders.
- Applications for these special restructuring loans would be subject to a due diligence assessment by the lending institution being asked to finance the proposed purchase.
- This would serve, after a little experience, to keep the selling price of fishing entitlements at a level that would be covered by the parameters of this loan program.
- This program will meet the objective, as stated in the MOU, of contributing to enterprise viability and extending fisheries employment in the province.
- These "enterprise combining" loans should be available for a minimum of five years to allow for adequate restructuring of this fleet. Continuation should be reviewed at that time in the context of the terms and objectives of the FIR and MOU initiatives.

- A target of 30% overall take-up by the Shrimp fleets would be a feasible level of restructuring to aim for, or expect, under this financing arrangement.

The following is a preliminary estimation of the cost of this proposal to the Government of Newfoundland and Labrador:

- If the 30% take-up is achieved over the five-year life of this lending program approximately 110 combinations within the shrimp fleets would be financed.
- If these average $1 million, the maximum guarantee exposure required of government would amount to $99 million.
- If the commercial rate on loans averaged 7% over the total life of this program, the fixed interest rate of 3.0% would cost government about $47.1 million over 15 years or so.
- This would represent the definitive cost to government in addition to the maximum guarantee exposure of $99 million which would decline as repayments proceed.

There is no obvious reason why this type of financing program should be limited to enterprises in the NL inshore shrimp fleets if others are willing to accept the conditions proposed above. As well, if this form of financing program proves successful in achieving the desired level of fleet rationalization, it could be extended to acquisition of the types of improved vessels and equipment that larger combined enterprises will need. The terms and conditions should also be extended to include existing vessel loans of those who have already invested in the future of the NL fishing industry.

4. THE RATIONALE AND BENEFITS

The following are some of the primary rationales for proceeding with this proposal. Some of these may be obvious from the earlier sections but are included here in the interest of a complete summary.

Rationales:

- Fleet rationalization is necessary for efficient, viable and competitive enterprises to operate a sustainable fishery. The industry is still in need of serious restructuring in the harvesting sectors. Efficient and viable enterprises in all sectors are necessary for a sustainable and globally competitive fishing industry.
- Present economic conditions are preventing this from occurring of its own accord. Fishing fleets have suffered through some five years of reduced earnings; and are likely to experience similar results for several more years.
- Promised financing for combining of enterprises has not been forthcoming. The type of financing assistance proposed here was first stipulated by the Government of Newfoundland and Labrador in 2007. While some enhancements have been instituted, financing for combining of enterprises is still not covered under the current loan program. In this respect, this proposal is simply asking Government to do what has already been indicated.
- This proposal will kick-start restructuring of the harvesting sector as intended under the MOU. The recent, and continuing, adverse economic conditions have created a financial roadblock to self-rationalization as enterprises cannot afford to take on more debt at full commercial terms and conditions.
- All necessary regulatory arrangements are in place for fleet self-rationalization. Combining rules and guidelines have existed for two years, new vessel replacements rules are in effect, "buddy-up" arrangements are essentially over and measures are in place to stop and phase out controlling trust agreements. Only a lack of financial capability and the continuing depressed industry conditions are preventing the start of harvesting sector rationalization.

- The development of this proposal by the NL inshore shrimp fleets indicates a willingness and commitment by these enterprises to pursue an assisted commercial solution to harvesting sector restructuring. It will meet the various tests of both federal and provincial objectives arising from the Fishing Industry Renewal and MOU on Industry Restructuring initiatives.

Benefits:

The above rationales outline a variety of reasons why this proposal needs to be instituted. They essentially call on the Government of Newfoundland and Labrador to assist a private sector commercial initiative to achieve fleet restructuring. There are also a number of benefits that will flow from this outcome that provide further justification for this proposal.

- This fleet restructuring initiative will create efficient and viable enterprises that will able to compete as part of the globally-based seafood industry. This industry demands that enterprises be technologically efficient to meet the ever-increasing standards required of seafood producers. Such competitive technological efficiency can only be achieved by fully viable enterprises at all levels of the industry.
- An efficient and viable fishing fleet will be able to undertake extended periods of fishing operations that are most effective for its activities. This will be possible when the burden of overcapacity is removed by the restructuring of the fleet. The extended fishing activities will provide the basis for the development of complementary efficient and viable processing activities.
- A reduction in the number of enterprises in the fleet would in turn reduce the number of landings during peak times in the summer resulting in a higher quality product. This has been an elusive goal for the last several decades because of overcapacity in the fishing

industry. This financing proposal will be a concrete step in removing some of that inefficient capacity.

- Higher average earnings in fishing and fish processing will arise from this initiative as fleets (and, hopefully, plants) become more efficient and viable. That development will attract and retain qualified individuals in all parts of the industry. This has been a growing concern of industry for some time.
- More efficient and viable fishing fleets, coupled with similar processing operations, will result in improved long-term economic conditions in rural Newfoundland and Labrador. These are a consequence of viable fishing and processing activities; they are seldom, if ever, generated by inefficient operations.
- This assisted commercially-based fleet rationalization proposal will allow licence holders who have spent a life-long career in what is usually a very challenging industry to exit with dignity. The lack of such opportunities has been a negative feature of recent attempts to improve conditions in the industry.
- The cost shared fleet rationalization measures proposed in this document will not, in and off themselves, solve the overall economic crisis confronting the harvesting sector. Fundamental restructuring of our seafood marketing efforts is also essential, with the cooperative involvement of the processing sector, if possible, but without it if necessary.

The rationales and benefits outlined above are in the context of acquiring access to capital on favourable terms to start rationalization of the harvesting sector. We believe in the benefits of onshore employment but not at all costs to harvesters. We expect the provincial government to ensure that mechanisms remain in place that provide for competitive dockside prices for our raw material comparable to other jurisdictions.

Annex 13
Newfoundland and Labrador Independent Fish Harvesters Association Proposal

The NLIFHA:

Recommendations in addition to the Shrimp Chair's Proposal on the MOU.

- Through the rationalization process initiated in 2007, harvesters acquired and will continue to acquire enterprises for combining and also in the progression from crewmember to owner-operator. In most cases these transactions have involved complete enterprises - vessels, gear, and licences. We believe that any new government loan guarantee program should cover all assets of an enterprise, such as vessels, licences, and gear. Using multiple financing programs for a single enterprise will only create confusion and unduly burden the enterprise with administrative duties. An all-inclusive program will create a more financially stable, practical, and efficient enterprise.

- In recent years the fish price negotiations process has been undermined by trust agreements between harvesters and processing companies. This situation has resulted in lower fish prices and loss of revenue to harvesters. As long as processors have control over harvesters through trust agreements fish price negotiations will not be a level playing field; processors will always have the upper hand and harvesters will not get fair prices. Removing trust agreements from the equation would result in higher fish prices to harvesters and more revenue for the enterprise. We believe that trust agreements should be illegal and enforced with stiff penalties.

- In addition to providing new financing options to enterprises that made transactions on and after 2007, we also feel that government has a responsibility to help harvesters who made substantial investments prior to this date. The cancellation of the loan board and the restriction put in place to prevent fish from leaving the island are just a couple of items that has contributed to the loss of revenue to these harvesters placing strain on their enterprises. They also have been making large investments in the industry and have been creating substantial amounts of employment. We feel that they should also be able to avail to such a financing program as the above proposal.

- The Government of the day put a policy in place that restricts fish harvesters from selling raw material to buyers outside the Province. Since then harvesters have lost millions of dollars being forced to accept lower prices under the monopoly created by that policy. This restriction effectively forces harvesters to subsidize thousands of workers in Newfoundland and Labrador. The real cost of selling into a restricted market and partially subsidizing the industry will never be known, but our past experience and knowledge of fish sales in other parts of the world suggests that it is a substantial loss to harvesters. A new loan guarantee program would be a step in right direction toward alleviating or sharing the burden created by the forced subsidization of the processing industry.

Annex 14
Processing Restructuring Working Group Work Plan

June 2010

Processing Restructuring Working Group Work Plan

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1.0 INTRODUCTION

This document is intended as a guide to assist in completing the final report of the Processing Restructuring Working Group (WG) established under the MOU on industry restructuring.

This working group is mandated to: "Prepare a comprehensive report and plan for consideration by the Government of NL, the Government of Canada, and NL fishing industry participants." This plan must quantify the need for processing sector restructuring and include financial requirements and cost-sharing arrangements.

The WG is expected to develop a report that covers the following:

- An assessment of the need for restructuring of the processing sector.
- Identification of possible models with input of the Financial Analysis Working Group.
- Assessment of the costs/benefits of each model.
- A cost estimate of implementation of any proposal including any anticipated federal and provincial costs, subsidies, or loan guarantees.
- Prepare report and recommendations for consideration by the MOU Steering Committee.

In July, 2009, DFA, the Union (FFAW) and the Association of Seafood Producers (ASP) agreed to the MOU process because of the economic difficulties facing the fishing industry. The MOU established working groups to examine and develop proposals related to:

- The financial state of the industry;
- The development of a restructuring model for the harvesting sector;
- The development of a restructuring model for the processing sector; and
- A long-term marketing strategy.

The complex, long-standing internal structural problems in the Province's fishing industry impede its ability to compete internationally. These impediments include overcapacity, seasonality as well as dependability and timing of supply. The seafood sector as a whole is also facing significant labour challenges including an aging and declining population, out-migration and an inability to compete nationally for skilled labour. Industry change and restructuring is necessary for the fishery to be economically viable, internationally competitive and ecologically sustainable over the long term.

The current MOU process is a continuation of the joint federal/provincial Fishing Industry Renewal initiative that was finalized in April 2007. At that time both governments announced "a number of policy changes and new investments that will strengthen the Province's fishing industry." Federal government changes included a licensing policy modification to permit combining, flexibility regarding vessel replacement rules, measures to curtail "trust agreements"

and to facilitate the use of licenses as collateral. Provincial government measures included revisions to processing licensing policy and an enhanced loan guarantee program to assist those taking advantage of the federal licensing changes.

The MOU process is intended to result in a sustainable, economically viable, internationally competitive and regionally-balanced industry which is able to:

- Adapt to changing resource and market conditions;
- Extract optimal value from world markets;
- Provide an economic driver for communities in vibrant rural regions;
- Provide attractive incomes to industry participants; and
- Attract and retain skilled workers.

This is the overall context in which the final report of the Processing Restructuring Working Group must be completed. The following sections will present a work plan and process to guide and facilitate completion of the final report. The various sections that follow will include some directed commentary on a variety of issues relevant to processing restructuring intended to guide the deliberations of the Working Group. Most sections include specific questions that should be addressed when considering restructuring models or approaches, assessing current proposals and arriving at the final conclusions to be presented in the Working Group's report to the MOU Steering Committee (and both levels of government).

2.0 FACTORS FOR CONSIDERATION

This section reviews the factors that the MOU process specifically identified as basic requirements for any processing restructuring. Also, several industry conditions that have been identified are included.

2.1 MOU Objectives

The Terms of Reference of the Processing Restructuring Working Group requires the following be taken into account:

- FIR/MOU Objectives related to processing restructuring
  - ✓ Complementary to other initiatives
  - ✓ Give consideration to timing of other initiatives
  - ✓ Minimize risk
- Processing and Provincial demographics (impact on workforce and port markets)
- Resource outlook (short and long term)
- Market outlook (short and long term)
- Costs of plant restructuring (acquisition and financing)

The issue of costs will need to be addressed by the WG in the context of its Terms of Reference which call for any proposal for government funding to be shared 70/30 federally/provincially and for the contribution of stakeholders to be clearly shown. In this cost sharing context the following questions are suggested for consideration by the WG:

Objectives:

- *How are proposed restructuring plans complementary to harvester restructuring and the marketing strategy?*
- *What is the most appropriate timing for processing restructuring given other initiatives underway?*
- *How are the risks for any restructuring initiative to be mitigated or minimized?*

2.2 MOU Considerations

Demographics: The WG's Terms of Reference require an assessment of the effects of demographic changes from restructuring efforts. This assessment will need data on the age profile of the processing populations as well as regional demographic trends. This assessment

should be conducted by Provincial economic region using 2006 census data, supplemented by a survey of plants.

An analysis of the demographic data for each economic region will provide an age profile within the processing sector as well as within the region. This will indicate if restructuring is more appropriate in some areas than in others. It might also identify regions where restructuring may be more difficult to achieve.

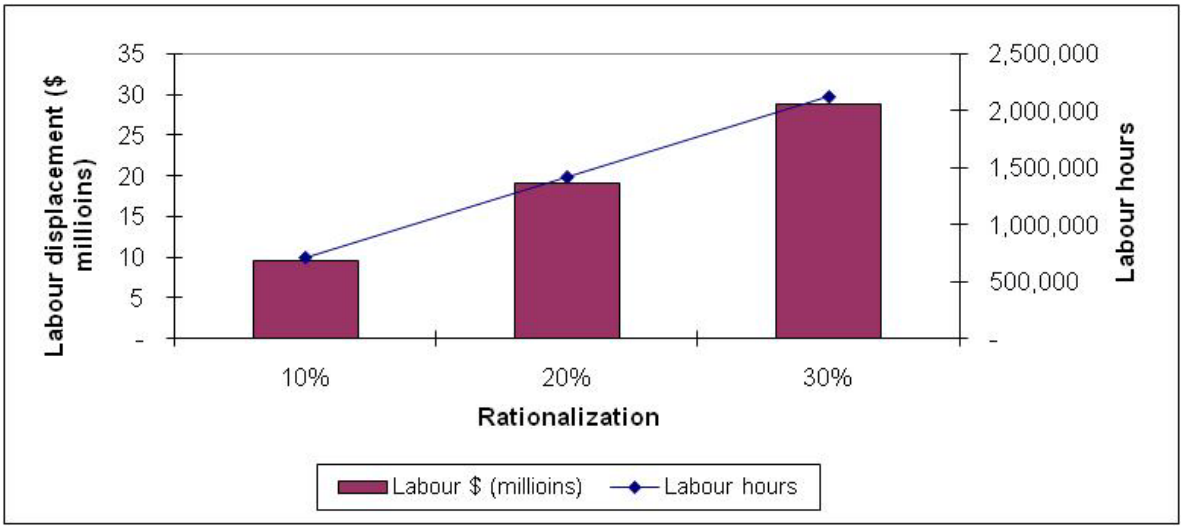
The age profile from plant surveys can be assessed in the context of the regional demographic profiles that have been prepared for major areas of the province. These profiles show where past population changes have taken place and project the future trends in population by area. These data should be analysed to determine the effect of demographics on processing restructuring plans for different areas of the province. Conversely, an assessment should also be made as to how the projected area population trend might affect plans for processing restructuring.

- *What is the age profile of plant workers, specifically how many may be eligible for early retirement versus being displaced or transferred to other plants?*
- *What are the public sector costs for early retirement and displaced workers?*
- *What particular measures should be adopted to advance the entry of younger new entrants to the processing sector (educational training, wage incentives, guaranteed weeks, etc.)?*
- *In what way should identified area population trends be taken into account in designing processing restructuring plans?*
- *Can processing restructuring play a role in changing an areas population trend?*
- *Does the demographic analysis suggest any considerations for regional balance in the processing sector?*

As plants are rationalized, labour within the affected communities will be displaced. Some of the labour force may be able to secure jobs at plants in adjacent communities as supplies increase at the remaining plants. In remote plant locations the labour force will likely be displaced from the seafood sector entirely, necessitating them to move or seek jobs in another sector within their community.

The following chart illustrates the 'maximum' labour displacement within communities resulting from different restructuring levels. Much of the labour dollars lost here will be offset by increasing direct labour demands (1:1 basis), and realizing some increase in plant overhead labour. Incomes from administrative positions would be eliminated and become part of the synergy of restructuring.

Community labour displacement – Maximum



Resource Outlook: Some understanding of the species resource situation is essential to gauge the degree of restructuring that might be needed or possible, especially when considering the adjacency of production capacity to available resources. All species do not face the same resource situation or outlook. It is therefore necessary to complete a short and long-term resource outlook for each species by area.

This information can be obtained from various scientific and management reports produced by DFO and through some directed questions. Some of these short term outlooks are already known to the processing stakeholders. This, in conjunction with other forecasts described below, would contribute to the WG developing a more tailored processing restructuring plan.

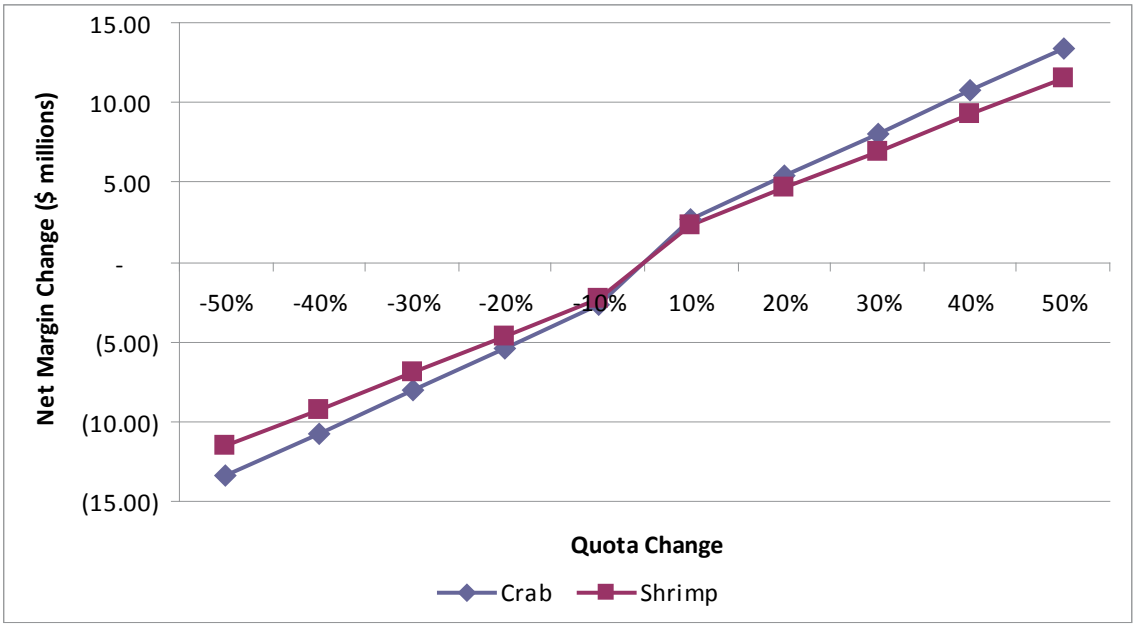
The resource and market outlooks are necessary for both the processing and harvesting restructuring plans, so it is suggested the groups work jointly on these research components or divide the responsibility between them (e.g. processing WG do market outlook and harvesting WG do the resource outlook).

The following are some pertinent questions to be addressed in this context:

- *What weighting should short-term versus long-term resource outlooks play in the design of proposed restructuring plans?*
- *How should the level of resource projections be factored into assessment of the need for processing plant reductions?*
- *How should any forecast resource declines be factored into processing restructuring plans?*
- *How is financial risk exposure affected by short and long term resource outlooks?*

Viability will be affected by changes in the volume of landings provided to the plants. The following chart illustrates for crab and shrimp the impact on net margin of various changes in supply. For every 10% change in supply, as measured against baseline (appendix 1), crab and shrimp net margins change by $2.68m and $2.31m respectively. The following chart provides estimates of net margin gains (losses) with changes versus status quo (4 year average) in crab and shrimp resources.

Industry net margin change with supply change ($m)



Market Outlook: The seafood market short and long-term outlook for the primary species is another significant factor that must be assessed. For example, the short-term outlook for crab may not be the one facing the industry in the longer term. In the case of groundfish, a long-term continuation of recent market conditions may well be likely. These sorts of details should be determined and factored into the design of sector processing restructuring plans.

This approach will indicate whether there is a need to vary the restructuring plans for different species or give priorities to certain species within the processing sector. A major market research effort is not necessary for this purpose, as information can be gleaned with input from seafood marketing reports and discussions with market specialists.

The following questions are suggested for consideration by the WG:

- *What weighting should short-term versus long-term market outlooks play in the design of processing restructuring plans?*

- *Should the varying market outlooks facing different species influence the level of funding made available to rationalize them?*
- *What marketing measures can be taken to reduce the level of restructuring otherwise needed?*

Cost Sharing: In normal times the price paid for a processing plant is determined by the buyer's determination of the available revenue stream over time (present value of future cash flows). This is a combination of the buyer's view of the revenue being earned by the current owner and expectations that the buyer will fare at least as well after acquiring the plant. Such an assessment made at a time when supply and markets are strong result in a higher value than when supply is declining and markets are weak. Similarly, more buyers are likely to exist when times are good than when earnings in the processing sector have declined. The supply of plants for sale is influenced by similar factors.

Restructuring of the processing sector is unique in that the only tangible assets are the plant, land and equipment, but value is attached to the sellers 'buy' in terms of goodwill. In a restructuring model, whereas the assets are to be retired or abandoned, they have very little tangible value (resale of equipment/structure/land, tax benefits on loss of disposal of assets) and will actually incur costs (municipal taxes, environmental contamination, etc.). The value to the buyer in the restructuring model is the incremental value to the plants which acquire the supply that is now no longer needed to support the closed plant. It is the synergies of using existing assets to produce this additional supply that is the basis for improving the economics of the processing sector.

There is a concern that a seller's market will prevail in any restructuring program that involves some form of government assistance. If buyers are viewed by sellers as being more likely to purchase a plant in such circumstances, asking prices will be higher than would otherwise be the case.

The WG is mandated to ensure best efforts are made to design a program that does not inflate the cost of rationalizing plants and thereby negatively impact the viability of those who remain in the fishery. Therefore, some ways and means of achieving this must be addressed. The following questions are suggested to assist in considering this matter:

- *How should the involvement of the federal government be pursued at this time?*
- *What is an acceptable timeframe for determining whether the federal government will participate?*
- *Can restructuring proceed without federal financial involvement?*
- *Is the Provincial government prepared to cost share with industry on their own?*
- *To what extent might each of the following measures ensure processing restructuring programs do not unduly increase the price of plants?*
  - ✓ *Reverse auction?*
  - ✓ *Target multiplier rates based on average net margins from GT report?*

- ✓ *Ratio of principal and financing cost to net margins from GT report?*
- ✓ *Are there other measures?*

- ➢ *How can the financial underwriting risk for government be minimized without burdening remaining stakeholders?*
  - ✓ *Should annual payment formulas be based on shares of historical supply rather than quantities, in order to reduce supply downside risk?*
  - ✓ *Should revenues generated by sales of assets be held in reserve to secure payments?*
  - ✓ *What other means of reducing non-payment of loans exist?*
- ➢ *Will underwriting of the interest rate below commercial rates expose the industry to countervail petitions?*

3.0 VIABILITY OF THE SECTOR

The MOU refers to viability in several different instances and contexts. Therefore, the following directed commentary is intended to properly define this concept for use in the design of processing restructuring plans.

3.1 Definition of Viability

It is useful to understand the basic differences between viability and profitability in economic and accounting terms. In the latter instance, profitability is calculated as the difference between all expenses and total earnings. If the result is positive, a profit is earned, if negative, a loss occurs. This approach does not consider or specify what the owner of the business should receive as his income or what return he should get on the capital he has invested in the operation. Economics includes these two "required returns" as costs that must be covered by total earnings before the business can be considered viable. Economics, furthermore, stipulates the level of these required returns as that which the owner and his capital could receive from the next best alternative use. These levels of returns are what are just sufficient to keep the owner and his capital engaged in that particular endeavour. To receive less means, in economic terms, that the business is not fully viable and the owner and his capital should engage in another activity.

The owner of a viable processing operation should, therefore, cover all his fixed and variable costs and receive, as his own compensation, the amount that he could earn in his next best alternative occupation or what is sufficient to keep him in the seafood processing sector as an owner/operator. The capital he invests in his processing plant also should earn a return at least equal to what it could receive if used or invested in the next best alternative.

The difficulty in determining the viability requirement is the value assigned to these two required returns. It is somewhat less difficult to determine the level of required return to capital than that to the owner's time and effort. A generally accepted proxy for the required return to capital would be the best available return if the capital were invested in a relatively safe commercial instrument. The normal rate can be increased by some level of premium to account for the extra risks of using capital in the seafood sector. There are higher likelihoods of physically losing capital assets in this industry; and assets acquired for processing purposes have little, if any, other immediate alternative use. Therefore, the normally acceptable return for capital invested in seafood processing would be the going commercial return plus a premium of several percent. The following rates of return are suggested by Grant Thornton:

- Weighted average cost of capital 9.25% (average – pg 45)

- Weighted average cost of equity 18.54% (average – pg 44)

The required return to the processing plant owner for his time and effort must be determined. Plant owners are executives of manufacturing and sales companies. The return to the owner, or shareholder, of any specific seafood processing operation can be defined by precedence of what is paid to non-ownership executives or executives of publicly held companies for a specific size (small, medium, and large) of operation. This remuneration can then be applied on a percent per sales dollar or other similar basis.

The WG must consider which level of (or proxy for) required operator returns should be used to calculate the viable size of the processing sector. In this context, the following questions are suggested for consideration:

- *What level of wage compensation for corporate owners should be used in estimating the rationalized processing sector?*
- *What level of return should be used as proxy for investment in processing plants?*
- *Should these returns vary by species?*

3.2 Achieving Viability

There are a variety of ways in which processing viability can be attained or the viable size of the industry determined. Essentially, the latter is the number of plants that can, on average over their economic life, cover all costs, including the specific required returns to owner's labour and his capital, from the total gross earnings available to the plant. In simplest terms, this is determined by dividing the total available species sector revenue by the average total required returns, thus giving the number of plants that might attain viability under those circumstances.

Two major factors can affect the total gross earnings of a species within the processing sector; one is a change in available allocations and the second is a change in prices received for the product sold. The first comes from changes in the resource or in allocation policy and the second from changes in market returns. When one or both of these are in a positive direction a larger number of viable plants might be supported and a smaller number when these changes are negative

Individual plant viability can also be influenced, or affected, by some factors other than changes in total potential earnings. Individual plants can become (more) viable by increasing total revenues more than total costs; reducing total costs while keeping total revenues constant, or some combination thereof. Total revenues can be increased by acquiring additional supply or obtaining more revenue through sales prices. Costs can be reduced or controlled by improving operating practices that increase throughput or yields thus decreasing per unit costs of production. Costs can also be positively affected by reducing or limiting debt burden, disposing of and/or replacing expensive or inefficient assets etc.

The relevance for processing restructuring is that plant revenues must increase more than total costs as a result of plant closures. Those that remain must achieve higher individual earnings. Processing restructuring, in this context, must therefore produce higher average net returns than existed before restructuring. If this cannot be achieved with the current numbers of operations, a smaller number of more efficient operations must be achieved. Even then, individual plant viability cannot be guaranteed across the board for all existing operators. Some plants may not achieve this goal because of uncompetitive processing technology, excessive debt load, lack of management ability, poor business decisions or simply bad luck. As well, viability cannot and should not be gauged on the basis of a single year's performance. It is best considered over a much longer period. A suitable guideline would be the duration of loan terms (15, 20 or 30 years) for restructuring.

The following are some suggested questions to focus Working Group deliberations in this area:

- *In which way(s) will fleet restructuring contribute to the viability of the processing sector?*
- *What duration should be used as a measure to determine short and long term viability?*
  - ✓ *What outside factors (supply, exchange, etc) may affect viability over the short and long term?*
  - ✓ *What is the likelihood that outside factors will affect short and long term viability?*
  - ✓ *What measures may be taken to mitigate these outside factors?*
- *How quickly can processing plant restructuring realistically occur?*
- *To what extent should restructuring be directed to processing segments (e.g. shrimp) where greater improvements in viability can be achieved in the short term?*
- *Are there any real alternatives to restructuring in the short-term? In the long-term?*
- *Are there some segments where viable operations are not possible?*
  - ✓ *What must be done, in addition to rationalizing, to make these segments viable?*

4.0 DEGREE OF RESTRUCTURING

If processing restructuring is to be properly pursued, the degree to which various segments within the sector must be reduced has to be determined. Grant Thornton provides a listing of segments within the sector and the base cost data needed to determine viability (Appendix I) and therefore the level of restructuring necessary.

The number of withdrawals necessary in each processing segment can be calculated using the following simplified "economic break-even analysis" approach:

- *Prepare a tabulation of average pro-forma operating and fixed costs based on the data provided by Grant Thornton for each processing segment (Appendix I).*
- *Add in the premium for the "required return and owner salaries", while backing out actual returns and salaries paid.*
- *Divide that total into average sales for each processing segment. These averages will smooth out some of the more severe year-over-year fluctuations.*

The result is the "first order of "magnitude" rationalized target. The difference between that number and the current plants within the segment is the number of plants that should be closed.

A more accurate and thorough approach is to complete an analysis of the synergies to be realized through restructuring on each processing segment and the industry as a whole. The answers to the following questions should be considered in the context of the restructuring plan pursued and the conditions thereof. The following questions should be considered:

- *How much will fixed and variable costs reduce with an increase in supply?*
- *To what degree can seasons be lengthened given a reduced fleet size, and seasonal factors related to quality and weather, etc.?*
  - ✓ *What are the financial benefits (inventory holding, financing) of extending the season?*
- *How should resource and market outlooks impact the degree of restructuring?*
- *If restructuring is achieved and supplies increase in the future, what threshold supply limits should be established before new entrants are allowed?*
  - ✓ *Should other determining factors be used in place of supply limits (e.g. ROE)?*
- *What other financial benefits will be realized by industry through restructuring?*
- *What measures must be put in place to determine the degree of success of restructuring and whether target levels have been achieved?*
- *How much additional capital is required to achieve a more competitive (higher yields, less labour, improved pack mix) segment within the processing sector?*
  - ✓ *How would these capital improvements affect the degree of restructuring?*

- *Is there resource or port management changes that could contribute to more viable segment results?*
  - ✓ *How would these affect the degree of restructuring?*
  - ✓ *How acceptable are these measures to regulators and harvesters?*

5.0 RESTRUCTURING OPTIONS

There are a number of possible models for achieving processing restructuring ranging from the status quo to a completely government funded buy-out. A qualitative review of the pros and cons of some options is provided.

5.1 ASP Proposal

Under this model industry has proposed that a reverse auction occurs through a third-party to vet sales proposals submitted. Those proposals granted favourable review from a second group would be purchased by a 'collective' owned by producers. The financing for restructuring is proposed to come in the form of a Provincial Government loan for a 30 year term at 2.5% interest.

All plants proposing to sell would sell all assets of the plant and the valuation would include all species produced at that plant over a specified timeframe. The assets of the plant would be transferred to the 'collective'. The plant would be decommissioned and licenses suspended.

Pre-defined target restructuring levels and timeframes are proposed for the shrimp and crab sectors. Funding to support interest and principal payments would be levied on a 20/80 basis from individual plants based on prior quantities and revised quantities.

	Pros	Cons
Process	Initial process confidential and arms length.	Secondary review process arms length, but not necessarily confidential.
	Effectively removes plants and owners through license retirement and non-compete conditions.	No defined sales values or guidelines for sellers.
Funding	Affordable to industry under current operating conditions.	Exposure to countervail through interest subsidy (NS rate 7.75%)
	Industry receives asset disposal recovery and possibly tax benefits on loss of disposal of assets.	Government exposure if stock decreases occur.
		Term (30 years) is longer than forecasted life cycle of any species.
Other	30% restructuring should provide significant synergies through reduced overheads and season	No defined re-entry strategy if stocks increase significantly.

	extensions.	
	Sellers receive value instead of abandoning assets.	Environmental liability from plant sites.

Some questions for consideration regarding the ASP proposal, not previously outlined, include:

- *Can the reverse auction process be improved to ensure confidentiality of the entire acquisition process?*
- *Should value ranges be established (e.g. asset value, supply value) and sent with a description of reverse auction process to all plants?*
- *Should value ranges change depending upon whether or not the plant being offered is part of a corporate consolidation versus a single plant company?*
- *What sureties could be offered to reduce government risk?*
- *Will restructuring indeed result in operating season extensions?*
  - ✓ *Will industry respond to increased supply by increasing capacity at remaining plants?*
  - ✓ *Does increasing capacity as part of restructuring offer more synergies than extending the season and keeping capacity static?*
  - ✓ *Will increasing capacity increase the problem of attracting people to the industry (e.g. same income profile).*
- *If interest rates cannot be subsidized by Government, how does this impact the gains anticipated by industry?*
  - ✓ *What are current rates being offered by banks for plant acquisitions?*
  - ✓ *How are other Provincial Government loan programs structured?*
- *If stocks decline significantly after restructuring what security can be provided against monies owing?*
  - ✓ *Is making interest only payments feasible if stocks decline?*
  - ✓ *If debt load is onerous how will that impact returns to harvesters?*
- *What supply threshold levels should be established to allow new entry (e.g. Vardy report shrimp 10,000 MT)?*
  - ✓ *Should other conditions of the time be incorporated into this consideration (e.g. exchange, market prices)?*
- *Who benefits financially from the ASP model in the short and long term?*

5.2 Status Quo

Restructuring within the processing sector has been underway since the cod moratorium in 1992. Even in recent years (2004 to 2009) more than 1/3rd of the processing workforce has declined (ASP submission, pg 29) due to restructuring and competition for workers from other sectors.

This reduction in numbers of licenses and active plants indicates that plant closures continue to occur even without a restructuring plan, though not at a pace to achieve sector viability.

	2009	2008	2007	2006	2005
Employment	10,705	11,377	12,080	12,550	14,000
Primary plants	101	115	113	112	113

Source: NLDFA – Year in review

There are pros and cons associated with this self-rationalizing option, as discussed:

	Pros	Cons
Process	Some plants are acquired from receivers or distress sellers making plants viable for a new operator.	In most cases assets are abandoned not providing any value to owner.
		No planned process, so closures have unexpected impacts on communities and industry.
		Harvesters and creditors are not paid amounts owing when bankruptcies occur.
Funding	No public funds required, except for worker adjustment programs, which are applicable under any model.	Worker reduction strategy is unplanned, likely increasing costs to Government.
	No long term liability exposure for government.	Banks become wary of making loans to the processing sector, increasing risk premiums as a result.
	No debt incurred by industry.	
Other	Supplies will be picked up by remaining producers, thereby increasing returns.	Reduction of local buying capacity, reduced competition for supply.

Some questions regarding continuing along with the status quo model for restructuring include:

- *What closures occurred from 2008 to 2009?*
- *Were licenses from closed plants suspended?*

- *Can changes to Provincial policy expedite closures without financial intervention?*
  - ✓ *What may be the implications to such policy changes?*
- *Can benchmark costs for worker adjustment be gleaned from these closures and applied to planned restructuring?*
- *Will self-restructuring increase or decrease given current conditions?*
- *Will self-restructuring ever achieve 1/3 capacity reduction?*
  - ✓ *What may it achieve?*
  - ✓ *How long may it take to occur?*

5.3 Other Options

The working group members should give consideration to other models in order to put forward the most viable report and recommendations to the Steering Committee and subsequently to governments for funding consideration.

Government agencies reviewing the final report or proposal from the Steering Committee will likely give consideration to a number of issues, some of which may include:

- Whether the proposal meets the long-term objectives of the MOU.
- Whether the proposal meets policy objectives of the Government.
- Whether all feasible alternatives have been explored and assessed.
- Whether the benefits from restructuring, direct and indirect, exceeding the public sector cost.
- Whether the risk of proceeding is shared or borne primary by Government.

5.4 Sensitivities **(This section is left blank intentionally due to confidentiality of the data.)**

6.0 FINAL REPORT PREPARATION

The following steps are suggested as a guide for completion of the Processing Restructuring Working Group final report for the MOU Steering Committee and the Governments of Newfoundland and Labrador and of Canada. The suggested sequence of tasks is as follows:

1. In Working Group session, address the various questions that are posed throughout this document.

2. Make the various decisions that these questions require.

3. Obtain the demographic data on the processing population in each economic region of the province.

4. Undertake the comparison of the demographic profile to that of the provincial area population trends. Document the findings in terms of the possible effects on processing restructuring.

5. Assemble the short- and long-term resource outlooks for the main species, including crab, shrimp, groundfish, capelin, herring and mackerel. Document the findings in terms of the possible effects on processing restructuring plans.

6. Do likewise for the short- and long-term market outlooks for the same species. Document the findings in terms of the possible effects on processing restructuring.

7. Complete an estimation of necessary plant reductions.

8. Calculate an acceptable value range for buying out species capacity. Subsequently, calculate the range of estimated costs to meet restructuring targets.

9. Compare the relative costs of all restructuring options under consideration.

10. Decide on the major terms and conditions that would apply to each restructuring approach.

11. Present the Steering committee with a final report that documents the expected costs, impacts, outcomes and major terms and conditions of recommended processing restructuring models.

7.0 SUMMARY OF QUESTIONS

MOU Objectives (pg 5):

- *How are proposed restructuring plans complementary to harvester restructuring and the marketing strategy?*
- *What is the most appropriate timing for processing restructuring given other initiatives underway?*
- *How are the risks for any restructuring initiative to be mitigated or minimized?*

MOU Considerations (pg 6):

- *What is the age profile of plant workers, specifically how many may be eligible for early retirement versus being displaced or transferred to other plants?*
- *What are the public sector costs for early retirement and displaced workers?*
- *What particular measures should be adopted to advance the entry of younger new entrants to the processing sector (educational training, wage incentives, guaranteed weeks, etc.)?*
- *In what way should identified area population trends be taken into account in designing processing restructuring plans?*
- *Can processing restructuring play a role in changing an areas population trend?*
- *Does the demographic analysis suggest any considerations for regional balance in the processing sector?*

Resource Outlook (pg 7):

- *What weighting should short-term versus long-term resource outlooks play in the design of proposed restructuring plans?*
- *How should the level of resource projections be factored into assessment of the need for processing plant reductions?*
- *How should any forecast resource declines be factored into processing restructuring plans?*
- *How is financial risk exposure affected by short and long term resource outlooks?*

Market Outlook (pg. 9):

- *What weighting should short-term versus long-term market outlooks play in the design of processing restructuring plans?*

- *Should the varying market outlooks facing different species influence the level of funding made available to rationalize them?*
- *What marketing measures can be taken to reduce the level of restructuring otherwise needed?*

Cost Sharing (pg 9):

- *How should the involvement of the federal government be pursued at this time?*
- *What is an acceptable timeframe for determining whether the federal government will participate?*
- *Can restructuring proceed without federal financial involvement?*
- *Is the Provincial government prepared to cost share with industry on their own?*
- *To what extent might each of the following measures ensure processing restructuring programs do not unduly increase the price of plants?*
  - ✓ *Reverse auction?*
  - ✓ *Target multiplier rates based on average net margins from GT report?*
  - ✓ *Ratio of principal and financing cost to net margins from GT report?*
  - ✓ *Are there other measures?*
- *How can financial underwriting risk for government be minimized without burdening remaining stakeholders?*
  - ✓ *Should annual payment formulas be based on shares of historical supply rather than quantities to reduce supply downside risk?*
  - ✓ *Should revenues generated by sales of assets be held in reserve to secure payments?*
  - ✓ *What other means of reducing non-payment of loans exist?*
- *Will underwriting of the interest rate below commercial rates expose the industry to countervail petitions?*

Definition of Viability (pg 12):

- *What level of wage compensation for corporate owners should be used in estimating the rationalized processing sector?*
- *What level of return should be used as proxy for investment in processing plants?*
- *Should these returns vary by species?*

Achieving Viability (pg 13)

- *In which way(s) will fleet restructuring contribute to the viability of the processing sector?*

- *What duration should be used as a measure to determine short and long term viability?*
    - ✓ *What outside factors (supply, exchange, etc) may affect viability over the short and long term?*
    - ✓ *What is the likelihood that outside factors will affect short and long term viability?*
    - ✓ *What measures may be taken to mitigate these outside factors?*
- *How quickly can processing plant restructuring realistically occur?*
- *To what extent should restructuring be directed to processing segments (e.g. shrimp) where greater improvements in viability can be achieved in the short term?*
- *Are there any real alternatives to restructuring in the short-term? In the long-term?*
- *Are there some segments where viable operations are not possible?*
    - ✓ *What must be done, in addition to rationalizing, to make these segments viable?*

Degree of Restructuring (pg 14/15)

- *Prepare a tabulation of average pro-forma operating and fixed costs based on the data provided by Grant Thornton for each processing segment (Appendix I).*
- *Add in the premium for the "required return and owner salaries", while backing out actual returns and salaries paid.*
- *Divide that total into average sales for each processing segment. These averages will smooth out some of the more severe year-over-year fluctuations.*
- *How much will fixed and variable costs reduce with an increase in supply?*
- *To what degree can seasons be lengthened given a reduced fleet size, and seasonal factors related to quality and weather, etc.?*
    - ✓ *What are the financial benefits (inventory holding, financing) of extending the season?*
- *How should resource and market outlooks impact the degree of restructuring?*
- *If restructuring is achieved and supplies increase in the future, what threshold supply limits should be established before new entrants are allowed?*
    - ✓ *Should other determining factors be used in place of supply limits (e.g. ROE)?*
- *What other financial benefits will be realized by industry through restructuring?*
- *What measures must be put in place to determine the degree of success of restructuring and whether target levels have been achieved?*
- *How much additional capital is required to achieve a more competitive (higher yields, less labour, improved pack mix) segment within the processing sector?*
    - ✓ *How would these capital improvements affect the degree of restructuring?*
- *Is there resource or port management changes that could contribute to more viable segment results?*

- ✓ *How would these affect the degree of restructuring?*
- ✓ *How acceptable are these measures to regulators and harvesters?*

Option 1: ASP Proposal (pg 17)

- *Can the reverse auction process be improved to ensure confidentiality of the entire acquisition process?*
- *Should value ranges be established (e.g. asset value, supply value) and sent with a description of reverse auction process to all plants?*
- *Should value ranges change depending upon whether or not the plant being offered is part of a corporate consolidation versus a single plant company?*
- *What sureties could be offered to reduce government risk?*
- *Will restructuring indeed result in operating season extensions?*
  - ✓ *Will industry respond to increased supply by increasing capacity at remaining plants?*
  - ✓ *Does increasing capacity as part of restructuring offer more synergies than extending the season and keeping capacity static?*
  - ✓ *Will increasing capacity increase problems attracting people to the industry (e.g. same income profile).*
- *If interest rates cannot be subsidized by Government, how does this impact the gains anticipated by industry?*
  - ✓ *What are current rates being offered by banks for plant acquisitions?*
  - ✓ *How are other Provincial Government loan programs structured?*
- *If stocks decline significantly after restructuring what security can be provided against monies owing?*
  - ✓ *Is making interest only payments feasible if stocks decline?*
  - ✓ *If debt load is onerous how will that impact returns to harvesters?*
- *What supply threshold levels should be established to allow new entry (e.g. Vardy report shrimp 10,000 MT)?*
  - ✓ *Should other conditions of the time be incorporated into this consideration (e.g. exchange, market prices)?*
- *Who benefits financially from the ASP model in the short and long term?*

Option 2: Status Quo (pg 18)

- *What closures occurred from 2008 to 2009?*
- *Were licenses from closed plants suspended?*
- *Can changes to Provincial policy expedite closures without financial intervention?*
  - ✓ *What may be the implications to such policy changes?*

- *Can benchmark costs for worker adjustment be gleaned from these closures and applied to planned restructuring?*
- *Will self-restructuring increase or decrease given current conditions?*
- *Will self-restructuring ever achieve 1/3 capacity reduction?*
  - ✓ *What may it achieve?*
  - ✓ *How long may it take to occur?*

APPENDIX I COST SUMMARY BY SPECIES

(This section is left blank intentionally due to confidentiality of the data.)

Annex 15
Executive Summary of Grant Thornton Report

Executive summary

Project overview

This report to the Department of Fisheries and Aquaculture (DFA) presents our observations, findings and conclusions with respect to the Financial Assessment of the Fish Processing Sector in Newfoundland and Labrador. Our assessment of the overall viability and the financial challenges associated with participation in this industry is based largely on the financial data acquired from each of the processors who participated in our sample. This data covers the years 2006 to 2008 and the ten month period ended October 2009. We have also included, for comparative purposes, performance data for the entire Canadian seafood processing and packaging sector for the years 2005 to 2007.

Although we were unable to encourage all of the processors who were selected to actually participate in our review, we were able to obtain samples within each of the four principal types of operations: shrimp, crab, groundfish and pelagics. Our results are provided by principal type of operations and on an aggregate basis. In the case of shrimp and crab, we believe our samples are representative of these sectors. In the case of groundfish and pelagics, our samples relate to medium to larger processors and do not include plants that produce limited volumes.

We acknowledge that our sample data suggests some variability (on a plant by plant basis), primarily due to size and geography. We also recognize that there are many variables to consider when determining the viability of this industry – some of which may not be apparent from the analysis that is forthcoming from the data in our sample. The cost-revenue model which has been developed in conjunction with this report will be an important tool in the ongoing assessment of the viability of the Newfoundland and Labrador seafood processing industry – either on a plant by plant sub-sector or industry basis.

Overall financial performance – results

While shrimp, crab, and pelagics sectors within the Newfoundland seafood processing industry generally attained some measure of profitability during the years 2006 to 2008, results were often sporadic. The groundfish sector experienced net losses throughout the study period. When taking all species into account, the 22 plants sampled, which represented about 44.0% of total production in the province, collectively averaged an annual net income of $9.6 million over the 2006 to 2008 period.

Net income

While the shrimp processing sector attained a measure of profitability during the years 2006 to 2008 (with an average net income of 7.7% of sales) this figure is slightly below the Canadian seafood industry average of 9.6%. A similar situation can be found in the NL crab processing sector during this

same period. In the crab sector, average net income was 3.0 % of sales, once again significantly below the Canadian seafood industry average of 9.6%.

Given the current market price for groundfish, margins in this sector were well below average even taking into account the lower prices paid for raw material. In fact, the groundfish sector recorded extremely high variable costs (e.g., raw material and direct labour) in 2007 and 2008, with these costs representing 114.0% and 101.0%, respectively, of net sales.

Conversely, the pelagics processing plants in the sample recorded average net income of 18.3% of net sales for 2006 to 2009. However, taking into account that many multispecies plants process both pelagics and groundfish, to a significant extent the profitability from the former is probably offset by losses from the latter.

On aggregate, the NL seafood processing sector recorded positive net incomes in two of the three full years that were reviewed for purposes of this study. In 2007, heavy losses in the ground fish sector were sufficient to impact overall sector performance. The highest net income for the entire seafood processing sector was recorded in 2008 when net income as a percentage of net sales reached 5.0% of net sales – once again below the Canadian industry average in this sector of 9.6%.

Gross margin performance and sustainability

The shift in net income over the three year reporting period (2006 – 2008) is largely attributable to the considerable change in total variable costs, which in turn affects gross margins. A closer examination of gross margin performance relative to the Canadian seafood sector (average) serves to highlight the magnitude of the problem. During the three year reporting period 2006-2008, the average gross margin for our sample was 9.8% as compared to the Canadian seafood processing sector average of 13.4% - almost 27.0% lower, on average. At this time the current gross margin in the NL seafood processing sector is not considered sufficient to sustain many of the plants in this sector over the longer term.

Return on net operating assets

There is significant variability in the Return on Net Operating Assets ("RONA") amongst current operators in the NL seafood processing sector. The median RONA for the NL sector is 8.0%, while the average is -13.0%, suggesting that some plants have achieved a marginally acceptable level of performance while other plants are performing far below the acceptable industry average standard of 5.0%.

Return on equity

There is also significant variability in the Return on Equity ("ROE") amongst current operators in the NL seafood processing sector. The median ROE for the NL sector was 1.0% in 2006, -13.0% in 2007 and 9.0% in 2008, whereas the Canadian seafood industry recorded an average ROE of 6.0% for 2005 to 2007. Once again, most plants participating in our sample are currently not achieving the necessary return on their equity investment to warrant continuing their investment. As a result, the ability of existing plants to secure the financing needed to make production improvements to meet their financial performance goals will be difficult under the current structure.

Risk and viability analysis

Further to our overview of the current financial performance in the NL seafood processing sector as noted above, we have also used the Build-Up Model to assess the cost of equity capital. In using this model, which takes into account risk and investment alternatives, we have estimated that an investor in the NL seafood processing sector would expect to receive a rate of return of 18.5% on their investment. We have also estimated an appropriate weighted average cost of capital of 9.25%.

When compared to our sample's average and median ROE and Return on Capital Employed we report significant shortfalls, once again reinforcing that the NL Seafood processing sector, as it is presently structured, is not viable.

2009 results

As there is significant seasonality in the NL seafood processing sector, virtually all of the revenues for 2009 would have already been recorded by those plants that participated in our survey, with the exception of pelagics. However as most plants also use accrual accounting methods to record general and administrative costs, closing the survey in October served to underestimate many overhead costs (e.g., by 16.6% for plants with a December 31st year end, and by 41.6% for plants with a March 31st year end). Although the interim results for 2009 suggest modest profitability for most sectors, it is likely that when year end statements are prepared which include all annual overheads, it will conclude that much of the processing sector was in a net loss position in 2009. For example, the interim results for all species combined show a net income of approximately $7,500,000 for the plants sampled, however if the final plant overhead costs are the same as 2008, the overall result for 2009 will instead be a net loss of approximately $1,800,000.

Summary of financial performance tables

	Canadian Industry Median 2005	NL Median 2006	Canadian Industry Median 2006	NL Median 2007	Canadian Industry Median 2007	NL Median 2008	Industry Average 2005 to 2007	NL Average 2006 to 2008
Return on net operating assets	5.0%	8.0%	5.0%	2.0%	3.0%	16.0%	4.0%	8.0%
Return on equity	8.0%	1.0%	6.0%	-13.0%	4.0%	9.0%	6.0%	-1.0%
Return on capital employed	5.0%	5.0%	5.0%	1.0%	3.0%	5.0%	4.0%	4.0%

	Canadian Industry 2005	NL Average 2006	Canadian Industry 2006	NL Average 2007	Canadian Industry 2007	NL Average 2008	Industry Average 2005 to 2007	NL Average 2006 to 2008
Gross Margin - all species	13.2%	10.0%	13.7%	6.0%	13.3%	13.0%	13.4%	9.8%
Return on net operating assets	5.0%	-52.0%	5.0%	-4.0%	3.0%	16.0%	4.0%	-13.0%
Return on equity	8.0%	2.0%	6.0%	-57.0%	4.0%	-19.0%	6.0%	-25.0%
Return on capital employed	5.0%	4.0%	5.0%	-4.0%	3.0%	8.0%	4.0%	3.0%

Summary of key findings

From an overall perspective, the NL seafood processing sector is achieving some profitability in shrimp, crab, and pelagics processing, but is incurring considerable losses on groundfish.

- The level of profitability (e.g., return on investment) is well below the Canadian seafood processing sector norms, and is considered unacceptable. The profitability level is not sufficient for the NL processing sector, on average, to make a secure capital investment and achieve long term viability.

- Profitability is very sensitive to price factors (i.e., raw material price, market price, and exchange rate shifts), especially for crab and shrimp processing, and very small changes in these price factors have a profound impact on net income.

Managerial conclusions and strategic implications

In order for the seafood processing sector in NL to be viable in the long term, processors must generate adequate returns. These returns must be sufficient to sustain current and future capital investment, while at the same time providing for a level of reward/return that would serve to compensate investors for the inherent risk associated with doing business in this sector. The serious deficiencies in the Return on Equity in the NL seafood processing sector suggest that: 1) the sector may in fact be unable to achieve a level of return that is sufficient to attract the necessary capital to maintain its operations in the long-term; and 2) if they can attract the kind of investment that is required, they may have to pay a premium (in the form of higher interest rates) to attract such an investment.

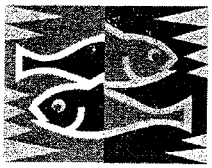
If this industry is not properly capitalized, and its operations are not generating sufficient earnings (and cash flow) to provide for a reasonable rate of return on equity, the industry as a whole is not viable.

Our findings on key operating measures such as gross margin and net profits indicate that the current gross margin compression that the industry is experiencing is a function of increasing raw material costs and lower market prices which, to a considerable extent, are also being affected by exchange rate shifts. Together these factors are rendering the industry unprofitable in the short-term and unsustainable in the long-term.

Our results further suggest that improved viability in the short-term and sustainability in the longer term can be achieved through rationalization and restructuring. In order to affect real change in the industry, plants must attain higher levels of production which, in the absence of significant quota increases, may only be achieved through plant closures.

Annex 16
Seafood Processors of Newfoundland and Labrador Proposal

Seafood Processors of Newfoundland and Labrador Inc.
239 Majors Path
St. John's, NL
A1A 5A1
Tel: (709) 757-3775
Fax: (709) 722-1136



February 17, 2010

Honourable Clyde Jackman
Minister of Fisheries and Aquaculture
30 Strawberry Marsh Road
P.O. Box 8700
St. John's, NL
A1B 4J6

Dear Minister:

On behalf of Seafood Processors of Newfoundland and Labrador please accept the recommendations contained herein which reflect the views of the small processing sector in Newfoundland and Labrador. This Association recognizes the difficult circumstances facing the Fishing Industry and commits to seeking long term solutions. Accordingly, we will continue to work with your officials toward achieving a framework for stability as outlined in the fisheries renewal process.

Collective Bargaining As communicated to previous Fisheries Ministers Rideout, Hedderson, and Labour Ministers Shelley and Sullivan, we respectfully request that Government amend the Fishing Industry Collective Bargaining Act to allow all processors access to collective bargaining. Currently, producers who are not a member of a majority processor organization are prevented from participating in collective bargaining on a given species despite the fact that legislation requires all processors to pay the cost associated with it. This is patently unfair and has negative implications for business owners who are not members of ASP.

Price Setting Panel As previously communicated to various Ministers, another approach to setting fish species is crucial in order to eliminate mistrust and restore confidence in the collective bargaining process. Processors have lost confidence in the how the Panel is discharging its responsibilities. The result is there is no collective bargaining. Our Association recommends replacing the panel with a single arbitrator who will be bound by the arbitration Act in the Province. The arbitrator should be selected on a rotational basis from a roster of arbitrators currently maintained by the Labour Relations Agency. It is noted that two years ago the Provincial Government modernized the arbitration process in the Province for all private and public sector companies with the exception of the Fishing Industry.

Elimination of processing fees The elimination of licensing fees will assist in reducing the costs of operating processing facilities thereby allowing for the opportunity to free up capital for new technology and opportunities.

Marketing This Association supports any initiative associated with marketing and promoting of Newfoundland and Labrador Seafood products. Our Association recommends that Government begin the process of working with industry participants to facilitate the Marine Stewardship Council (MSC) label for all major species, including pelagic, that compete in the international market place. Government should continue to partner with individual companies on specific initiatives on a species by species basis as is currently ongoing. We also strongly support a generic marketing campaign for seafood products generally.

Rationalization

Government should take a hands off approach. Alternatively, the principle of restructuring has to be based on all species.

It appears that fisheries restructuring has been treated as an end in itself rather than an important tool to enhance the well being of small rural communities. Throughout the last decade there have been numerous studies and considerable public debate about how to improve the economic validity and sustainability of the province's fishing industry. Almost all the studies stated that excess capacity is the number one issue and have pointed to the need for rationalization. **The key question has somehow degenerated to the following: which plants should close or which ones should remain active**. This Association believes that rationalization via market forces is occurring and will continue to occur over the long term. Government should not intervene to financially assist sector specific companies to operate. Nor should financial support or other forms of support such as exemptions to current regulations be given to an individual company. This approach over time has given rise to inefficiencies and hence our current structural problems.

We believe that if a processing facility has not been active for 2 years it should be closed and any licenses attached to the facility should not be reinstated. Furthermore, we believe that small active processing facilities that have been in operation for many years should not be subject to further weakening by provincial restrictions. We believe that species specific processing licenses that were removed because of the 2 year use it or lose it policy should be reinstated for small processors. Our member companies would be please to work with the Department to discuss the recommendations in more detail.

George Joyce
Executive Director

Annex 17
Final Report to Steering Committee
(Harvesting and Processing Working Groups)

Steering Committee Presentation

October 19, 2010

Finalized

Options Analyzed

- FFAW Proposal (FFAW)
- NL Inshore Shrimp Fleets (Shrimp)
- Combining at Commercial Rates and Terms (Commercial)
- Moderate Scenario for each option

FFAW Proposal

- 30 to 40 Percent Rationalization
- Government Buy-out
- Industry-Government Funded
- 10 year Program Horizon
- Separate lobster submission

Inshore Shrimp Fleet Proposal

- Government subsidized loan at 3%.
- 90% loan, 10% down payment (maximum)
- 15 year loan term
- 5 year time horizon

Model Assumptions

- FFAW Proposal – term 15 years, loan board rates 6.42%
- Shrimp Proposal – Government subsidized loan, term 15 years, loan at 3%
- Commercial – term 8 years, commercial rate of 7%.
- Compare all outputs against current buddy-up and combining arrangements.

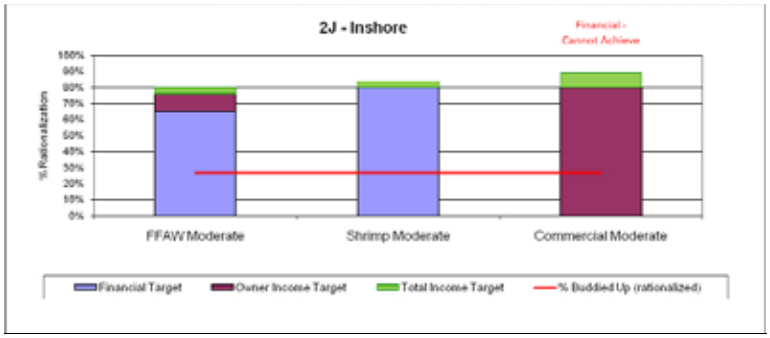
Model Variables

- Change in shrimp market prices.
- Increased shore prices.
- Affected both harvester and producer model results.

	Crab	Shrimp	Gfish	Pelagics	Lobster
Market Price - Gross $ Cdn					
Pessimistic	$ 3.27	$ 3.38	$ 1.83	$ 0.74	
Moderate	$ 3.85	$ 3.69	$ 2.12	$ 0.83	
Optimistic	$ 4.43	$ 3.99	$ 2.41	$ 0.93	
Shore Price - Harvesters					
Pessimistic	$ 1.16	$ 0.44	$ 0.53	$ 0.09	$ 3.00
Moderate	$ 1.39	$ 0.50	$ 0.66	$ 0.13	$ 3.50
Optimistic	$ 1.64	$ 0.58	$ 0.77	$ 0.17	$ 4.00

Inshore Results

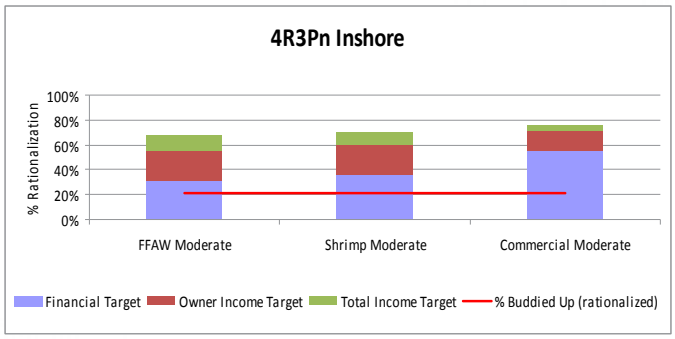
2J Inshore
Rationalization Required



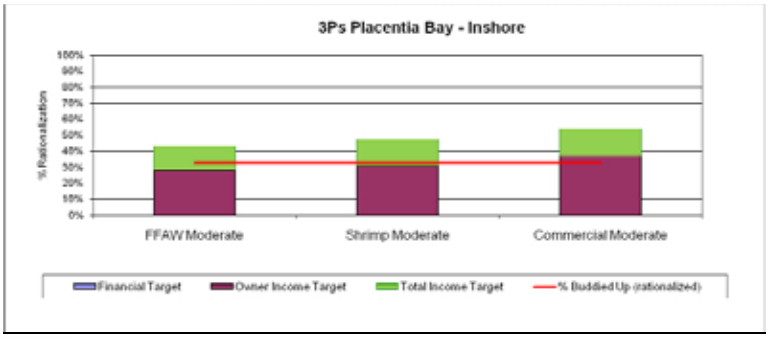
4R North Inshore
Rationalization Required

3K Inshore
Rationalization Required

4R3Pn Inshore – Rationalization Required

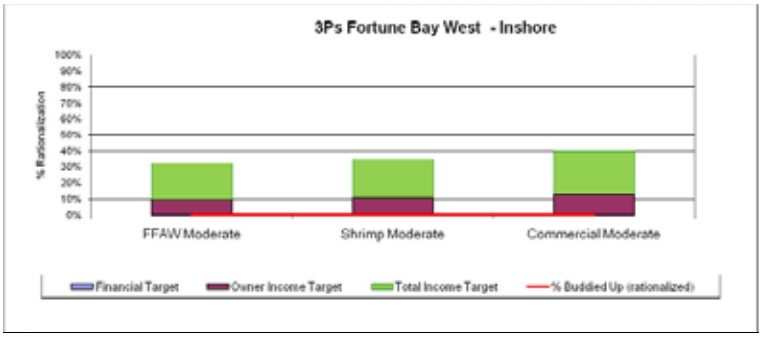


3Ps Placentia Inshore Rationalization Required



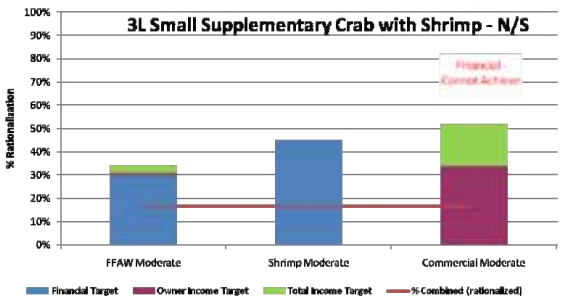
3L Inshore
Rationalization Required

3Ps Fortune Bay West Inshore
Rationalization Required

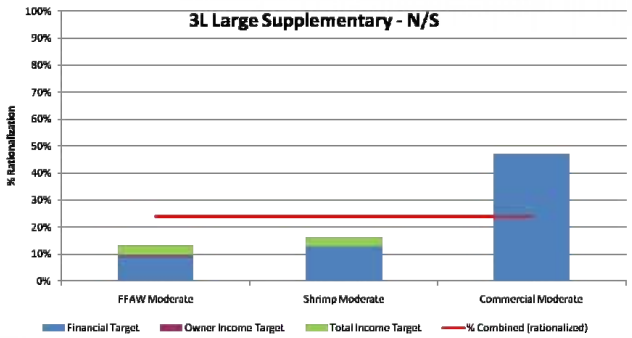


Nearshore Results

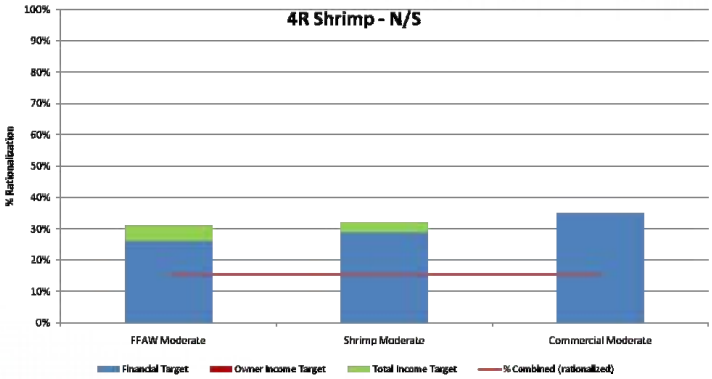
3L Small Supplementary with Shrimp Rationalization Required



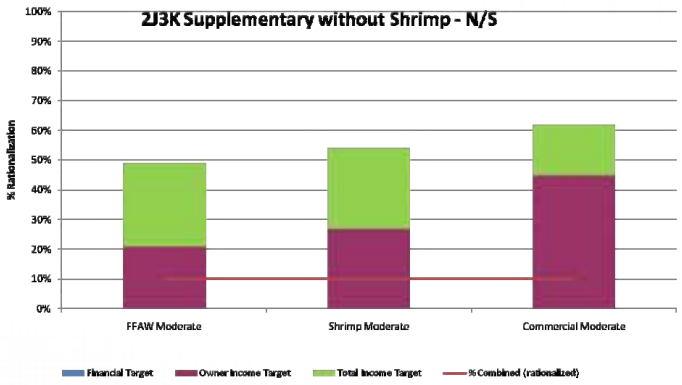
3L Large Supplementary Rationalization Required



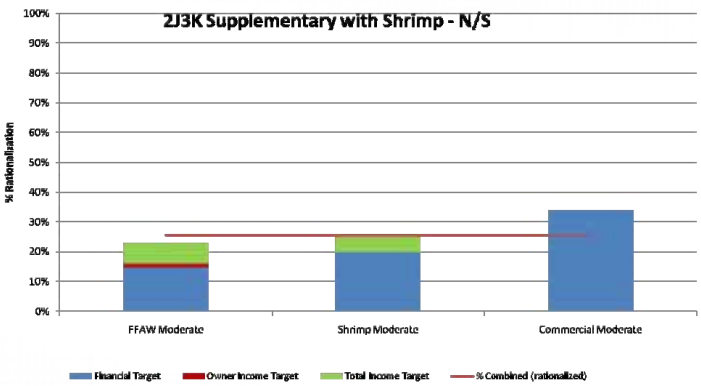
4R Shrimp Rationalization Required



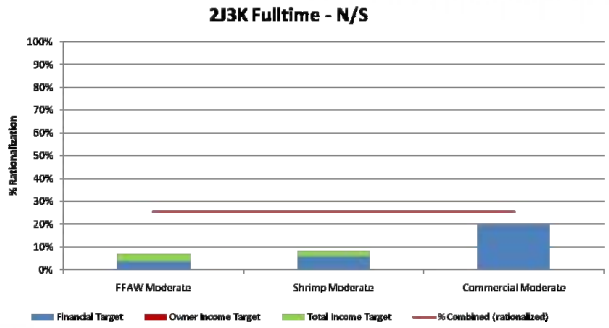
2J3K Supplementary without Shrimp Rationalization Required



2J3K Supplementary with Shrimp Rationalization Required

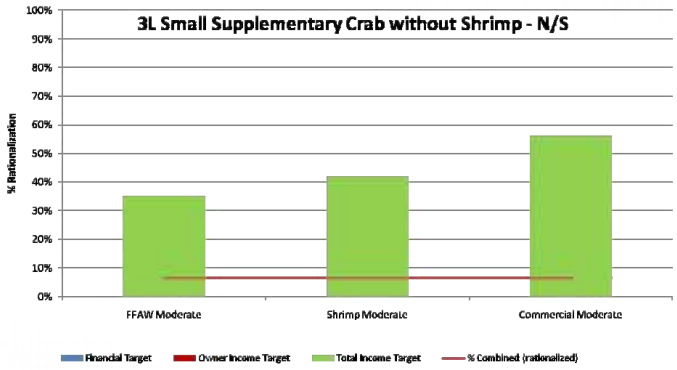


2J3K FT Crab Rationalization Required

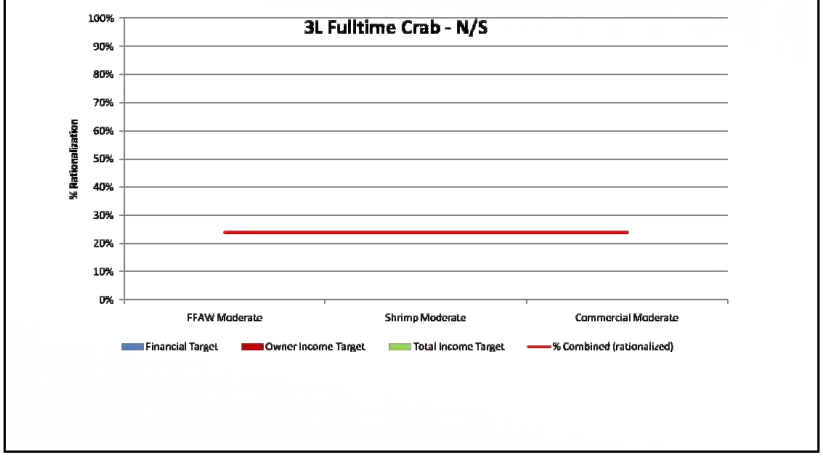


- Four 2J enterprises included. They have 25% less crab available to them than 3K FT fleet.

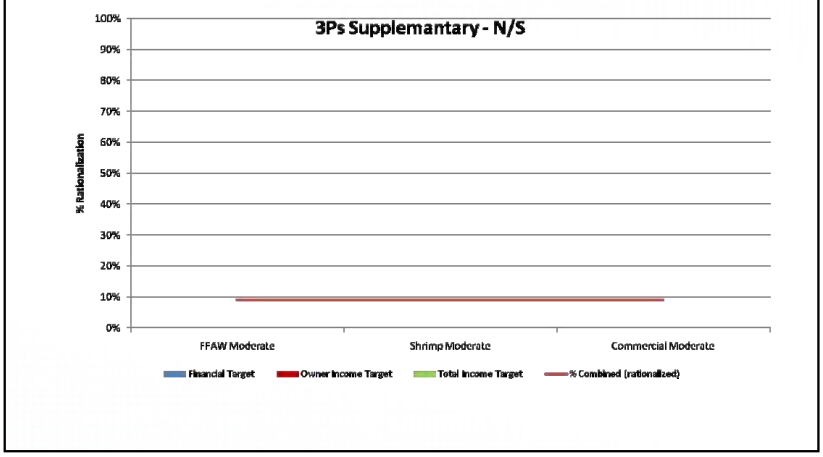
3L Small Supplementary without Shrimp Rationalization Required



3L Fulltime Fleet Rationalization Required



3Ps Supplementary Rationalization Required



Processing Sector: Current Proposals

- ASP
  - 30 Percent Restructuring (snow crab and shrimp)
  - $80 million
  - 30 year term
  - Fixed 2.5% rate
  - Reverse auction asset offers
  - Independent review of offers
  - Suggested value per supply pound
- SPONL – Self rationalization

Processing Sector: Financing

- Financing options were evaluated to determine debt service needs (interest and principal).
- The cost of servicing of debt is expressed as percent of net margin increase versus 0% restructuring.
- The options evaluated include:
  - 30 year term at 2.5%
  - 15 year term at 2.5%
  - 15 year term at 7%

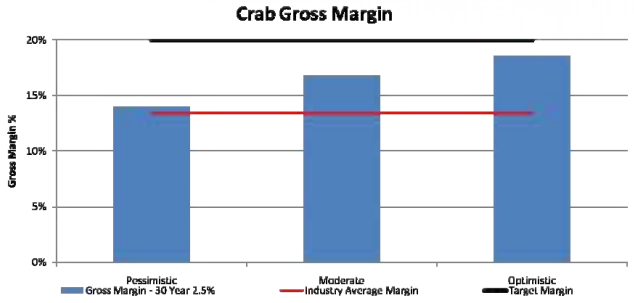
Other Rationalization Benefits Below Gross Margin Line

- Overhead Cost Savings:
  - SGA Expenses – 100%
  - ITD Expenses – 100%
- Increase in production workers incomes for these who remain.

Other Restructuring Costs

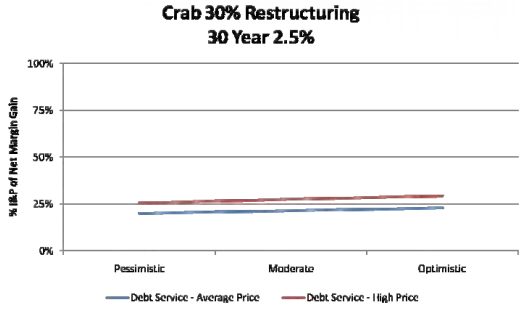
- Economic and Social Costs
  - Debt servicing
    - Interest
    - Principal
  - Interest Subsidization
  - Spin off and indirect community impacts
  - Displaced Harvesters
  - Displaced Processing Workers

Result of 30% Restructuring Snow Crab Sector 30 Year 2.5%



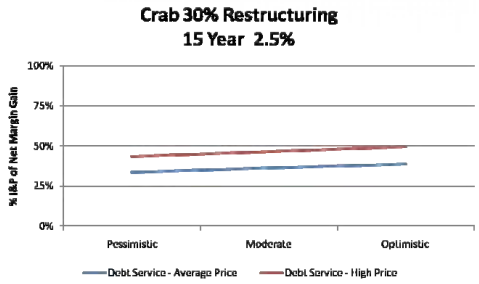
- To achieve target margin of 20%, 64% restructuring would be required under the optimistic scenario. Other scenarios cannot achieve target.

Snow Crab 30% Restructuring Debt Obligations 30 Year 2.5%



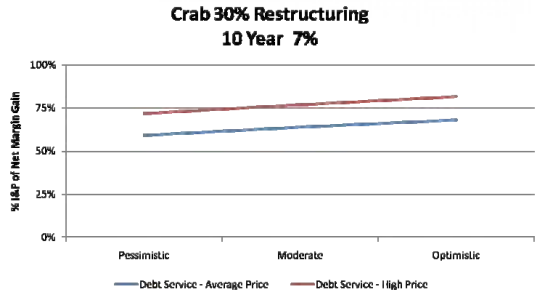
- Average purchase price of $1.50 per pound and maximum price of $2.00 per pound

Snow Crab 30% Restructuring
Debt Obligations
15 Year 2.5%



- Average price of $1.50 per pound and maximum price of $2.00 per pound

Snow Crab 30% Restructuring
Debt Obligations at Commercial Terms
10 Year 7%



- Average price of $1.50 per pound and maximum price of $2.00 per pound

Snow Crab Plant Worker Income

Snow Crab Plants

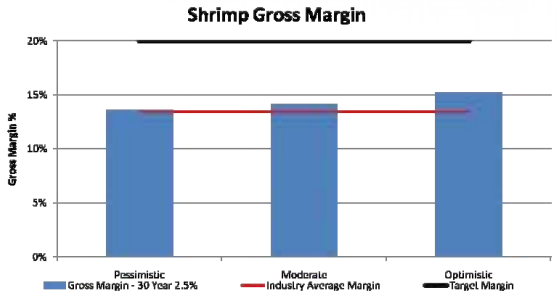
Rationalization	Number	Total Hours	Hours/Worker	Plant Income (Avg. Rate -$11.20)	Plant Income ($12)	Plant Income ($15)
0%	5,814	3,498,709	602	$ 6,741	$ 7,221	$ 9,027
30%	4,070	3,498,709	860	$ 9,630	$ 10,316	$ 12,895
66% Income Target	1,960	3,498,709	1785	$ 19,995	$ 21,421	$ 26,776

Policy Implication: Current Resource Thresholds

Snow crab

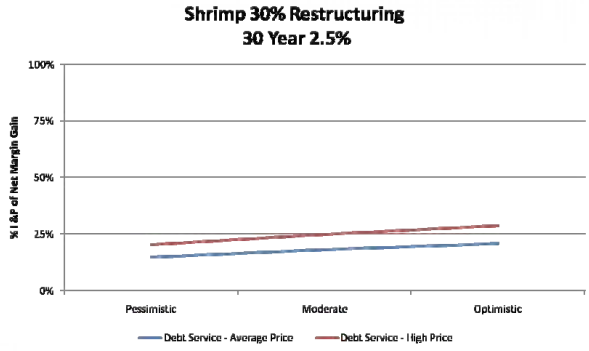
- Currently 2,500 tonnes per plant
- Based on optimistic scenario support 21 plants
- To achieve target margin of 20%, 64% restructuring would be required under the optimistic scenario (would mean 13 snow crab plants remaining).

Result of 30% Restructuring Shrimp Sector 30 Year 2.5%



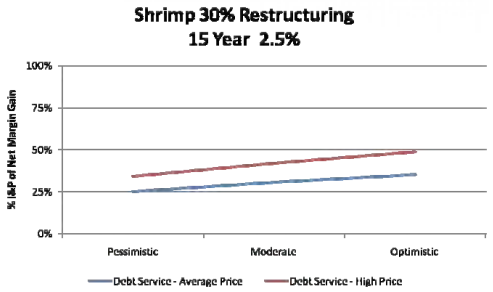
- Shrimp cannot achieve 20% margin target under any scenario.

Shrimp 30% Restructuring Debt Obligations 30 Year 2.5%



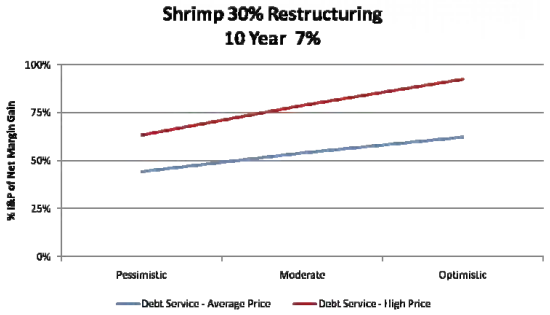
- Average price of $0.75 per pound and maximum price of $1.00 per pound

Shrimp 30% Restructuring
Debt Obligations
15 Year 2.5%



- Average price of $0.75 per pound and maximum price of $1.00 per pound

Shrimp 30% Restructuring
Debt Obligations at Commercial Terms
10 Year 7%



- Average price of $0.75 per pound and maximum price of $1.00 per pound

Shrimp

Shrimp Plants						
Rationalization	Number	Total Hours	Hours/Worker	Plant Income (Avg.Rate -$11.70)	Plant Income ($12)	Plant Income ($15)
0%	2,089	1,362,494	652	$ 7,630	$ 7,827	$ 9,783
30%	1,462	1,362,494	932	$ 10,901	$ 11,181	$ 13,976
62% Income Target	797	1,362,494	1,710	$ 20,000	$ 20,513	$ 25,641

Policy Implication: Current Resource Thresholds

Shrimp

- 8,000 tonnes per plant
- No scenario supports financial target
- 62% restructuring required to meet worker income target
  - 5 plants remaining

Workers Adjustment Sub-Committee

- A sub-committee of the Processing Restructuring Working Group.
- To examine alternatives to address worker impacts from rationalization.

Workforce Adjustment Framework

- Government's framework of transitional supports is designed to assist plant workers displaced through the permanent closure of a fish processing plant.
- The Framework provides:
  - Short-term employment creation projects.
  - Transitional employment counselling and other supports to help workers move to alternate work.
  - Economic diversification efforts, including a transitional wage subsidy, to help displaced workers move to other employment with better long-term potential.

Previous Programs: Federal Financial Expenditures

- In total, the Government of Canada has spent $3.9 billion for income support, industry adjustment measures and economic development assistance programs for the Atlantic fishing industry between 1992-2001.
- Previous Programs:
  - NCARP 1992-1994
  - AGAP 1993-1994
  - TAGS 1994-1998
  - CFAR 1998-2001
  - Early Retirement for Plant Workers 1995-1997
  - Fishplant Older Workers Adjustment Program (FOWAP)
  - The Atlantic Fishers Early Retirement Program (AFERP)

Outcomes

- The primary objective of the Worker Adjustment Sub-Committee is to examine alternatives to address the impacts of rationalization on plant workers.
- Both ASP and FFAW noted that any rationalization in the processing sector coming out of the MOU process would require additional supports for plant workers than those currently available under the province's Workforce Adjustment Framework.
- There was a general discussion of the challenges that will arise in making a transition from the existing older workforce
- It was generally agreed that it will be necessary to create new opportunities for younger workers and that this will only be possible if they can be offered higher wages, longer work periods, and more sustainable employment.
- Completion of MOU process necessary prior to identifying specific worker adjustment initiatives.

Annex 18
Seafood Marketing Final Report
(includes Beothic Proposal on Marketing Structure)

Final Report

Seafood Sales and Marketing

Submitted to:

MOU Steering Committee

Submitted by:

Seafood Marketing Working Group

Department of Fisheries and Aquaculture (DFA)
Association of Seafood Producers (ASP)
Fish, Food and Allied Workers Union (FFAW)

December 3, 2010

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3.0 Scope of Work 3

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- 5.2 Marketing Function 13
- 5.3 Summary of Recommendations 15
- 5.4 Additional Comments and Caveats 17

6.0 Implementation Costs 18

Appendices:

A. Working Group Terms of Reference (ToR)

B. Association of Seafood Producers Inc. (ASP) *Newco* Proposal

C. Beothic Fish Processors Limited Concept Proposal

D. Seafood Marketing Review Panel, Report of the Chairperson, Alexander (Sandy) Roche, 2008

E. Overview of Federal Initiatives for Seafood Marketing

F. Implementation Costs

Seafood Marketing Working Group

Mike Warren, Working Group Chairperson
Sean Barry, DFA
Paul Martin, DFA
Stephanie Lewis, DFA (Researcher)

Derek Butler, ASP
Caroline Davis, ASP
Gerry Donovan, ASP
Paul Grant, ASP
Gabe Gregory, ASP
Blaine Sullivan, ASP

Earle McCurdy, FFAW
Dave Decker, FFAW
George Feltham, FFAW
Keith Sullivan, FFAW

Tom Clift, MOU Chairperson

Jim Davis, DFO (Observer)

Sandy Roche (Consultant, Review of Industry Proposals and Consultant to Working Group)

Brian Burke (Consultant, Review of Industry Proposals)

1.0 Background

On July 14, 2009, the Government of Newfoundland and Labrador, the Fish, Food and Allied Workers Union (FFAW/CAW) and the Association of Seafood Producers (ASP) signed a Memorandum of Understanding. The MOU represented the commitment of the parties to consider and make proposals addressing structural problems in the fishery, and built on the Fishing Industry Renewal Strategy (FIRS) announced by the Government of Newfoundland and Labrador and the Government of Canada in 2007.

As part of the MOU, a Steering Committee (S/C) with an independent chairperson was established, as well as a number of government and industry working groups to deal with specific facets of the industry, including a Seafood Marketing Working Group (W/G). The Marketing W/G was tasked with identifying and assessing options for a more collective and collaborative approach to the sales and marketing of NL fish and seafood products. The W/G was chaired by DFA and included representatives from the processing and harvesting sectors, as well as the provincial and federal governments, and the MOU Steering Committee Chairperson. This report deals with the work of that W/G.

The W/G was tasked, as referenced in the Terms of Reference, to make recommendations on ways and means to improve seafood marketing, and more specifically, to make recommendations on an improved seafood marketing structure aimed at achieving a more coordinated and coherent Newfoundland and Labrador strategy in the marketplace to optimize returns from world markets. Any proposal developed by the W/G had to take into consideration the timing of other measures developed under the MOU and be complementary in nature. DFA, FFAW and ASP agreed that fundamental structural change to the sales and marketing of NL seafood products is essential to meet the objective of achieving optimal value for our industry. Fundamentally, it was acknowledged that any change in marketing is required as part of overall structural change within the industry. It was also agreed that any delay or failure by the harvesting or processing working groups in developing proposals would not automatically or necessarily prevent the marketing proposal from proceeding.

The W/G was also tasked to revisit the seafood marketing council concept as a potential initiative to better coordinate the industry's marketing efforts, and to consider the reasons why the council might have been rejected in a vote by the province's producers in 2008. While the W/G did not consider it in detail, one notable concern on the part of producers was the prerequisite that issues in the industry be addressed holistically, and that industry/government not simply look at marketing alone for a fix while leaving structural issues unaddressed.[1]

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1 The Marketing W/G was preceded in 2007 by the work of a Seafood Marketing Review Panel, chaired by Mr. Alexander (Sandy) Roche. Roche carried out a comprehensive analysis of the options to establish a Seafood Marketing Council in the province (see Seafood Marketing Review Panel, Report of the Chairperson, Alexander (Sandy) Roche, 2008, Appendix D). This analysis included identifying key marketing challenges facing the seafood industry and recommending approaches to address these challenges, as well as determining the options for the mandate and administrative operation of the Council. Government ultimately accepted the Chair's recommendations to establish a Marketing Council on a three-year pilot basis, provided that the processing sector was supportive (the latter forming part of the recommendations of the Chair's report). Subsequently, a vote by processing companies resulted in the rejection, by a narrow margin, of the formation of a Council.

2.0 Objective

In support of the objectives of the MOU, the objective of the W/G on Seafood Marketing was to carry out a comprehensive analysis of the options to more effectively and efficiently market Newfoundland and Labrador (NL) seafood; and to use this analysis to make recommendations to the province's fishing industry and government on ways and means to improve seafood sales and marketing.

3.0 Scope of Work

The W/G prepared a Terms of Reference which outlined the W/G's objectives, scope of work and deliverables (see Appendix A). As work progressed, the scope of work was slightly modified from the original Terms of Reference and the following more accurately reflects the work carried out by the W/G:

- Carry out a comprehensive review of seafood sales and marketing by NL companies and industry competitors;
- Propose a budget and implementation plan for the proposed new sales and marketing structure(s);
- Review the availability of federal programs which might be relevant to funding these new structure(s);
- Critique industry proposals for new marketing entities; and
- Seek the views of processing companies not represented by ASP. [ASP agreed to undertake this task.]

4.0 Work Completed

The W/G's first meeting was held on August 17, 2009, at which time the members discussed their mandate, expectations and deliverables. The W/G Terms of Reference was subsequently prepared and used as a guideline in identifying the W/G's work plan. The initial scope of work focused on sales entities and how their implementation in the NL industry could improve the sales and marketing of NL seafood products.

The MOU S/C thought that this mandate was too focused and would limit the analysis of the underlying sales and marketing issues, challenges and opportunities. It was felt that a broader approach was required, so it was decided to employ a consultant(s) to carry out a comprehensive review and analysis of sales and marketing and make recommendations to the W/G on how best to improve these functions within the NL fishing industry.

Between October and November 2009, a Terms of Reference for a comprehensive sales and marketing review and analysis was developed and a Request for Proposals (RFP) was issued. Based on an evaluation of the proposals received, the W/G was unsuccessful in identifying a consultant proposal that would meet the scope and depth of work required. As a result, it was considered necessary to explore alternative approaches.

In the midst of outlining and implementing an alternate approach, ASP submitted a proposal for a single sales entity with mandatory industry participation (referred to as *Newco*). While supported by the majority of ASP's members, a number of processing companies felt that a single/mandatory sales entity would be too restrictive. In response, Beothic Fish Processors developed an alternative concept paper for consideration. It proposed multiple and voluntary sales entities.

The W/G decided that an independent review and analysis of these (and potentially other structures) would be helpful in determining the best approach to take in moving forward with recommendations on collaborative sales entities. Seafood marketing and fishing industry consultants Alexander (Sandy) Roche and Brian Burke were contracted to analyze the ASP and Beothic proposals, and to consult further with industry on the concepts of collaborative sales and marketing entities.

In the process of this analysis, ASP submitted a revised proposal to government in mid-January 2010 in response to a direct request from DFA. The proposal focused on processing sector rationalization and included more detail on the Newco concept, with a significant change: a voluntary rather than mandatory approach (but still a single entity). A draft version of this proposal was reviewed by the consultants in late-January 2010.

In early February 2010, Roche and Burke submitted their report which primarily focused on an analysis and comparison of the ASP and Beothic proposals and made conclusions and recommendations on how the W/G should proceed.

The following summary is provided for each of the proposals as well as an overview of the key conclusions and recommendations in the Roche/Burke report:

<u>ASP (Newco) proposal (Appendix B)</u>

- Sales and marketing cannot be addressed in isolation of structural issues and challenges;
- Achieving higher returns requires a fishery timed for maximum quality, collaborative/ disciplined selling and financial/logistical ability to hold inventory (i.e. prevent distress selling);
- Rationalization is a prerequisite to Newco;
- Participation to be voluntary;
- No harvester involvement;
- Newco services would include sales, working capital, storage/transportation, inspection/quality control;
- Year 1 – "clearinghouse" for producers, expand function in subsequent years;
- Provincial government funding will be required for set up and inventory financing; and
- Newco is broadly supported by the majority of ASP members, but a limited number of ASP members and non-members would not participate (i.e. not able or willing to change current sales arrangements)

<u>Beothic proposal (Appendix C)</u>

- Multiple sales entities – companies gravitate to one that best suits their needs;
- Need to increase trust, ensure quality, provide financial stability and increase transparency (harvester involvement);
- Harvesters, processors and government need to develop a long-term strategy for sales and marketing (could be facilitated through Seafood Marketing Council); and
- Inventory financing terms could be better negotiated (may not require government guarantees).

Roche/Burke Analysis

- Agreed that there are too many sellers going to market and that sales consortia could alleviate this problem;
- Distress selling acknowledged, but magnitude and foregone sales revenue unquantifiable;
- Newco's "clearinghouse" function deemed not feasible;
- Questioned practicality of all NL companies becoming one sales entity and concluded that multiple sales entities were more practical;
- Provincial government inventory financing should only be available to sales consortia;
- Industry/government committee should be set up to develop criteria for sales consortia;
- Seafood Marketing Council (SMC) should be prerequisite to provincial government financing (set-up and inventory) for sales consortia; and
- SMC should handle broader marketing issues, strategic planning and generic promotion.

After reviewing the Roche/Burke report, the W/G felt it needed additional information on sales and marketing consortia that existed in other jurisdictions in order to determine what might best work within the context of the NL fishing industry. A number of outside resource people were identified for consultation. The W/G met with Fridrik Pálsson, an individual with extensive experience in the Icelandic fishing industry. Several members also held a conference call with representatives from the Alaska Longline Cod Commission (ALCC) - Lance Magnuson, President of the Commission, and Kenny Down, Executive Director of the Freezer Longline Coalition (parent organization of the ALCC). The additional resource people identified were unable to arrange meetings or conference calls within the timelines identified by the W/G (and in line with the deadline for submitting its final report to the MOU Steering Committee).

Mr. Pálsson met with the Marketing Working Group to give a presentation on his experience in/with sales and marketing collaboration (past and present) in Iceland. W/G members were also able to ask questions in the context of how the NL fishery could implement similar measures to improve its sales and marketing efforts.

Mr. Magnuson and Mr. Down spoke about the ALCC which was formed as a collaborative effort to market frozen-at-sea longline Alaska cod following a catastrophic market decline in 2008. They presented information on the structure, function, challenges and success of the Commission.

Next, the W/G held a facilitated workshop in September to discuss issues/challenges, industry perspectives on seafood marketing, and complete a SWOT analysis (strengths, weaknesses, opportunities and threats) for the marketing of NL seafood. More importantly, the workshop was also used to discuss and identify consensus on key conclusions and recommendations for the W/G's final report. In addition to the above work, the Department of Fisheries and Oceans prepared a summary of federal programs and services to support seafood marketing for presentation at the workshop. The main programs and services identified were:

- Atlantic Canada Opportunities Agency (ACOA): Business Development Program
- Business Development Bank of Canada (BDC): Market Expansion Loan
- Export Development Canada: Export Guarantee Program; Accounts Receivable Insurance
- Agriculture and Agri-Food Canada (AAFC): Canada Brand initiative; Agri/ Marketing Program; Agricultural Flexibility Fund; and Seafood Value Chain Roundtable
- Foreign Affairs and International Trade Canada (DFAIT): Canadian Trade Commissioner Service.

Information on each of these federal programs and services is included in Appendix E.

5.0 Analysis, Conclusions and Recommendations

Varying views still exist within the W/G on the extent and degree to which sales and marketing - in and of themselves - can optimize returns to the industry in absence of any other structural changes. The W/G hopes that the conclusions and recommendations that follow will help the MOU Steering Committee develop a comprehensive plan that will result in a more viable and globally competitive fishing industry for the province.

It is generally recognized that there are shortcomings in **both** the selling and marketing of NL's seafood products. These shortcomings restrict the ability of the industry to maximize returns from the marketplace on a consistent basis. Differences of opinion nonetheless exist within the industry as to the degree to which changes in sales and marketing can be achieved without addressing structural challenges within the industry.

The consistent feedback from the processing sector is that selling and marketing are hindered by structural issues in the NL fishing industry, including over-capacity in harvesting and processing, financially limited companies, lack of consolidation or coordination between the harvesting and processing sectors, seasonality, instability caused by disruptions and delays in prosecution of fisheries, and so forth. Newfoundland and Labrador does not have a vertically integrated industry, unlike competitors such as Iceland and in Alaska.[2]

2 Alaska includes substantial industry consolidation and plant production quotas. Iceland is vertically integrated since before WW II.

Those within the harvesting sector are of the view that substantial improvements can be made in the sales and marketing of NL seafood products, even in the absence of major rationalization and structural changes in the industry.

W/G members recognize that the current industry structure prevents the industry from optimizing value. This structure includes seasonality, volatility of quality, price and supply, lack of 'vertical cooperation,' etc, as well as uncoordinated sales and marketing. Changes could help the industry extract more value from our fish resources and provide benefits to all stakeholders, and to the province in general.

The conclusions and recommendations have been linked together in an issue/challenge and solution format in order to better understand the reasoning behind the W/G's recommendations. Selling and marketing functions are also separated to avoid confusion between the two terms (while frequently used interchangeably, the terms are distinct and require different solutions to address their shortcomings, as covered in the Roche Report 2008).

5.1 Selling Function

Issue/Challenge

Many discussions on sales and marketing challenges dealt with the issues of destructive or predatory pricing and distress selling. These terms were used interchangeably throughout the MOU process and the causes for this behaviour are explained below. While the extent to which these selling practices result in lower unit prices for our products is difficult if not impossible to quantify, the consensus of opinion is that the lost revenue can be significant. Our inability to maximize and stabilize pricing in the marketplace is a recurrent and "heated" issue within the industry and must be dealt with if the industry is to move forward.

Cause

All industry stakeholders felt that predatory pricing practices in the market were inherent in the industry because there are too many sellers going to market. Also, because processors compete with each other for raw material supply, this inhibits cooperation in the marketplace. W/G members acknowledged the need to eliminate or, at the very least, minimize these practices so industry could maximize its market returns. For example, in the snow crab sector, there are some 36 plants owned by approximately 27 arms length processing companies who, in any given year, bring their product to market through 15 to 20 sales companies. Many vary their sales agents (brokers) from year to year and some use multiple sales agents. This is further exacerbated due to factors such as inadequate working capital resources to enable disciplined release of product into the market; insufficiently capitalized companies; companies adverse to the market risk inherent in holding product; and with the exception of a few companies, a lack of in-house sales and marketing expertise (hence the use of brokers).

Furthermore, all processors have to operate in a compressed production season which increases working capital requirements and necessitates disproportionate management and entrepreneurial focus on raw material retention. There is also the issue of overcapacity in the processing sector which is consistently identified in numerous studies and raised by the processing sector (as well as all signatories to the MOU) as an impediment to stability in the marketplace. Ultimately, there are too many processing companies going to the market, few of which have significant critical mass and coordination to maximise the sales and marketing value.

Restructuring/rationalization in the harvesting and processing sectors is intended to result in a more efficient and effective industry with strengthened financial and management capabilities. In turn, this would likely result in a more consistent and strengthened ability for industry to extract the maximum attainable returns from the marketplace.

Solution

The proposed rationalization alone will not achieve the desired level of sales consolidation. In the context of the NL seafood industry, the establishment of sales consortia should help to:

- minimize destructive selling practices;

- enhance and stabilize prices for NL seafood products;
- lead to more consistent quality product;
- avoid potential or perceived violations of anti-competitive legislation;
- build a stronger degree of trust and professionalism among consortium participants; and.
- achieve mutual and equitable benefits for all stakeholders, notably processing and harvesting sectors.

The W/G acknowledges that the best approach to implementing sales consortia would be through a voluntary collaborative process involving "like-minded" companies. It is of upmost importance that companies feel compatibility with each other, especially in the NL fishing industry where overcapacity, competition for raw material and other factors have caused much distrust and discord within the industry. [3]

The right number of such consortia is open to debate but consensus is that three to five would be practical to achieve critical mass and put in place the level of sales and marketing expertise required to extract maximum value from the marketplace. This target offers a greater possibility of individual processors finding a group within which they can feel compatible, while still maintaining healthy competition within the industry.

The processing sector supports a voluntary approach to the establishment of sales and marketing consortia. Government incentives and/or regulations may assist in the establishment of such sales consortia. However, there was a strong consensus within the W/G that the provincial government should focus on an "incentive" approach rather than a "regulatory" approach. FFAW feels that the provincial government should explore regulatory measures if an incentive approach does not achieve desired results. Processors feel strongly that coordination in sales and marketing would be positive for the NL industry but concur with an industry analyst who said a sales and marketing prescription cannot fix everything. They also feel that structural change needs to occur in both the harvesting and processing sectors in order for sales and marketing to be truly effective. The instability of the industry (whether real or perceived) prevents the industry from making any meaningful and sustainable gains in the market.

The FFAW feels that a more coordinated approach to sales and marketing would help achieve better returns from the market, though agrees it would probably be more substantial with industry restructuring.

Recommendation

The W/G's main recommendation is that the NL seafood industry should establish sales consortia, either entirely new or from existing marketing entities. The initial focus should be on crab and shrimp sales with expansion to other species (e.g. capelin, lobster and groundfish species) as opportunities arise.

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3 The W/G acknowledged the difficulty in building collaborative sales and marketing relationships when processors are competing with each other for raw material. As a result, companies also end up *competing* with each other in the marketplace, to the detriment of the processing and harvesting sectors. All agreed that the effort and resources used for such practices would be better invested in collaborative sales and marketing work.

To encourage the formation of sales consortia, it is recommended that the provincial government work on developing two forms of financial incentives, namely, (1) offsetting incremental start-up costs to participants interested in establishing sales consortia; and (2) enhancing, for at least an initial period of time, the working capital capability of the consortia. It is felt that collaborative efforts by the provincial government, federal agencies (e.g., Export Development Canada), commercial banks and companies comprising sales consortia could result in inventory financing arrangements that would exceed that which is currently available to any individual company, but at the same time, would not constitute direct subsidization from government.[4]

Further details on industry assistance should be decided through discussions with industry participants. However, it is felt that financial assistance for a minimum period of three-years is required to establish and operate the sales entities, and it should be incremental to the costs associated with current sales and marketing efforts. It should include assistance for legal requirements to establish the entities, as well as for marketing strategy development and implementation.

In an effort to more clearly define what the sales consortia would or should look like, the W/G focused its attention on the criteria sales consortia would have to meet in order to qualify for the funding support outlined above. It would be extremely difficult, and perhaps meaningless, for the W/G to define the actual structure of sales consortia as they would likely have their own unique characteristics depending on objectives, company membership, product mix and other variables. The W/G also felt that flexibility was needed in the criteria so as not make it difficult and onerous for companies to come together. The ultimate goal is to consolidate the number of sellers going to market.
While criteria as to what constitutes acceptable consortia will have to be developed more definitively, such criteria would address such questions as:

- Does it significantly reduce the number of companies selling into the market?
- Does it represent at least 15% of the production of that specie?
- Does it have dedicated in-house sales/marketing expertise?
- Does it have a well-defined Quality Assurance regime?
- Is it a well-defined, legally structured entity with formal governance and operating procedures and requiring a multi-year commitment by its participants?
- Does it provide for expanded membership in future?

As an incentive to establish and maintain collaborative sales entities, government should also consider offering access to enhanced funding programs and services for sales consortia in the future (e.g. higher levels of funding in existing funding programs, and higher priority in accessing new processing licenses). Finding creative ways to nourish and support these entities will help make them viable and sustainable.

4 It is crucial that any forms of financial assistance from government be provided in compliance with domestic and international trade agreements.

While the W/G members strongly agree that the best and preferred approach to achieving the MOU sales and marketing objectives is through an incentives approach, if sales consortia are not formed within a reasonable period of time, the provincial government should consider, in consultation with industry, regulatory options within its jurisdictional powers to reduce the number of sellers going to market,.

We must recognize that a planned approach to bring processing companies together to collaboratively sell and market their products is a radical departure from the status quo. In the past, industry collaboration was generally when industry worked together out of need or in times of crisis. W/G members felt that there was a failure to sustain this collaboration because of the high level of competitiveness and inherent lack of trust within the industry.

Funding incentives and possible regulatory measures alone will not guarantee the implementation of sales consortia. Failure to deal with the industry structure may be a major hindrance to the development of collaborative sales and marketing entities, and the processors reiterated that the W/G TOR stated a change in marketing "is required as part of overall structural change."

The W/G also felt that greater transparency within sales and marketing efforts would be essential in building greater collaboration within the industry. To achieve this, leadership from all facets of the industry and the provincial and federal governments will be required to break down barriers from the past and build renewed trust within the industry.

5.2 Marketing Function

Issue/Challenge

The seafood industry, not unlike any other industry, is driven by consumers. The basis of successful marketing is having a consumer-focused marketing orientation – determining what consumers want and marketing products that meet those wants (e.g., quality, taste, convenience, nutrition, health, and value). Current sales and marketing efforts must be improved and consolidated. Failure to do this limits the ability to differentiate NL products from those of our competitors, to project the important attributes of our products to consumers, and to fully achieve the benefits that normally accrue to a dominant supplier in the marketplace (e.g., crab and shrimp). Increasingly, competitors in other jurisdictions (e.g., Iceland, Alaska and Norway) have the benefit of industry-wide branding and other marketing support initiatives.

Cause

In the processing sector, few companies retain any significant level of marketing expertise or fund marketing activities. As well, resource management regimes are not always aligned with marketplace realities (e.g., length of season, time of catch, and quality retention).

Solution

As an outcome of the MOU process, the fishing industry needs to commit itself to a collaborative seafood marketing effort. In addition, insofar as nature permits, restructuring and rationalization in the harvesting/processing sectors must include market-oriented measures to extend operating seasons and maximize fleet/plant capability to produce the highest quality products and to extend the periods these products are available to the market.

The W/G feels the Seafood Marketing Council proposed in the 2008 Report of the Seafood Marketing Review Panel (the Roche Report) should be revisited. This organization would allow the industry to work together to conduct market intelligence, develop and execute a marketing strategy, actively promote NL product in the marketplace, and share the mutual costs and benefits of improved and enhanced marketing of our products over the entire industry.

The council could help improve transparency and in doing so help build stronger relationships and collaboration, thereby reducing mistrust within the industry. W/G members understand the need for confidentiality requirements for proprietary corporate information. It is generally felt that active participation by harvesters on the council, as recommended in the Roche Report, would help accomplish greater transparency and trust in the industry. Industry stakeholders, particularly processors and harvesters, need to feel a sense of ownership in such an organization, so it is crucial to get buy-in from industry and active participation from key industry stakeholders.

Recommendation

A Newfoundland and Labrador Seafood Marketing Council, as recommended in the Roche Report, should be established in consultation with industry.[5] The W/G feels that the conclusions and recommendations identified in that report remain relevant today as they did in 2008.

The key activities of the Council as outlined in the report would be:

- *Market Intelligence/Industry Collaboration* - to collect and disseminate market intelligence and information to better enable processors to “go to market” each season in a more coordinated manner and to better sustain that coordination throughout the production/selling season;

- *Image Development & Product Promotion* - to develop and promote the image of the province’s industry as a supplier of quality seafood and to augment company marketing efforts with product promotion campaigns in selected markets;

- *Long Range Market Planning* - to facilitate and encourage industry focus on proactive longer range market planning; and

5 ASP has noted that it would not recommend the creation of a marketing council if it is to be the only or most significant outcome of the MOU process.

- *Public Relations* - to be the industry vehicle for dealing with market relevant public relations issues and opportunities.

The W/G feels that the staffing, budget, funding, structure and governance of the Council, including the composition of its Board of Directors, should be as outlined in the Roche Report. However, it is felt that a vote to proceed with the Council is no longer necessary and that industry, through an appropriate consultation process, should proceed to establish the Council as one of a number of outcomes of the MOU process.

The NL fishing industry, as represented by the Association of Seafood Producers and the Fish, Food and Allied Workers, in partnership with the Government of Newfoundland and Labrador will request financial support from the Government of Canada to establish and operate the NL Seafood Marketing Council. The W/G felt strongly that the establishment of sales consortia was an important step in enhancing the sales and marketing of our seafood products. Sequentially, it would be preferable, but not mandatory, to establish the Council after seafood sales consortia have been formed.

5.3 Summary of Recommendations

Sales Consortia

1. Seafood sales consortia should be established within the NL fishing industry.

2. The provincial government should work on developing two forms of financial incentives: (1) offsetting incremental start-up costs to establish sales consortia; and (2) enhancing for at least an initial period of time the working capital capability of the consortia.

3. The provincial government, federal agencies (e.g., Export Development Canada), commercial banks and sales consortia should collaborate to assist in the provision of inventory financing arrangements.

4. Further details on industry assistance should be decided through discussions with industry participants. Financial assistance should be provided for at least a three-year period to establish and operate the sales consortia. It should also be incremental to the costs associated with current sales and marketing efforts. Assistance should be considered for activities such as legal requirements to establish the entities, as well as marketing strategy development and implementation.

5. It is crucial that any forms of financial assistance from government should continue to be provided in compliance with domestic and international trade agreements.

6. There should be flexibility in the criteria to establish the consortia, so as not to make it unreasonably difficult and onerous for companies to collaborate. The criteria as to what constitutes acceptable consortia will have to be developed more definitively but should address such questions as:

- Does it significantly reduce the number of companies selling into the market?
- Does it represent at least 15% of the production of that specie?
- Does it have dedicated in-house sales/marketing expertise?
- Does it have a well defined Quality Assurance regime?
- Is it a well defined, legally structured entity with formal governance and operating procedures and requiring a multi-year commitment by its participants?
- Does it provide for expanded membership in future?

7. Government should also consider offering enhanced access to funding programs and services for sales consortia (e.g. higher levels of funding in existing funding programs).

8. If sales entities are not formed within a reasonable period of time, the provincial government in consultation with industry should explore regulatory options within its jurisdictional powers to reduce the number of sellers going to market. Such measures must be determined following a thorough analysis to ensure that the industry continues to comply with trade agreements and that the provincial government acts within its jurisdictional responsibilities.

9. All fishing industry organizations as well as the provincial and federal governments should collaborate to promote the merits of sales consortia within the industry.

Seafood Marketing Council

10. The NL Seafood Marketing Council as recommended in the 2008 Roche Report should be established in consultation with industry.

11. The key activities of the Council as outlined in the report should be: market intelligence/industry collaboration; image development & product promotion; long range market planning; and public relations.

12. The NL fishing industry, as represented by ASP and FFAW, in partnership with the Government of NL should request financial support from the Government of Canada to establish and operate the Council.

Other Recommendations

13. The priority with respect to the establishing sales consortia and the marketing council should be on crab and shrimp products. However, efforts should be made as opportunities permit to include other species such as capelin, lobster and groundfish species.

5.4 Additional Comments and Caveats

These recommendations should be implemented in line with recommendations from other Working Groups, particularly regarding harvesting and processing sector rationalization. The successful implementation of sales consortia and the Seafood Marketing Council as envisaged in the Roche Report will require change in industry structure and substantial horizontal and vertical collaboration within the industry.

FFAW feels that transparency is essential, particularly in the context of any processing sector rationalization, which has the potential to increase consolidation and thereby diminish competition for raw material. FFAW is therefore opposed to any plant rationalization program that is not implemented in conjunction with full transparency as to actual market prices paid for NL seafood products.

The processing sector disagrees with the FFAW position as stated above. They do not feel that plant rationalization will be so extensive as to result in only a handful of buyers. Furthermore, the consolidation of sellers into consortia will not change the number of processors competing for raw material.

All agree that a win-win situation must exist for harvesters and processors, which in turn will benefit the entire province.

6.0 Implementation Costs

The implementation costs for the W/G's recommendations including rationale and assumptions are outlined in Appendix F.

Appendix B

Association of Seafood Producers Inc. (ASP)

Newco Proposal

Information excluded at the request of ASP.

Appendix C

Beothic Fish Processors Limited

Sales Consortia Concept Proposal

PROPOSED MARKETING STRUCTURE

Submitted to: Marketing Working Group

Submitted by: Beothic Fish Processors Limited

November 23, 2009

General Overview

As part of the recent Memorandum of Understanding between the Association of Seafood Producers (ASP) and the Fish, Food and Allied Workers Union (FFAW, and the Department of Fisheries and Aquaculture (DFA), the marketing Working Group has been tasked with developing various structural options for the marketing of Newfoundland and Labrador's seafood. ASP has proposed a model based on a single marketer. However, a significant number of ASP members do not agree that a single marketer is practical or feasible, particularly if the proposal requires mandatory participation by all processors. Beothic understands fully the value of consolidated selling and indeed has participated in such activity for several decades. Most of the processing sector and the FFAW seem to be unanimous in their belief that less marketers is the best option. However, Beothic does not believe that making it mandatory to market our products through a single marketer is the best option for the industry. Beothic is one of the companies that strongly believe that many of the objectives of consolidated selling can be achieved by selling through a limited selection of multiple marketers with closer collaboration among marketers via a coordinating vehicle. This option provides a more palatable solution to those who absolutely disagree with the mandatory, single marketer option and is a more viable solution for a variety of reasons. These reasons include

- Legal obligations with existing marketing organizations – Beothic owns part of a marketing company Atlantic Queen Seafoods Limited (AQS) that has been around for more than 40 years. It has recently signed a long-term agreement with Whitecap International Seafood Exporters Limited to have Whitecap manage AQS on behalf of its shareholders. Prior to Whitecap's incorporation Fishery Products International was the exclusive marketer/manager of AQS;
- AQS markets significant quantity of product from outside Newfoundland;
- Our partner in AQS is from New Brunswick and is not a party to the discussions taking place in Newfoundland nor are they particularly interested;
- The competitive nature of our industry does not provide reason for optimism that processors can co-exist within a single marketing company;
- A single seller of crab and shrimp from Newfoundland does not provide sufficient choice to larger customers who, as a matter of policy, will not purchase their needs through a single supplier;
- A limited multiple marketing environment will encourage and stimulate product improvement and market development moreso than a single selling environment;
- The timeframe for such a drastic rationalization of the number of marketers and the establishment of a new marketing company is simply not feasible; and

- The link between marketing restructuring and processing rationalization has not been clearly defined.

Seafood Market Council

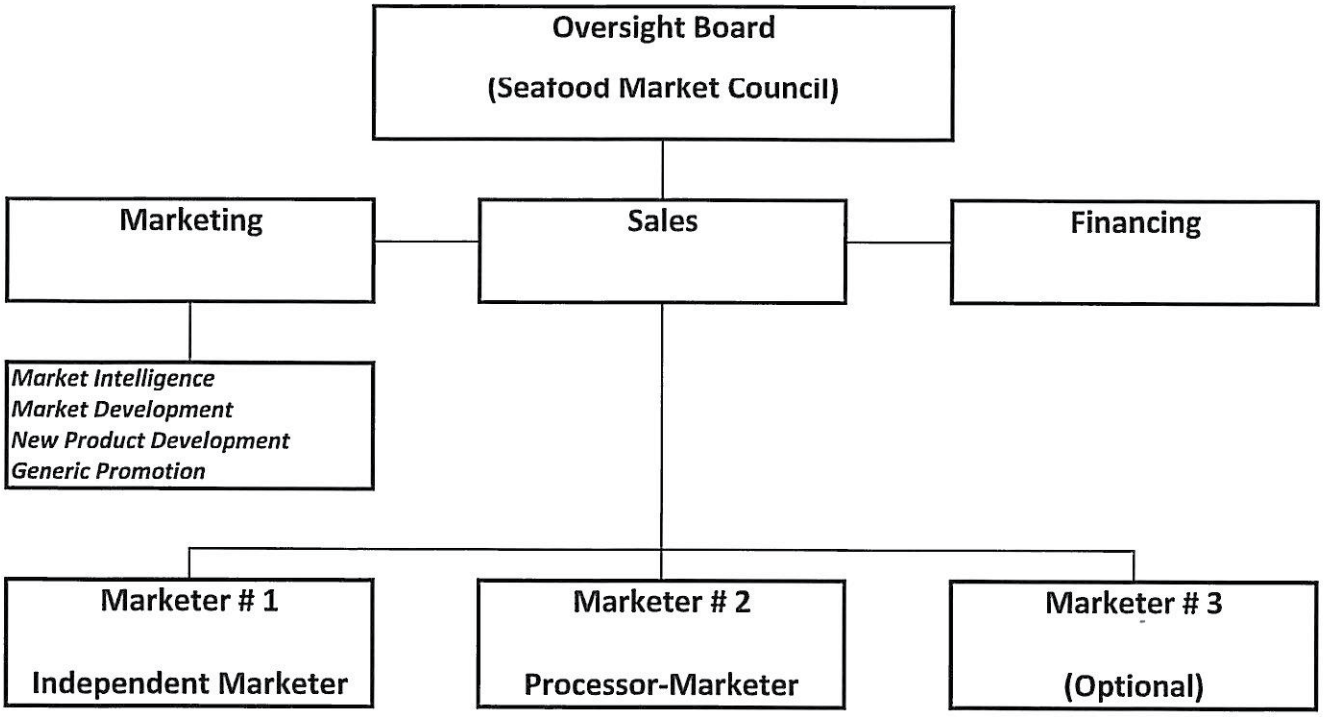
The SMC could be used as an overview body which provides a forum for managing and communicating the marketing and sales strategy for all crab and shrimp products. This forum would be the coordinating vehicle in a multiple marketer environment. The SMC would have representatives from ASP, FFAW, DFA and SPNL. The SMC function would be divided into three (3) distinct areas – Marketing, Sales and Financing. All marketing areas would report back to the central oversight board (SMC). Information would be reported on the key commodities, and would include lbs produced and revenue generated by market. Proprietary information on any specific company would remain confidential. The SMC could also get involved in issues related to tariffs, FDA regulations or any other issue of general importance to the industry.

Marketing: Marketing would deal specifically with tasks, issues and initiatives that are general in nature and for the benefit of all producers. The outcomes or specific benefits can often be difficult to quantify. Activities undertaken would include market and product development, generic promotion of NL seafood, and especially, gathering of market intelligence.

Sales: This area would involve the actual sales of product and the coordination between marketers to ensure that the maximum value is attained. All sellers/marketers must be evaluated from a sales force and financial capability perspective. The concept is built around consolidating the production of a number of processors, preferably under common brands, and selling the combined production through up to three (3) approved sales arms. The objective is to eliminate or mitigate predatory sales practices. Processors would have to ***voluntarily*** choose one of the approved marketers. It is recognized that the fewer the number of brands being used the better. This would provide the needed consolidation while still providing sufficient choice to customers (and processors also). All packers would be subject to ***strict quality control*** guidelines and must agree to abide by the specifications outlined for all processors. This would be monitored by the marketer's QC department and/or DFA's monitors. All results of sales would be reported to each processor in aggregate and individual format in a ***transparent*** manner.

Financing: As often our production season is compressed in comparison to our selling season, it is imperative that the marketers be capable of holding inventory for long periods and that processors be shielded somewhat from ***distress selling*** through the provision of a financial safety net. Processors falling below an arbitrary production threshold would be permitted to receive a partial payment up to 70% for their season's production with the remainder coming no later than 30 days after the product is sold. Larger processors who hold a greater % of provincial production would ***pool*** their product and receive a portion of each months sales equal to their percent of the pooled product. It is acknowledged that a system of financial advances upon production and settlements upon selling would have to be offered to the larger processors as well to encourage their participation in the consolidated selling approach.

Conclusion: It is Beothic's belief that the marketing objectives of consolidated selling can be achieved by going to market via a limited number of marketers while at the same time providing an appropriate mechanism such as the SMC to coordinate industry strategy and that this alternative provides a more palatable and attractive option to the greater majority of industry than a mandatory single selling approach.


Oversight Board
(Seafood Market Council)
Marketing
Sales
Financing
Market Intelligence
Market Development
New Product Development
Generic Promotion
Marketer # 1
Independent Marketer
Marketer # 2
Processor-Marketer
Marketer # 3
(Optional)

Appendix D

Seafood Marketing Review Panel

Report of the Chairperson, Alexander (Sandy) Roche, 2008

Seafood Marketing Review Panel
Report of the Chairman

Alexander J. Roche

February 2008

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Foreword

The essence of my assignment from the Minister of Fisheries and Aquaculture was to consider ways in which a seafood marketing council could help address the key marketing challenges faced by the Newfoundland and Labrador fishing industry (excluding Aquaculture).

At the outset of my work a three person Seafood Marketing Review Panel was struck to act in an advisory capacity with me as its Chairperson. Members of the panel were Derek Butler, Association of Seafood Producers; George Joyce, Seafood Processors Association of Newfoundland and Labrador; and Earle McCurdy, Fish, Food and Allied Workers Union (FFAW-CAW).

All three were extremely helpful and responsive to me throughout the course of my work and especially so at the beginning when I was in need of reorientation, having not been actively involved in the industry at the time of taking on this assignment. I nonetheless undertook my terms of reference independently, and took the requisite latitude to form my own opinions and reach my own conclusions, for which I take responsibility.

I would be remiss if I failed to acknowledge the assistance readily provided by the staff of the Department of Fisheries and Aquaculture. Everyone to whom I came for assistance of one kind or another was most obliging. I am especially indebted to Sean Barry, Wanda Lee Wiseman and Brian Delaney. My thanks also to Rose Ledwell whose secretarial skills transformed my final report into a professionally prepared one.

Section I: Summary and Outline

Summary

One of the outcomes of the Fishing Industry Renewal Process was a proposition that a Newfoundland and Labrador Seafood Marketing Council would be a worthwhile initiative. This was based on the perceived need for more collaborative marketing.

Since, de facto, the processing sector is the sales and marketing arm of the industry I had assumed, very much incorrectly, there would be general support for this initiative amongst the companies comprising the sector.

Having conducted over 25 interviews with members of the processing sector I am unable to determine from whom or how this proposition arose. No one wishes to be acknowledged as having proposed it. So I found myself having to ask companies, irrespective of how the idea came about, do you feel it would be a worthwhile endeavor? I also asked the same question of myself.

The response to this question from companies was an overwhelming - no! Some companies put their response in the context that there are many important issues to be addressed in this industry and a marketing based initiative is not near the top of that list. Others, I think, were influenced by the current black cloud of mistrust that seems to hang over the industry. Many felt that the decision to have such a Council was already made and thus to express any kind of support for the idea would only enable government to feel legitimized.

As for my response to my own question, I have convinced myself there could be considerable merit in having an industry wide sales and marketing related entity and hence I have made such a recommendation. However, I emphasize the words “could be” because in making my recommendation I realize all too clearly there are a number of realities that must be understood, accepted, and gotten around by all involved before such an entity should even be created let alone have a chance to succeed.

The idea of a Newfoundland and Labrador Seafood Marketing Council is not a new one. An organization of the same name and purpose was brought into existence in the 1990’s. It had marginal impact and eventually fizzled out.

When viewed against the above background, the recommendation to try and establish a similar type organization again is not an obvious one. This report will explore the matter in considerable detail and give grounds for the positions taken.

Outline

Section II begins with a brief description of what is normally meant or should be meant by the word marketing. This section also endeavors to distinguish marketing from selling since the two words were so commonly and inappropriately interchanged in most of my interviews.

Section III describes the two organizations placed before me as possible models for a similar undertaking here, namely the Alaska Seafood Marketing Institute (ASMI) and the Norwegian Seafood Export Council (NSEC). In my interviews, I found most companies were unaware of these organizations. Amongst those who did have a fair knowledge of either one or the other, there were a number of misconceptions that I have addressed.

Section IV is a summary of the interviews I had with members of the processing sector. Rather than provide a long list of the comments made to me I decided to synthesize the common threads into my own words. In so doing I may have lost some of the colorfulness with which they were delivered but hopefully that is offset by a sharper focus on their substance.

Section V is my attempt to fulfill the section of my terms of reference that required me to identify what are the key marketing challenges faced by the Newfoundland and Labrador industry. I found this to be a particularly challenging part of this assignment, for two reasons. First, when I relayed the question on to those I interviewed their answers had more to do with the industry's pressure points than with marketing challenges per se; second, it was hard to describe market challenges without describing the markets themselves which made the section longer than I would have liked; and finally, my own absence from the industry for a number of years, while an advantage overall in this assignment, worked against me in this particular section.

Section VI contains the basis for my recommendation that we try once again to have a sales and marketing related industry body (subject to the caveats laid out in Section VIII). For want of a better name I would continue to call that body the Newfoundland and Labrador Seafood Marketing Council.

Section VII outlines my suggestions regarding the mandate and key activities of that Council. It also speaks to what the Council may hope to accomplish along with my thoughts on funding and staffing issues.

Section VIII outlines three industry realities that must be recognized, the existence of which shapes my recommendations on the structure of the Council and the manner in which it might be implemented.

Section IX contains observations on some matters not covered in the above and my conclusions.

Section II: Marketing versus Selling

As I went through this assignment, I found that the word marketing had many different meanings depending on who was using it and what was being discussed. The word was used in widely varying contexts and often to describe an activity or function that it was never meant to describe. To some it is just a buzzword for advertising and promotion while others used it to refer to product information materials. The most common occurrence was the use of the words marketing and selling as if they were synonymous. I feel it necessary, therefore, to differentiate between the two, or rather, to try and see how they are supposed to be differentiated.

As any first year business school student would know, marketing in its simplest and unadorned sense occurs when one exchanges something of value for another thing of value. In our case it would most commonly be money for food. A marketer, then, is a person or organization who desires to make an exchange and a market consists of people or organizations with wants or needs to satisfy, money to spend and a willingness to spend it. In summary, markets are composed of customers and marketing is the process of satisfying customer needs and wants through an exchange process.

So far the distinction between marketing and selling is not highly contrasted. However, when you look at what constitutes a marketing program the difference starts to emerge. A marketing program consists of a product, a pricing structure, distribution systems/ channels and promotional activities. Selling, along with pricing, packaging etc. are only components of a marketing program.

Modern day marketing implies a customer first orientation throughout all the activities of an organization with the ultimate objective of achieving customer satisfaction. It is an integrated approach throughout an organization. To repeat, marketing encompasses selling. The two are not synonymous. Some basic differences may be described as:

- Selling is oriented to what is available and the organization's needs - marketing is oriented toward the customer's needs and how these can be satisfied;
- Selling is about finding a home for the product you have produced - marketing is about how to produce, deliver and communicate to a customer that your product can be relied upon to satisfy their needs;
- Selling is volume oriented - marketing is profit oriented;
- Selling focuses on the short-term, move product, etc.- marketing focuses on longer-term, relationship building, repeat business, new products, tomorrow's markets and future growth;
- Selling is about closing a purchase and sale transaction with a customer - marketing is about creating new customers and maintaining existing ones;
- Selling is about the seller-marketing is about the customer.

Marketing also involves a continuing evaluation of and sensitivity to changing market environments. In the case of our industry, this would include such things as changing concerns for the environment, evolving attitudes towards healthy eating, cultural changes in market composition, actions by our competitors, the implications of technological innovations, foreign exchange developments and so on. Assessments of ever changing market environments can lead to adjustments in or a complete restructuring of a marketing program.

The above brief (and admittedly somewhat academically oriented) discussion of marketing versus selling will undoubtedly provoke mixed reaction amongst industry participants. A valid question it might raise would be this - does marketing as described above have any relevance in an industry whose output is determined by uncontrollable natural forces and where the stages of production are not integrated? That, of course, is the key question underlying this report.

Section III: Other Models - ASMI and NSEC

Two of the more recognized seafood marketing organizations are the Alaska Seafood Marketing Institute (ASMI) and the Norwegian Seafood Export Council (NSEC).

The mandate of both of these organizations is essentially the same - to generically market and promote worldwide seafood from their respective regions. Both are export oriented but ASMI also has a major focus on the U.S. domestic market given its size. Neither organization is involved in direct selling.

Both organizations also carry out their generic marketing role in much the same way with emphasis on branding and product promotion.

Branding: This involves creating positive awareness and recognition of Norway/Alaska as the place of origin for high quality seafood. In positioning their respective brands both make extensive use of consumer appealing images - seafood from clean, cold, wild, natural, unpolluted environments, and both highlight commitments to resource sustainability.

Both also consider their generic brand to be like an umbrella brand, i.e. one that has more consumer awareness than could be obtained by any single company brand yet allows individual company brands to piggy back on its success. The Executive Director of ASMI, drawing on his former career with the U.S. Coast Guard, expressed it to me quite graphically by comparing the Alaska Seafood Brand to the icebreaker that forges the way for other ships to follow.

Both organizations have their highly visible, trademarked, brand logos that they encourage members to use for co-branding purposes.

Both are very protective of the image of their respective brands and of the family of seafood products associated with the brand. Each seeks to be proactive and quickly responsive to any publicity potentially negative to that image. NSEC, in particular, has a dedicated crisis management team, which monitors media and other sources to identify and manage industry's response to negative stories about Norwegian seafood.

Product Promotions: In alignment with their respective industry members, both ASMI and NSEC are very actively engaged in product promotions. These are structured with retail grocers, restaurants and even food service distributors each of whom benefit from increased volume movement during the promotions. ASMI/NSEC provide the point of sale materials, advertising support, in-store demos, cross branding with wine companies etc. in support of the promotion. In effect they remove from the retailer et al. a lot of the effort and cost involved in a promotion and provide the pull for the products being promoted.

Both organizations claim they have more success getting retailers et al. to conduct product promotions than would individual member firms since the latter focus on selling product which in turn leads to a focus on price. Once a product promotion has been largely structured and member companies come in behind with product for the promotion, price becomes less of a focus.

The branding and product promotions activities of both organizations are complimented by public relations activities, trade education, sponsorship of culinary events, feature articles in relevant trade magazines, trade show participation and so forth.

Market Intelligence: Both organizations collect and disseminate market intelligence to members on a regular basis covering such topics as prices, trends, competitive activity, currency movements and similar issues. Special analysis of new markets, products and opportunities are regularly conducted and distributed to members.

Both ASMI and NSEC are government legislated, independently operated, processing sector controlled, mandatory membership bodies.

ASMI has a seven person Board of Directors. Five must be from processor companies (and one of these must be from a small sized company as defined). The other two must be commercial fishers.

NSEC has an eight person Board of Directors of which at least five and invariably six are from processor companies. There is also one each from the fishers and plant workers organizations.

Both ASMI and NSEC have in place formalized internal structures and mechanisms to ensure their activities are directed by and remain relevant to their respective industry members.

The funding available to each of these organizations is considerable. NSEC has a budget in the order of $42 million Can., coming entirely from industry, mostly from an export levy. This levy varies by product within a range of 0.2% to 0.75% of export value. In 2006 Norway's seafood export value was about $6.6 billion Can. so the levy averaged approximately 0.6%. By comparison, the value of this province's seafood exports in 2007 was about $670 *million. The same levy here would generate funding from industry of about $4 million. It should be noted, however, that applying the Norwegian species levies to the province's species mix and values would result in a lower total levy of roughly $2.2 million.

ASMI's budgets have been in the range of $15 to $18 million U.S. of which about half comes from industry and the balance from some combination of the two levels of governments, State and Federal. The industry portion is derived from a levy of .5% on the landed value of each company's fish purchases. In 2006 the total Alaskan seafood harvest was valued at about $1.4 billion U.S., generating industry assessments totaling over $7 million U.S. Again by comparison, the value of this province's seafood harvest in 2007 was about $350* million. The same levy here would produce funding from industry of about $1.8 million.

I thought it would be worthwhile to try and get a feel for how these organizations are perceived by the industries that they serve. Any sort of formal, widely based survey was not practical, but I did contact either personally or through associates just under a dozen Norwegian companies of various sizes and species focus to ascertain how they viewed NSEC. Based on this albeit small sample, there was a high degree of satisfaction with the work of the Council. I found it very interesting that even the companies in highly consolidated sectors of the Norwegian Seafood Industry still felt there was a need for an industry wide organization to carry out generic marketing and other sales and marketing related functions on behalf of the industry as a whole.

With regards to Alaska, I discovered that in 2004 the Alaska processors were given the opportunity to vote on whether or not to continue the industry assessment that provides the core funding for ASMI. This was essentially a vote on whether or not the organization should continue. The processors voted not only to continue but also to raise their assessment from 0.3% to its current 0.5%. In return the organizations governing structure was streamlined and the processing sector given greater control over the activities of ASMI.

I think it is relevant to note that neither of these two organizations was put in place because their respective industries felt the need to have the activities and services these two organizations now provide. ASMI was formed over 25 years ago in the aftermath of a botulism scare that devastated the Alaska salmon industry. It was a public relations effort to rebuild consumer's confidence in Alaska salmon products.

* Excludes values of offshore shrimp and surf clams and seals.

NSEC was formed in 1991 when Norway was forced to rationalize its heavily subsidized seafood industry in the face of the growing European Economic Union. Previously, Norway had a dozen or so marketing or quasi-marketing boards for different species/products which led the industry into a number of embarrassing instances of huge inventory stockpiling. NSEC was put in place to help the Norwegian industry make the painful transition to non-subsidization. There was no clear vision at the time as to what this new organization should actually do and few would have expected it to grow beyond its initial staffing of a half dozen people.

The key point here is that " yesterday's" processing industry in both these countries did not explicitly see the need for the activities currently carried out by these two organizations but "today's" processing industry supports (and indeed pays for) these activities stemming from the advantage of having had time to see the benefits that come from them.

Many I talked with assumed these organizations have a quality monitoring function on their members. I did not find that to be the case. Both ASMI and NSEC conveyed to me the sense that quality control issues are the domain of government regulatory departments/agencies and individual companies. When asked, "How do you prevent member companies from bringing poor quality products to market?" their response was they don't. They feel that those who produce poor products don't long survive, that most major buyers have common sense enough to know that one company's poor product does not taint the whole industry and that, particularly in Europe, the retail chains are very demanding and technically capable of avoiding poor quality suppliers.

A final note in relation to NSEC - a number of people have highlighted to me that NSEC controls the issuance of seafood export licenses in Norway and by inference the number of exporters. While it is true companies cannot export without a license issued from NSEC, it is also true that NSEC issues these licences without any real restrictions. If a company applying for an export license has met all the relevant government regulatory requirements the issuance of an export license is pretty well automatic.

Section IV: The Processing Sectors Viewpoint

During the course of this assignment, I met with over twenty-five people from thirteen companies in the processing sector. The companies were both large and small and were from all regions of the Island and from Labrador.

Each company, without exception, readily agreed to meet with me, had their key people in attendance and allowed the meetings to occur uninterrupted and for whatever time was necessary. I solicited their views on issues of marketing, the marketing challenges faced by the industry, the need, if any, for a marketing Council of whatever nature, and the possible structure, governance and financing of such an organization were it to come about.

Rather than list all the comments made and points raised in these interviews I have tried to summarize below the common threads of the discussions. I hope that the people with whom I met will, upon reading this report, concur with my synopsis (for which I nonetheless take full responsibility).

By far the most common and intensely held view was that the industry is circumscribed by structural problems of which marketing or the lack thereof is by no means the one that should be given priority.

Priority should first be given to addressing issues such as: too many plants; too many fishers; lack of vertical integration; vessel size restrictions; the manner and time we catch certain species; and how raw material prices are determined, etc.

It is beyond the scope of my assignment to go into a lengthy description of these and the other structural issues raised and, in any event, the issues are well known and have been thrashed about in many forums on many occasions. Suffice to say that it is a strongly held view of the industry that these structural impediments have marginalized both our processing and harvesting sectors and have prevented the kinds of industry modernization and renewal that has and is occurring in our competitor countries.

The industry feels failure to address the structural problems above has resulted in an industry with the following features that are relevant to how it conducts sales and marketing:

- Too many companies which in turn leads to fragmented selling;
- Too few bigger companies with sufficient size to have a proper and adequately funded marketing function;
- Too many smaller companies lacking the financial ability to inventory product and lacking any in house sales capability and hence the extensive use of brokers;
- An overriding preoccupation with competition for raw material which lessens the attention on other business functions, i.e. marketing, and militates against industry cooperation in other areas, i.e. marketing;
- The fishery for some species not being conducted when the quality is best for the consumer;
- The harvesting of major species being compressed to a point where a processor's ability to preserve quality and produce the best-finished product is severely taxed, and the requirement for working capital greatly increased; and
- Fishers who would be willing to fish a longer season and/or have better on board handling equipment being effectively barred from acquiring the kind of vessels needed due to vessel size and other restrictions.

When I asked individual companies to outline their specific market challenges the response would invariably revert back to the structural problems of the industry and to the issue of fragmented selling and destructive pricing. The latter issue was mentioned by all, but opinion on the magnitude of the problem varied. Some of the companies with a large presence in a particular species felt it wasn't a significant issue. Most, if not all the smaller companies, felt it was indeed a problem

With a few notable exceptions most companies possessed only a very general awareness of the Alaskan and Norwegian seafood marketing organizations, assumed incorrectly that they were government financed and couldn't perceive their generic marketing activities to be of much tangible value to their members.

The notable exceptions were very much aware of the work of these organizations, felt that they did add a significant dimension to their respective industries, and felt there are voids in our marketing efforts that could possibly be filled by some similar type of organization here.

Every company I talked to expressed the concern that government(s) will unilaterally impose some kind of marketing initiative on the industry irrespective of the industry's views. Quite a number feared it might even be a marketing board with single desk selling etc.

Needless to say, given all the above and the general lack of enthusiasm for the notion of a Marketing Council, one could have guessed the reaction to suggestions of an industry wide levy to fund it and having harvester involvement in the governance of it were negative.

Section V: Markets and Market Challenges

The following review of markets is meant to be more qualitative than quantitative. In some instances the statistics quoted may not be the most currently available. However, I am certain that where that may be the case, the use of the more up-to-date data would not have significantly altered the wording of the market review in question nor the market challenges identified.

Shrimp

The global catch of *Pandalus Borealis* is now probably less than 430,000 metric tons (MT) of which about 270,000 MT is landed for the purpose of cooking and peeling (C&P). About half of this amount is the so-called industrial component of the frozen-at-sea shell-on offshore fisheries and thus it becomes twice frozen C&P product. Approximately 130,000 MT is landed in a fresh state and becomes once frozen C&P

product. Canada has by far the largest share at around 100,000 MT of which approximately 65,000 MT is processed in this province.

Newfoundland and Labrador is a relatively new entrant into the world's C&P markets on a major scale. The genesis of its entry was the explosive growth of the shrimp resource here in the 1990's and Government's decision to allocate the bulk of that growth to the inshore fishery on the North East Coast. Prior to that the C&P markets were the domain of three main players - Iceland, Norway and Greenland. Canada now has about one third market share and the other three supplying countries each have a little fewer than twenty percent market share.

The consumption of C&P coldwater shrimp essentially occurs in northern European countries with the United Kingdom being by far the biggest single market at about 40% of the total world consumption. Norway, Sweden and Denmark each comprise five to ten per cent of total consumption. The European market is predominantly a retail market.

From a marketing perspective, it is interesting to note that the northern European country with the highest population, Germany, consumes barely 5% of world supply. Also, the United States with a population close to all of northern Europe, and the world's largest shrimp consumer, accounts for less than 13% of world consumption of C&P coldwater shrimp. Canada with one tenth of the US population consumes almost half the quantity the U.S. does.

The European Market – Three Quarters of the Global Market

The dominant factor for Newfoundland and Labrador companies supplying C&P shrimp to Europe has been the 20% EU tariff and the relative strength of the Canadian dollar against the currency of its key shrimp markets. Recently the volume that can be exported to the EU at the reduced tariff rate of 6% was substantially increased from 6,000 to 20,000 MT.

The UK – The Single Biggest Market

The retail "multiples" comprise about two thirds of the total C&P market in the UK. The product forms at retail are frozen consumer packs, chilled modified atmosphere packages, bulk shrimp defrosted in the fresh fish counters, sandwiches, cocktails and as a component of ready cooked meals.

The large chains have long-standing supplier relationships with C&P producers in Iceland, Norway, Greenland and the Faroese. Breaking into this established network of users/suppliers has been a formidable challenge to nascent Newfoundland & Labrador producers operating from an artificially imposed 20% cost disadvantage. In addition, these chains have very high food safety standards and specifications which supplier plants must be capable of meeting and must be fully audited and approved by the retailer or its agent. This requires significant added capital costs and adoption of rigorous operating procedures. Although all the shrimp peeling plants in this province are of recent

construction only a few were constructed from the start with this important market segment in mind. There are still plants not approved.

Sales to UK retail customers by Newfoundland and Labrador suppliers have shown a steady albeit unspectacular increase, an increase that unfortunately is not commensurate with our resource growth nor our relative size in the global coldwater shrimp industry. Those companies that have targeted this important segment and have made the requisite plant investment and have presence in the local market have reaped increases in both volume and higher returns.

Scandinavia - A Quarter of Global Consumption

A product form known as brine cured shrimp dominates the market for C&P Coldwater shrimp throughout Scandinavia. As its name suggests the product is marinated in a low Ph brine solution that gives the product about a two month shelf life. The brining process works much better with once frozen raw material and hence briners specify and buy only once frozen product.

This is a fortuitous situation for Newfoundland & Labrador processors who produce mostly once frozen product. Greenland is also predominately a once frozen producer and is therefore a major competitor country that has duty free access to the EU. Production and marketing is carried out through the state monopoly corporation, Royal Greenland, which also operates one of the largest brining plants in Europe. Royal Greenland also has a C&P shrimp plant here in Canada.

Observations: From a marketing perspective, I make the following observations with respect to the European market:

- Europe is our dominant market but it is a mature market;
- The price of C&P shrimp has been in steady decline since Newfoundland and Labrador became a significant supplier. A slight recovery occurred in 2007;
- Our main competitor countries each go to market through considerably fewer entities than we do. This is because of industry consolidation, the use of marketing consortia, and in the case of Greenland the existence of a state monopoly. Our industry goes to market with more entities and with greater use of middlemen - a situation that is exacerbated when viewed in a Canadian context because of the additional players in the Gulf. As an industry we have lacked the solidarity and conviction necessary to bring about the market impact that a major supplier normally can achieve. It could also keep us from gaining the maximum advantage from the current and anticipated weakening supply situation in our competitor countries;
- The 6% reduced tariff rate only applies to product used in the EU for further processing. A fairly detailed documentation trail is required for product to qualify. Only a few Newfoundland and Labrador producers have their own logistics capabilities inside the EU. Most sell ex-plant to their European

- middlemen and thus lose control of whose product is used for what purpose which could limit the benefits from the expanded ATRQ; and
- The pending approval by Marine Stewardship Council (MSC) of the Newfoundland & Labrador shrimp fishery could be leveraged strategically by targeting the environmentally super-sensitive retailers in Europe, particularly those in the UK.

The North American Market – Underdeveloped

▪ The United States

Americans are huge per capita shrimp consumers. However, they are predisposed towards the much larger warm water species. Coldwater C&P shrimp represents about a paltry 2% of total U.S. shrimp consumption. Most sources I have consulted contend the major market channel is at retail especially on the west coast where there is a local coldwater shrimp fishery.

Only one Newfoundland and Labrador company has made a concerted and sustained effort to enter the U.S. market with a branded product supported by a structured marketing campaign. It achieved significant volume growth at acceptable margins, but I am given to understand their allocation of product to the U.S. market has been curtailed due to exchange rate and other factors. Interestingly, the major market channel for their product was in the foodservice arena, not retail, which probably speaks to what can be done with a sustained marketing approach. In the food service sector C&P is mostly used as a component in a food serving or as an ingredient for ready meal manufacturers and tends to compete with the smaller sized warm water species.

Coldwater C&P shrimp has many significant attributes over its comparably sized warm water species. It is wild caught, in icy cold clean waters, has a natural versus an artificially induced pink color, tastes better and so forth. As with the situation in Europe, American retailers are also becoming more eco-sensitive and the pending MSC certification referenced above offers a real opportunity to differentiate our shrimp from the environmentally challenged warm water varieties. With adequate and sustained marketing support it could easily be elevated to its own category and command higher returns.

The U.S. is our most natural market in many respects, given it is duty free, transportation costs are low comparatively, overall logistics are simpler, regulatory requirements fewer and so on. It is also an underdeveloped market for coldwater shrimp as opposed to the much more mature European market.

To develop our superior product to its potential in our most natural market would require that we commit to making it happen and commit product for it to happen. We may have to be prepared to periodically forgo short term better returns in other markets due to fluctuating exchange rates and other factors.

- **Canada**

In our domestic market, consumption of coldwater C&P shrimp remains fairly static. The strongest demand is in Quebec and British Columbia, with Ontario having the weakest demand on a per capita basis. The product form is mostly IQF bags of various weights. The largest market channel is food service and within that channel it has an increasing utilization as a component in home meal replacement type products. As in the U.S. similar size warm water species are the primary competing product.

Canada too has to be considered an underdeveloped market. Increasing concerns with food safety on imported shrimp from China and other countries represents a significant, currently unexploited opportunity to advance the positioning of the product relative to its competition. The Canadian market obviously has no foreign exchange issues and in this age of currency volatility and uncertain net returns, the Canadian market presents a very attractive target for market development with a proper marketing strategy.

Crab

The world supply of snow crab is considered to be about 150,000 MT. While this comes from six countries, for the most part, Canada and Alaska have always dominated world supply with one replacing the other as the dominant supplier.

Alaska has had the more volatile supply swings. Recently its catch has been under 20,000 MT but that will increase in the current year to the 30,000 MT range. In the past Alaska has had the ability to supply almost 150,000 MT in a single season.

Currently Canada holds the top position supplying about two thirds of world consumption. Newfoundland and Labrador has been the dominant Canadian producer in the past decade or so. Recently landings have been around 50,000 MT following a peak of 62,000 MT in 1999. The Gulf region has been supplying in the order of 40,000 MT.

Sections are the dominant product form and there are essentially two customers - the United States and Japan. In the U.S. the demand trend was upward until high prices impacted consumption in 2004. Canadian snow crab has filled in the void left by the major decline of the domestic Alaska fishery. In Japan the demand trend has been downward because of general economic conditions. The Russian crab fishery, that is unregulated and currently the subject of much international scrutiny, has also negatively impacted Canadian imports.

- **United States**

In the U.S. snow crab sections are consumed at both retail and foodservice. In both market channels it is a volume mover. Foodservice customers are buffet houses with an all you can eat venue, casinos, mid priced restaurant chains and Asian cuisine eateries. At retail most snow crab sections are sold on promotion.

Supermarket chains seem to have concluded that a low margin/high volume combination works best for this product.

In both market channels, conventional wisdom, expert advice and most persuasively, history, has shown that as the wholesale price of sections approaches the $3.75 U.S. range, the product ceases to be able to return to both retailers and the big usage restaurant chains the margin they require at an end price their customers are willing to pay.

- **Japan**

The Japanese consume snow crab in section form and as meat primarily for the sushi market. The meat extraction is increasingly being carried out in China and other Asian countries. Snow crab sold at foodservice in Japan is generally to higher end restaurants than in the U.S. and at retail it tends to be seasonally featured. Live and frozen snow crab from the uncontrolled Russian crab fishery is highly prized in Japan and it has virtually replaced the once highly desired gas frozen sections from the Gulf.

Observations

There have been so many reports, studies, presentations, analyses and commentaries on the Newfoundland and Labrador (and Atlantic) snow crab industry that I find it difficult to word any observations of my own without plagiarizing on the wording of similar observations made by someone else. The report that I felt best captured in substance and wording the points I would have made in its absence is the Gardner Pinfold report of June, 2006 entitled Overview of the Atlantic Snow Crab Industry

The wording of the following points is largely drawn from that report:

- Newfoundland and Labrador's 35 odd processing plants (and Atlantic Canada's 80 plus processing plants) mostly produce a single product; crab sections;
- The industry relies on two markets, the U.S. and Japan and more so the former. Such high dependence on a market as narrow, commodity based and price sensitive as the U.S. leaves processors and thus all industry stakeholders in a vulnerable position;
- Industry structure creates a competitive environment that subordinates the processing and selling of crab to raw material supply pressures. Short processing periods and the resulting peak working capital requirements result in the processors need for immediate sales which is pursued in many cases through brokers/distributors some of whom prey on their cash flow pressures. All this leaves little room for individual companies to engage in market or product development;
- Newfoundland and Labrador (and Atlantic Canada by extension) should be able to exert more market power given the amount of crab it controls. While possible, it is unlikely unless the industry were to approach the market with a more united

front on product supply and pricing issues. The industry would need to behave in a less fragmented way - seeing the competition not as each other but as suppliers of substitute products and the importers/distributors who handle them; and

- Looking ahead, the major concern on the horizon for Newfoundland and Labrador (and Atlantic Canada) is likely to be a recovery of the Alaska fishery.

The observations above beg this key question- should Alaska reemerge, as is probable, a more major supplier of snow crab to the world market, how would the Newfoundland and Labrador industry be positioned against that competition? The following points are relevant:

- Newfoundland and Labrador has over **3000** vessels engaged in the crab fishery. (Atlantic Canada about 4,000). Alaska's crab fleet has been reduced through Government financed loan buy-out programs from about 280 to about **80** vessels;
- Newfoundland and Labrador has **35** crab processing plants. (Atlantic Canada over 80). Alaska has about **15**. (including mobile plants)
- Newfoundland and Labrador has **28** companies bringing crab to market (Atlantic Canada probably in excess of **55** companies). Most Alaskan crab is sold through **4** companies.
- Most Newfoundland and Labrador (and Atlantic Canada) crab suppliers go to market through intermediaries. Alaskan suppliers sell direct to end users or final stage distributors;
- The Alaskan companies supply their crab customers in both Japan and the U.S. with significant other seafood products, including other popular crab species. Few, if any, Newfoundland and Labrador (or Atlantic Canada) companies can do so to the same extent;
- Two of the four Alaskan companies are Japanese owned;
- Alaskan snow crab, as a rule, tends to have a better color than some Newfoundland and Labrador crab and it is generally 1-1.5 oz larger; and
- Alaska has an industry wide marketing organization, which promotes its snow crab under the Alaska Seafood umbrella brand and undertakes product promotion campaigns with major snow crab end users. Newfoundland and Labrador (and Atlantic Canada) has no similar marketing activities in support of its product and seems to be content having its fortunes in the market dictated solely by crab supplies.

Caplin

In recent times caplin supplies have come from three countries - Canada, Iceland and Norway. Newfoundland and Labrador is essentially the sole producer in Canada. Norway, having flooded the caplin market three years ago, hasn't had a fishery since. Currently, Newfoundland and Labrador at about 40,000 MT and Iceland at about 180,000 MT have the only significant caplin fisheries. However, Iceland's caplin, while generally preferred because of its higher fat content, is smaller in size that limits its demand in the major caplin food markets. Iceland also harvests its resource with fewer and bigger

vessels. These two factors make production into fishmeal a better economic option for Iceland leaving Newfoundland and Labrador as the main food caplin supplier.

Newfoundland and Labrador's production of female caplin in 2007 was about 15,000 MT of which about 9,000 MT went to Japan. Historically Japan was the only market for food caplin. It is still our biggest market but no longer our only market. Taiwan is now an increasingly important market and China, Thailand, Korea, Vietnam, highly populated Asian communities in North America and Russia, including some of its former republics, are now also markets.

The Japanese are very discerning buyers and their in-plant inspectors make deductions for caplin that are damaged, spawned, male, and have red feed, etc. Other markets are not as fussy in comparison and so the Japanese offer price is normally discounted by about 15% when making apples to apples comparisons with prices available in other markets. Also, specifications sometimes differ which inhibits price transparency.

In Japan (or increasingly in China) the caplin are individually hung for semi drying in a cold air process after which they are refrozen and tray packed for sale mostly in supermarkets. There are only a handful of such caplin processors and they are a very tight lipped and almost secretive group. About ten or so Japanese importing companies purchase the caplin for resale to these processors.

While currently Newfoundland and Labrador has a favorably market environment for the sale of its caplin this has not always been the case and likely will not be the case again at some future time. For quite a few years prior to about 2003 both Norway and Iceland were bigger producers of food caplin and since their seasons are before ours this was a period of little or no demand for Newfoundland and Labrador caplin. During that time period only a few processors stuck with the product. Other markets had to be sought out and developed.

Over the past number of years as market conditions improved, mostly because of supply side changes, more processors have come back into caplin production. This trend was also facilitated by the growth and steadier availability of the mackerel resource, which requires much the same processing equipment (graders, blast freezers). Currently we have about forty companies going to market with caplin.

Producers of product for Japan sell direct to the Japanese importer who normally takes delivery of the product as it is produced. However, due to costs, Japanese importers are tending toward having technicians in just the bigger volume plants. This leaves smaller processors having to sell their production to other markets. Most Newfoundland and Labrador companies go to market outside Japan through an intermediary.

Although there have been efforts in the past by individual processors to diversify product mix, little success has been achieved.

Mackerel

Mackerel is a global fish. Landings are in the millions of tonnes worldwide and because it is such a globally available fish the markets for it are global but very challenging competitively. Resource variability is also a factor. For example, in 2006, Japan, a major importer of mackerel, had a fivefold increase in its own resource and so became a net exporter.

Newfoundland and Labrador, even with its recently increased catches of around 40,000 MT, is a very minor player on the world scene. Our volumes are small and supply inconsistent, our mackerel are of inconsistent quality and subject to red feed and other types of feed. Competitor countries catch their mackerel with large vessels designed to deal with the specific quality challenges this species presents. (It is not even certain that our mackerel could be harvested with such vessels.) Also countries with large and consistent mackerel landings, i.e. Norway, are infrastructurally prepared to handle this large volume/short time span fishery.

For quite a period in Newfoundland and Labrador only a few companies carried out significant production of mackerel for export. These were mostly on the west coast where mackerel availability was more consistent. Some had their own vessels as well as being supplied by independent fishers and for the most part the harvesting and processing of mackerel was carried out in an orderly fashion. Companies carved out market niches where, when appropriately priced, the kind of product produced here could be made to work. This is mostly in Eastern Europe for applications less sensitive to feed content and a smaller amount into the more discerning Asian market. Over time less and less product had to be sold for bait.

In the past number of years however many more companies are into processing mackerel because of a combination of these factors:

- The resource has appeared in bigger quantities and with more consistency outside the west coast than was previously the case;
- Pressure from fishers to handle all catches available to them and from plant workers for more work hours;
- Crab profitability alone no longer ensures survival; and
- Investment in caplin processing equipment to take advantage of the rebound in that species worked equally well for mackerel.

In 2007 over 30 companies processed mackerel in almost fifty plants. By contrast, in 2007, three of Norway's already big pelagic producers merged into a single entity.

Unlike with caplin, there are not a dozen or so importers waiting to take delivery of the product as it is being produced. Also, a frequent lack of cold storage space creates even more pressure on processors to transfer ownership of product unto someone else as soon as possible.

The new environment as might be expected has resulted in greater quality inconsistency and more fragmented selling through a more opportunistic cadre of intermediaries.

Herring

Herring is mainly a northern European species. The big consuming countries there are supplied from European resources that are in excess of 1.5 million MT and are currently trending upwards. Canadian herring into the EU faces a 14% tariff. Our herring resource is inherently inferior to the European resource because of its size, fat content inconsistency and, at times, red feed content. Where some small market access is achieved it is generally because of price point and that becomes more difficult when supply is abundant, as is now the case. Recently unfavorable currency exchange rates have exacerbated the challenge.

There is a market for herring in some underdeveloped countries but the combination of low market price and high transportation costs make these markets generally uneconomic for Newfoundland and Labrador producers.

A relatively small amount of our herring was traditionally filleted and cured by a number of processors and sold in North America to a handful of companies that produce herring in jars etc mostly for ethnic population centers. It has been a gradually declining market. Currently, I believe there is only one company that does herring filleting on a consistent basis and one or two others who do so on order only.

The bait market on the Atlantic coast remains a major outlet for herring but the prices for bait make this a very marginal proposition.

Groundfish

There are over a dozen groundfish species currently processed in Newfoundland and Labrador. While landings of any one of these species may still be important to individual plants none any longer play the dominant role once occupied in the industry. I will make a few remarks on three species - cod, turbot and yellowtail flounder.

- **Cod -** About 17,000 MT of cod is now landed in Newfoundland and Labrador. About 60% is salted in 40 or so plants by almost the same number of companies. 10% is sold in fresh forms by about 20 companies, the largest concentration of which are a half dozen or so companies around the southwest corner of the province. The 30% processed into frozen fillets/loins is carried out by three companies, of which one is dominant.

- **Turbot -** Turbot production is now mostly either head-on or head-off for Asia, mostly Japan, Taiwan and China where markets are favorable in large part because of the reduction in supplies from Iceland and the relatively high prices for quasi competitive species such as black cod and Chilean sea bass. Currently about 25 companies produce this product, most of whom sell through one of a dozen

intermediaries. Turbot has also become an important contributor to the economics of the offshore shrimp trawlers.

- **Yellowtail Flounder -** It is the only flounder species for which there has been any significant return of quota. It is the smallest of the flounder species. If processed into frozen fillets the smaller sizes must compete with the Pacific twice frozen yellowfin sole processed in China. This is difficult to do economically and so the fresh market is a better alternative. The larger size fillets do not compete with yellowfin but with other higher priced, similar sized flatfish species mostly from Alaska.

  There are potential markets in the EU given the decline of the European flatfish resources, however, a 15% tariff and nomenclature issues remain significant impediments

  A possible negative development for existing North American markets could come as an indirect result of the significant reduction in the Alaska Pollock quota in 2008. This might result in a substantial increase in the directed flatfish fishery in Alaska.

Lumpfish Roe

Lumpfish roe is the raw material for caviar, the production of which is carried out by only eight or so companies in Germany and Scandinavia. Lumpfish caviar is consumed mostly around the Christmas season and France alone accounts for over half the market. It has a unique storage requirement of between –2 and + 4 degrees Celsius. There are three other major lumpfish roe producing countries: Iceland whose fishery starts the first, followed by Norway, then Greenland and finally Newfoundland and Labrador. Being the last of four suppliers works against you when there is oversupply and for you when there is undersupply.

There are about 30 processors of lumpfish roe in Newfoundland and Labrador. However, I find it most interesting that unlike any other species or product, the vast majority of these processors go to market through three of these processors. At least in one species we have a Newfoundland and Labrador marketing consortium albeit an informal one. Why this has come about for lumpfish roe and not for other species is an interesting question. No doubt there was a unique set of circumstances, but nevertheless, it shows what can be done.

Section VI: The Case for an Industry Sales and Marketing Organization

The ultimate objective of all participants in the industry must surely be to increase the economic return from our seafood resource consistent with sustainability. To achieve this objective we ought to be constantly improving and changing in all three stages of the industry - harvesting, processing, sales and marketing – in the face of changing technology, customer demands, and economic factors, none of which we control.

Clearly it would be ideal if all three stages of the industry were integrated so that, across the industry, improvements could be priorized and synchronized. There would be greater commonality of purpose and coordinated implementation. Such is not currently the real world in our industry nor is it likely to be in the foreseeable future. (I do not say that lightheartedly.)

The lack of integration in this industry is a serious constraint to its ever being a truly customer oriented industry and to its competitiveness.

Our major competitor countries have either allowed integration to occur to varying degrees or have achieved much of the benefits of integration through other measures such as the removal of constraints of vessel size, consolidation, etc.

That being said, the issue comes down to this - are we doing the best job we can in the selling and marketing of our seafood products or can we make meaningful improvements there notwithstanding the structural inadequacies of the industry. Put another way, in the absence of addressing the structural issues in the industry that should be addressed is there nothing we can do on the sales and marketing front?

It is my judgment that, collectively, we are not selling and certainly not marketing our products as well as we could. Furthermore, I think there is potential in the sales and marketing phase for companies to bring about some reduction of the problems that flow from the unaddressed structural issues cited.

A reader of the previous section of this report would note that there are many instances in our markets where:

- We are a major supplier of a product but haven't captured the market strength that normally comes with it;
- We have a product with inherent strength that is not being sufficiently positioned and promoted in the market to gain better advantage over its competitor products and thus for our companies to gain more advantage over their competitors;
- We are too heavily dependent on brokers; and
- Simply put - there are too many of us.

Selling

On the selling side we must and can become less dependent on and more discerning of the brokers we use. There are knowledgeable, ethical brokers who work like partners with their suppliers. On the other extreme, there are brokers who are nothing short of market manipulators and not for the advantage of their Newfoundland and Labrador suppliers.

We must try to reduce the sheer number of us that go to market and not wait for industry consolidation alone to bring this about. There is no structural impediment that I am aware of that prevents processing companies in Newfoundland and Labrador from coming together and forming their own marketing consortia. It is commonplace in most of our competitor jurisdictions. Whether it is to increase the market presence of companies on the southwest corner of the province selling fresh fish into the Boston market, or to reduce the fragmented selling of crab sections into the U.S. or to enable C&P shrimp producers to have a better chance of convincing a major U.S. restaurant chain that we can supply sufficient product for it to menu our coldwater shrimp, a marketing consortium is a viable option to bring about any of these outcomes.

We must become more collaborative in how we go to market, whatever our numbers, in order to extract from these markets the returns we should reasonably expect. I think most people in the industry share this view. I can say from personal experience, in markets where we compete, people in the trade often look upon us as a fragmented group of sellers.

We do not communicate amongst ourselves extensively or intensively enough to have a more collaborative approach in how we go to market. In some species sectors it is simply impractical due to the sheer number of companies. In the absence of an industry vehicle to do this it becomes too much to expect of any one or a few companies.

Where communication does occur it is often less than productive because:

- Of a lack of trust stemming in large part from the intense competition for raw material;
- The tendency for most discussions to devolve onto the price of raw material on the wharf or the price of product in the market rather than on the market itself. This situation is exacerbated when participants are operations rather than sales personnel;
- The process is complicated by the large number of companies who use brokers and whose view of the dynamics at play in a given market is through the eyes of someone who is not personally present in the communication process and oft times has another agenda.

I think that much can be done to address these issues through an industry association with an active market intelligence gathering and dissemination role and with measures in place to encourage the formation of selling consortia within the processing sector.

Marketing

By in large, our industry does not understand and therefore does not appreciate the role of marketing, which is why the word is used synonymously with the word selling. For whatever reasons, valid or otherwise, there is general industry apathy towards marketing.

Marketing activities can be an important part of increasing market share and increasing net returns. As referenced in Section V, in important markets for our key species, competitors have national marketing campaigns either through their industry marketing association or a major corporation (Greenland). We now have neither.

We lack any semblance of effective marketing communication. Our industry has no common marketing theme nor have we woven together the important attributes of the products we sell and projected these to our markets in a manner that can differentiate us from our competitors. For example, in the UK, the biggest C&P market in the world, we as the biggest producer of C&P in the world ought to be telling the market and the consumer there that we are the biggest supplier, that our resource is sustainable (MSC), that it is caught near shore by smaller boats, processed in ultra modern facilities, flash frozen within minutes of cooking, only once frozen meaning sweeter, more succulent, etc., etc. I do not see that we are doing that in any kind of coordinated, concerted fashion.

Industry apathy of the importance and potential impact of meaningful marketing activities is, in my view, a reason to make a start. It is not a reason for inaction.

Those I interviewed, who had some appreciation of marketing, raised the issue of their company's financial inabilities to engage in any sort of significant marketing activities. In light of the "structural" apathy, if I may call it that, and the financial resources concerns, it is my view that if we wish to have our industry become more marketing oriented the initiative needs to be through an industry organization that:

- Is dedicated solely to that purpose;
- Houses the requisite skills to assist the industry in developing and executing marketing strategies; and
- Spreads the costs over the entire industry sector.

In short, I am of the opinion there is merit in having an industry organization related to its sales and marketing functions.

In the following sections I will outline what I think is the kind of organization needed, the critical factors for its success and how I think its implementation should be carried out.

I think the name "Newfoundland and Labrador Seafood Marketing Council" is as appropriate a name as any other that comes to mind.

Section VII: A Newfoundland & Labrador Seafood Marketing Council

The ultimate goal of the Newfoundland and Labrador Seafood Marketing Council should be to increase the economic value of the province's seafood resource. Initially it should have the following objectives in pursuit of that goal:

- **Collaboration** - to better enable and actively encourage Newfoundland and Labrador processors to "go to market" each season in a more coordinated manner and to better sustain that coordination throughout the production /buying season.
- **Image Development & Product Promotion** - to develop and promote the image of Newfoundland and Labrador as a supplier of seafood and to augment the marketing efforts of our companies with product promotion campaigns in selected markets.
- **Long Range Market Planning** - to facilitate and encourage industry focus on proactive longer range market planning.
- **Public Relations -** to be the industry vehicle for dealing with market relevant public relations issues as well as opportunities.

Collaboration

The main activities of the Council in support of this objective would be:

Market Intelligence - This would involve extensive market intelligence gathering and the timely and regular dissemination of this intelligence to all Council members. Market intelligence information would be gathered from:

- Sales and marketing personnel within member companies;
- Industry contacts in selected markets;
- Field agents in chosen markets who might be retained by the Council for the purpose of identifying and/or analyzing relevant market factors in that market (local laws, tariffs, customs, industry practice, etc.); and
- The ever-expanding array of information available from the Internet.

I believe that such a market intelligence function would:

- Result in a more shared appreciation of the market dynamics at play for a given species and thus the more likely formulation of a common "go to market" approach for that species before the tumult of the production season comes upon processors;
- Give processors, whether small, medium or large a common point of reference and also a person, who is not a competitor, who they can call for questions, concerns and issues that inevitably arise relating to the selling of a given species during the course of the hectic production season.

Market Consortia - I would see the Council actively encouraging companies to develop their own marketing consortia especially small and medium sized companies. The council should make available to interested parties, legal, financial and marketing organization expertise on retainer to the Council. By making such expertise available without significant cost companies may be more apt to consider and explore the merits of coming together for marketing purposes and hopefully then carry the idea through to conclusion on their own.

I feel that the combination of these activities by the Council could in the short run significantly increase the extent of collaborative marketing in the industry and, over time, lead to a greater degree of consolidation in the number of companies going to market.

I also think that by encouraging consortia formation and giving companies who sell through brokers (that is - the majority) independent intelligence as to what is happening in a given market it can only increase the likelihood of these companies:

- Exercising greater control of their brokers where this has not been the case;
- Upgrading to what I would refer to as partner type brokers; and
- Dispensing with broker selling as the so-called "normal" way to bring product to market.

Image Development and Product Promotion

I have joined these two objectives together because I think that the two should be closely coordinated and one should not get out ahead of the other, certainly in the initial stages.

In most of our markets, Newfoundland and Labrador, as a seafood supplier, needs to create, enhance or correct its image. In all our important markets we need to create an image that more powerfully conveys the positive features of Newfoundland and Labrador as a seafood source. Our clean environment, icy cold northern waters, sound management regimes, sanitary standards, etc. are all positive attributes that need to be conveyed to the markets we serve.

We need to reposition our image in the global seafood trade from a once major groundfish supplier to a major North Atlantic Shellfish producer. Our commanding position as the major supplier of both snow crab and coldwater shrimp is a powerful evoker of image. If we want to be market leaders for these species we have to act like market leaders. This requires an assertive marketing role.

Image development provides the backdrop to product promotion activity which in turn enables individual company's branded campaigns to have increased effectiveness. As a gardener the analogy of a good lawn comes to mind. While you clearly need good soil (the products), fertilizer (product promotions) enhances the soil and limestone

(image/awareness) enhances the fertilizer. We need the good soil, fertilizer and fertilizer enhancement; good products, promotions and image/awareness.

Our products must be of acceptable quality to our customer. The value of the product and the amount sold can be enhanced by the combination of company marketing efforts, product promotional campaigns and an overall strong, compelling image.

Image development and product promotions involve an array of activities which include: print and media advertising (to the extent affordable); featured articles in trade journals; sponsoring culinary events; structuring product promotions in individual retail and food-service chains as well as to full scale food service distributors; providing in-store demonstrations, point-of-sale materials and so forth.

Development of the actual image Newfoundland and Labrador wishes to portray is beyond the scope of this assignment. It will instead take some work by the Council staff together with industry.

The possibility of having a combined Newfoundland and Labrador/Canada image or incorporating Canada into the Newfoundland and Labrador image utilizing Agriculture Canada's Canada Brands Program and logo should certainly be pursued. The name "Canada" has very high and very positive recognition worldwide and if it could be woven into the overall theme of a Newfoundland and Labrador image that would be highly desirable.

Long Range Market Planning

I believe the Council could be a vehicle that assists the industry in periodically standing back from its day to day imperatives to focus on longer term market considerations. The emphasis would be on proactive planning and would involve research and analysis of perceived new market opportunities whether for new products or new geographic regions, relevant trends that may impact existing markets or open up new ones and even retrospective evaluations of the impacts of past industry sales and marketing decisions.

Public Relations

I believe the Council would need to have a two-sided public relations role. One would be to seek out and arrange industry participation in public relations events in our major markets and also to react quickly enough to take advantage of public relations opportunities that arise unexpectedly. One would think, for example, of the backlash that arose this past year to food imports from China and the missed opportunity to better our products against those of some of our competitors.

MSC certification is also an example of a positive development that can significantly impact on those who make the decisions to purchase our seafood, but only if it is communicated effectively. I am led to understand that MSC works with its respective clients to take advantage of this label where a mechanism to do so exists.

The other side of the dual public relations role would be to better prepare the industry to deal with negative publicity. I would see the Council monitoring media and other sources to identify potentially negative stories and arming its members with timely, credible, reliable information and guidance as to if, when and how industry should respond. This would clearly require close liaison with Government departments and industry associations.

Staffing

I would envisage the Council when fully operative requiring a full-time staff of four to six persons. There would be an Executive Director, an Administrative Secretary, two or three species focused Coordinators (Shrimp, Crab, Groundfish and Pelagics) and a combination of either one full-time or several part-time researchers/analysts.

When and wherever possible the Council would draw on the resources within member companies but I do not sense processors have sufficient staff to permit their secondment to the Council for any extended periods. Selective secondment from within government departments is a possibility worth exploring.

Budget and Funding

It is very difficult to say what size budget the Council would require to meaningfully carry out the mandate and activities outlined above. Obviously, the more funding, the better the job can be done. My estimate would be that once fully operational the Council would require a minimum budget in the order of $3.6 to $4.0 million annually to be effective. While this is small in relation to either the Alaskan or Norwegian bodies, a considerable portion of their expenditure is directed to salmon, either farmed or wild. In the case of NSEC salmon is about two thirds of their budget. The Council here would have a smaller budget but also a smaller range of products over which to apply it.

I would see this level of expenditure being funded from three sources. The core funding, comprising about half the annual budget, i.e. $1.8 to $2.0 million, would come from the processing sector companies. The other half would come from the provincial government and from federal government sources referenced later.

For an initial period only, as outlined in the next section, I am proposing that funding come mostly from government sources.

Section VIII: Realities, Structure, Implementation

Realities

Having defined the role and the key activities of a Newfoundland and Labrador Seafood Marketing Council I now turn to three major realities that have shaped my

recommendations on the structure of the Council and how it might be brought into existence, if at all. The realities are:

1. The Council must not be a government dominated organization.

2. The Council will not succeed as a meaningful, industry relevant organization unless the processing sector can and does take ownership of it.

3. The high degree of skepticism amongst processors as to the merits of a Seafood Marketing Council must be recognized and taken into account in any implementation plan.

No matter how well intentioned the aim, imposing a Seafood Marketing Council on an industry that, rightly or wrongly, does not want it makes no sense at all.

Processors, at the time of my interviews, certainly expressed little if any interest in such a Council. Whether upon consideration of this report and its recommendations they come to a different view, time will tell. I am proposing an implementation plan that gives them the opportunity to experience a Council for a trial period before having to make a final decision on its permanent existence. But,

If it is the wish of processors, independently given and accurately recorded, that we not go forward again with a new Seafood Marketing Council no matter what is being proposed then the matter should die.

If we are to try again to have a Seafood Marketing Council it has to be controlled and directed by the players who sell and market the seafood products it is being created to promote.

The companies that sell our seafood products must become active participants in every aspect of the Council's activities.

This did not happen in the first Seafood Market Council and that is a big part of the reason why it did not sustain itself as a vibrant, viable industry organization. The same result will occur again in the same set of circumstances.

Council Structure

In making the following recommendations as to how a Newfoundland and Labrador Seafood Marketing Council might be structured, I have leaned more toward the ASMI model because I think it is more aligned with the circumstances and industry orientation here.

Legislated Existence

- The Council would be established by an Act of the Legislature, administered by the Minister of Fisheries and Aquaculture and have its financial affairs audited by the Auditor General.

Mandatory Membership

- Membership should be mandatory for all processors with landed value above a certain administrative minimum.

Board of Directors

- The governing body would be a Board of Directors consisting of seven voting members appointed by the Minister from nominees of the fish processing and harvesting sectors.
- Five Directors would be from processor companies, of which at least two would be from small or medium sized companies. Two Directors would be fishers who are owner/operators actively engaged in fishing as their primary source of income, one each from the small and large fleet sectors.
- Directors would elect a Chairman.
- Directors would serve three year staggered terms.
- Director's remuneration would consist of meeting per diems and travel expenses.
- The Board would appoint the Executive Director and other staff as necessary.

Core Funding Assessment

- Core funding would be derived from an assessment on all members based on a percentage of the landed value of their fish purchases. Earlier, I estimated the core-funding requirement to be in the range of $1.8 to $2.0. This, in turn, would require an assessment rate of about 0.5%. (During the trial period a different funding arrangement would exist as outlined below.)

Sunset Provision

- The enabling legislation would contain a provision that upon a petition to the Minister by members comprising 25% or more of landed value a vote must be held on whether to continue the Council. Its continuance would require a 51% majority vote based on landed value.

Internal Administration

The Board of Directors and the Executive Director would organize the Council's activities. In my conversations with the staff of ASMI and NSEC I extracted some points related to their internal administration that may have relevance. I list these in no particular order:

- Directors from processor companies are expected to be the Heads of the companies and where that is not possible, they must be from their first reports;
- Sector committees (retail, foodservice etc.) or species committees seem to be the prime mechanisms for ensuring alignment between the Councils' and Members' interests and activities. The committees are comprised of people from within member companies. This is where the real work of these organizations gets done. Active and energetic participation is expected from those on the committees. In one of the organizations the Board itself evaluates the degree of participation and ruthlessly makes changes when necessary;
- To the extent feasible, attempt is made to correlate expenditures on a species with the revenue brought in from that species.

Implementation

I am recommending a three phase sequential approach to the implementation of the Council. This phased implementation, incorporating a three year trial period, would give the processing sector time to experience what might be achievable with a Newfoundland and Labrador Seafood Marketing Council without making a blind or burdensome financial commitment up front.

Stage One - Industry Vote on Trial Period

I am proposing that an organized, regulated vote be taken amongst all companies in the processing sector to determine if there is sufficient interest in having a Council for a trial period. A vote representing 51% or more of total landed value in favor of a trial period would be required.

Stage Two - Three Year Trial Period

A Newfoundland and Labrador Seafood Marketing Council would be established as if it were to be a permanent organization except that it would be given an initial three-year time horizon.

Stage Three -The Council Dies or Becomes Permanent

Towards the end of the three-year trial period a second vote would be taken on the same basis as the initial vote to decide if the Council is to be a permanent feature of our industry landscape or cease operations.

Funding During the Trial Period

I am proposing an interim funding arrangement for the trial period only. During the trial period, should there be one, funding for the Council should come mostly from the monies already allocated by the Department of Fisheries and Aquaculture and from funding to be obtained from federal government departments and agencies including Agriculture and Agri-Foods Canada, Atlantic Canada Opportunities Agency, and Department of Fisheries and Oceans.

In year two and three of the trial period Council members should have to contribute in total an amount of about $250,000 per annum which would be derived from a membership fee related to company size.

Should the industry decide at the end of the trial period to make the Council permanent it would be on the basis that, thereafter, it has to provide the core funding as outlined earlier. Government sources would have to continue to provide funding of an amount approximately equal to the core funding

Section IX: Observations and Conclusion

Before the conclusion of my report I will touch on three subjects that have not fit neatly into the report thus far but on which some observations must be made. These relate to the issue of harvester representation on the Board of the Council, marketing boards versus marketing councils and the Atlantic Canada regional issue.

Harvester Representation on the Board

I have proposed a governance structure that provides for two active harvesters on the Council's Board of Directors. Intellectually and pragmatically I was comfortable in doing so.

The Council, should it come about, will only succeed in its market oriented mission if it stays above the day-to-day fray of the industry here in our own backyard. It must deal with the bigger picture, such as, our international competition, better connection to the consumer, market diversification and similar issues. I think it is appropriate that the broad direction of an organization charged with addressing these issues have the involvement of the two groups who must put capital at risk to be in the industry, that is, both processors and harvesters. It should help to bring about a more common understanding of the global challenges our industry faces as a whole and of the limitations on our ability to meet these challenges, self imposed or otherwise.

From the practical perspective, I would make two observations. First, the Executive Directors of both ASMI and NSEC were confident in saying to me they cannot recall an issue where their Board was split on processor versus harvester lines. The reason is simply because the kinds of issues these organizations are meant to deal with do not give rise to differences of opinion on that basis. Second, I just do not see it as a tenable proposition that funding for the Council will come from governments without their insistence on the Council's Board having harvester representation.

Marketing Boards vs Marketing Councils

The subject of Marketing Boards came up repeatedly throughout this assignment, including the very first day. In most instances the subject arose in the context of a fear that government was seriously considering this as one of its options for a marketing initiative. In case there is a body of support out there for the notion of a Marketing Board(s) that I failed to encounter, I felt I should express my views on the issue.

The evidence is very compelling that Marketing Boards, (as distinct from marketing councils) have not been a successful method of economic regulation in the fishing industry. They tend to be cumbersome and unresponsive to changes in consumer tastes, competitive pricing, resource availability, variations in quality and other factors affecting the supply and demand of seafood. The problems associated with the Canadian Saltfish Corporation have been well documented and owing to the Corporation's mandatory purchase obligation were centered on inconsistent quality, poor market access and timing issues. The result was substantial losses that were financed by governments.

A Marketing Board by its very nature does not allow differences in quality of raw material or finished product to be adequately rewarded or punished. Without a direct contact to buyers or consumers, producers become disconnected from their needs. A needed change in product specification or packaging becomes a bureaucratic exercise rather than a nimble response to market demand.

As I mentioned earlier in this report, the current Norwegian Seafood Export Council replaced a dozen or so marketing boards or quasi marketing boards that led Norway into some very embarrassing and costly inventory fiascos. Then and even more so now, the inevitable requirement for government money to solve the problems such boards create leads to international trade actions and countervail.

The Atlantic Region

One of the matters that nagged me as I worked through this assignment was the geographical feature, that is, that our two principal, most valued species are also present in the Atlantic Region, not just our province. One can only dream of the huge added dimension that would come from a fully integrated "Atlantic Canada" sales and marketing campaign for these two species. The funds available to do the job would be significantly increased at the same time as our market strength was being ratcheted up considerably.

The reality, as opposed to the dream, is that if establishing a Newfoundland and Labrador Seafood Marketing Council is a challenge then establishing an Atlantic Canada Seafood Marketing Council is a Herculean task for sure. Nonetheless in time anything is possible. We can best help to bring something like this about by first getting our own act together here in this province. If then in three years time we have a vibrant Council making good headway the door should always be opened to expanding the Council beyond our provincial confines.

Again, as I referenced earlier in this report, incorporating "Canada" into the Brand image the Council will have to develop would likely facilitate blending in to that brand other parts of Atlantic Canada.

Conclusions

As I went through this assignment and became more up to date on what has been occurring in the seafood industry in our competitor countries, the more obvious became the need for change here in Newfoundland and Labrador.

I am proposing that we try and re-establish a Newfoundland and Labrador Seafood Marketing Council. I am all too aware that this is what I would term a sub-optimal initiative. It will not take us a quantum leap forward in terms of improved industry efficiency or make us truly market driven and so forth.

Nonetheless, I do believe it could be a very worthwhile or even necessary undertaking if we are to keep our position in some markets from eroding in the face of our increasingly leaner competition.

I have proposed a Council structure and an implementation plan that I believe takes into account the principal concerns I heard from the processing sector (or, more aptly, the selling and marketing sector). If the recommendations in this report are accepted:

- Nothing will be imposed on the processing sector;
- Processors (i.e. sellers) will have control of the Council;
- The Council will have a built in mechanism for its removal should it become irrelevant; and
- The Council is proposed initially on the basis of a kind of trial free period.

As is always the case there are trade-offs. Processors must now wrestle with whether they want such an organization and, more importantly, with whether they are prepared to commit to that organization the time, effort, and finances needed to make it a success. It is for certain that the Council can only be as good as their commitment to it.

In optimistic anticipation of the recommendations in this report being accepted and of the processing sector wanting to go forward with the establishment of a Newfoundland and Labrador Seafood Marketing Council I will close my report with a few words on two matters that will be so very important to making that Council successful.

The Executive Director

Obviously, selecting a good leader is important for the success of any organization. Given the milieu in which this council will come into existence, selecting the right first leader, takes on an added importance. If at all possible, it should be someone from within the industry with widely recognized experience in sales and marketing. The person would need to be mature, even-tempered, communicative, well respected on a personal level, energetic and capable of keeping a diverse group of people on a defined course in the face of probable constant distraction.

I offer the following observation from my own knowledge of the industry. There are many who might wish to be candidates for this position but there are few who are right for the position. It is critically important that the founding leadership of the Council not be deterred from going after the best possible candidate.

Competing Objectives

The Council has to be allowed to concentrate solely on that which it is being created to do - enhance the selling and marketing of the province's seafood products. It should not be brought into other activities that will only distract it from its mission. It must not be used by processors or harvesters to achieve purposes for which it is not intended. I would strongly suggest that, although there may be cost savings forfeited, the Council offices not be located within either of the existing industry association offices.

I thank the Department of Fisheries and Aquaculture for giving me the opportunity to take on this assignment and I thank everyone with whom I came in contact for the cooperation that was unfailingly given to me.

Appendices

Extract – Terms of Reference

The Seafood Marketing Review Panel will be comprised of representatives from the processing and harvesting sectors and government. Members of the panel will act in an advisory capacity to the Chairperson on a voluntary, non-remunerative basis. The Chairperson shall undertake and complete a comprehensive analysis of the options for establishing an umbrella seafood marketing organization including the identification of key marketing challenges facing the Newfoundland and Labrador seafood industry and approaches for addressing these challenges.

To complete this work, the Chairperson will have to review the input received by Government through the Fishing Industry Renewal of consultation process, conduct additional consults with key industry players as required and review and analyze similar organizations in other jurisdictions such as the Alaska Seafood Marketing Institute and the Norwegian Seafood Export Council.

The primary areas to be addressed in this study include:

a) Identification of the key marketing challenges faced by the NL fishing industry (excluding aquaculture);
b) Consideration of ways a seafood marketing organization could help address such challenges
c) Development of options for the establishment and administration of a seafood marketing organization including structure, mandate, membership, costs, etc. and identification of the recommended option, taking into account the potential for success in facilitating collaboration marketing, and cost effectiveness;
d) Identification and prioritization of the key areas the marketing organization should focus on; and
e) Review of options and mechanisms to secure participation (including funding) by industry, the federal government and other stakeholders and a recommended approach to move forward.

Appendix E

Overview of Federal Government
Programs and Services for Seafood Marketing Initiatives

Overview of Federal Programs and Services for Seafood Marketing Initiatives

This document provides brief summaries of Federal programs and services which have some relevance to the international marketing of Canadian seafood. It is based largely on an internet search, as well as additional information provided directly by some of the respective departments and agencies delivering these programs and services.

Although every effort was made to identify all relevant initiatives, this may not be an exhaustive list. Links to the corresponding websites are provided. Further information on any of these initiatives should be sought through direct contact with personnel from the departments and agencies in question.

Atlantic Canada Opportunities Agency (ACOA)

Business Development Program (BDP)

The BDP is designed to help set up, expand or modernize business enterprises. Focusing on small and medium-sized enterprises (SMEs), the BDP provides access to capital in the form of interest-free, unsecured, repayable contributions up to $500,000. Not-for-profit organizations that provide support to the business community may also qualify for non-repayable assistance.

Eligible activities include business studies, capital investment, training, marketing, quality assurance, and not-for-profit activities that support business in the region.

Marketing initiatives include:

- Development of a marketing plan
- Hiring of marketing expertise to implement the plan
- Related marketing activities such as labelling, packaging, promotional materials, advertising, product demonstrations and participation at trade shows.

http://www.acoa-apeca.gc.ca/English/ImLookingFor/ProgramInformation/Pages/ProgramDetails.aspx?ProgramID=2

Business Development Bank of Canada (BDC)

BDC Market Xpansion Loan

Provides up to $100,000 to expand domestic markets or explore foreign markets. The program offers longer term and flexible repayment schedules.

Eligible activities include:

- Implement marketing strategies, develop new products and markets, or boost inventory to support increased sales
- Participate in prospecting initiatives like trade shows overseas
- Develop export and/or e-commerce plans
- Advance SR&ED (Scientific Research & Experimental Development) refunds to replenish working capital, or cover SR&ED consulting costs
- Conduct product development and R&D
- Purchase additional inventory for export

http://www.canadabusiness.ca/eng/summary/1052/

Export Development Canada (EDC)

Export Guarantee Program

The Export Guarantee Program, by providing a guarantee to the company's financial institution, can help access additional financing to support export-related activities and/or foreign investments.

EDC does not provide working capital financing, but guarantee coverage can be provided for up to 75% for guaranteed amounts greater than $500,000 and up to $10 million.

Any Canadian company with export-related activities or foreign investments may inquire about this program. To qualify, the company's financial institution must be willing to establish a credit arrangement with the company and participate in the financing.

http://www.edc.ca/english/financing_export_guarantee.htm

Accounts Receivable Insurance

Accounts Receivable Insurance (ARI) covers the exporting company for up to 90 per cent of losses against such commercial risks as customer non-payment. Coverage can be flexible to accommodate the company's unique needs, including ARI for foreign affiliates.

Other risks covered may include:

- Refusal to accept the goods;
- Bankruptcy or insolvency;
- Cancellation of import or export permits;
- Currency transfer;
- War, revolution, or insurrection; and
- Contract cancellation.

Any Canadian business that exports goods or services can apply.

http://www.edc.ca/english/exportfinanceguide/efg_sub6_12114.htm

http://www.edc.ca/english/docs/12e_final_ari_e.pdf

Agriculture and Agri-Food Canada (AAFC)

Canada Brand

If you produce, promote or support Canadian food and agriculture products, you can enhance your marketing program by adding the Canada Brand logo to your product line and promotional material.

As a Canadian organization, you can be approved to use the branding graphics and photos for products that were originally grown or harvested in Canada, or products produced elsewhere using Canadian inputs.

http://www.canadabusiness.ca/eng/summary/1592/

AgriMarketing Program

AAFC's Market and Industry Services Branch provides services and expertise to the agriculture and agri-food industries, including the fish and seafood industry. The AgriMarketing Program offers 50% funding, cost-shared with industry, in the form of contributions to assist national industry associations in identifying market priorities and equipping themselves for success in global markets. Applications are accepted from the agriculture, agri-food, fish and seafood sectors. The Program enables industry to develop and implement Long Term International Strategies (LTIS). Starting in 2010-2011, associations are required to have a multi-year LTIS in place and must integrate the Canada Brand.

http://www4.agr.gc.ca/AAFC-AAC/display-afficher.do?id=1239048540113&lang=eng

In addition, individual companies (with less than 250 employees) can apply for up to $50,000 per year, cost-shared at 50%, under the SME element of AgriMarketing. This funding supports market development activities specific to the company, to be undertaken in geographic areas other than the United States.

http://www4.agr.gc.ca/AAFC-AAC/display-afficher.do?id=1281731001985&lang=eng

Agricultural Flexibility Fund

The Agricultural Flexibility Fund (AgriFlexibility) is a five-year (2009-14) $500 million fund. Its objective is to facilitate the implementation of new initiatives, both federally and in partnership with provinces / territories and industry. These initiatives should be designed to improve sector competitiveness and help the sector adapt to pressures through non-business risk-management measures that will reduce costs of production, improve environmental sustainability, promote innovation and respond to market challenges.

In meeting this objective, there are three main elements to AgriFlexibility:

- Help reduce the cost of production or improve environmental sustainability for the sector
- Support value-chain innovation or sectoral adaptation
- Address emerging market opportunities and challenges for the sector

The fish and seafood sector is eligible under this program only for the purpose of undertaking activities related to international marketing.

Funding provided to for-profit organizations will normally be in the form of repayable contributions. Funding provided to not-for-profit organizations will be non-repayable. AAFC reserves the right to assess proposals against the need to respect regional balance with regard to overall spending of AgriFlexibility funds.

http://www4.agr.gc.ca/AAFC-AAC/display-afficher.do?id=1247082294164&lang=eng

Seafood Value Chain Roundtable

The Seafood Value Chain Roundtable (SVCRT) was launched in June 2003 and brings together key leaders from across the seafood industry - retail, food service, processing, harvesting and trade associations. AAFC facilitates and funds SVCRT, and plays a role in secretarial operation of the SVCRT through meeting organization, content, and communication with industry.

The SVCRT has conducted several studies and served as a vehicle for engagement on Brand Canada, as well as a vital feedback mechanism for industry to government.

This group focuses on three key priorities:

- Improving the image of Canada's seafood
- Enhancing the industry's ability to compete
- Encouraging an integrated government response to issues facing the industry.

http://www.ats-sea.agr.gc.ca/rt-tr/sea-mer-eng.htm

Foreign Affairs and International Trade Canada (DFAIT)

The Canadian Trade Commissioner Service can help a company succeed globally and lower costs of doing business. International business professionals, market intelligence and expert advice are available to support export, investment abroad, or technology and R&D partnerships.

Trade Commissioners are located in more than 150 cities worldwide and in Regional Offices across Canada. As well, a Virtual Trade Commissioner tool is available.

A Trade Commissioner will work to assess potential in a target market by providing:

Market intelligence -

- Up-to-date market information
- Information about barriers and regulations associated with entering a specific region
- Knowledge sharing about upcoming opportunities
- An inside look at what's going on in your area of business

Advice on improving your market strategy -

- Whether you're looking to export, invest abroad or seek technology and R&D partnerships
- Reference to qualified local firms for additional market research

http://www.tradecommissioner.gc.ca/eng/services.jsp

Appendix F

Implementation Costs

Implementation Costs

The implementation costs for the W/G's recommendations on the Seafood Marketing Council, sales consortia and inventory financing (deficiency guarantees) are outlined below.

Seafood Marketing Council [1]

	FY 2011/12	FY 2012/13	FY 2013/14	Total for 3-Year Trial Period
Government	$ 2,000,000	$ 2,250,000	$ 3,000,000	$ 7,250,000
Industry	$ -	$ 750,000	$ 1,000,000	$ 1,750,000
	$ 2,000,000	**$ 3,000,000**	**$ 4,000,000**	**$ 9,000,000**

Sales Consortia[2]

	FY 2011/12	FY 2012/13	FY 2013/14	TOTAL
Government	$ 1,500,000	$ 1,200,000	$ 1,200,000	$ 3,900,000
Industry	$ 500,000	$ 800,000	$ 800,000	$ 2,100,000
	$ 2,000,000	**$ 2,000,000**	**$ 2,000,000**	**$ 6,000,000**

[1] The 2008 Roche report recommended an annual budget of approximately $4 million to operate SMC. It is anticipated that this full budget would not be required in the first year of operation as time will be required for strategy development/implementation to get the organization fully operational. Provincial government funding is recommended at 100% in Year 1 and 75% in Year 2 and 3. Industry, with support from provincial government, will try to leverage federal government funding as well. It is anticipated that an industry levy program will be required to ensure that industry's funding contribution is collected on a fair and equitable basis to fund the SMC on a short and long term basis.

[2] This cost is based on estimated funding for a maximum of five sales consortia. The eligible funding for Year 1 would primarily include activities to get the consortia set up and operational (i.e. organizational, administrative, legal, etc.). These activities would be funded at 75%. There would also be funding available for incremental activities to assist coordination of various functions within the sales consortia (e.g. hiring of a Quality Control Manager to coordinate and ensure products from various operations meet required product specifications). These activities would be funded at 75% in Year 1 and 60% in Years 2 and 3. Sales consortia may also be eligible for other federal and provincial government programs for sales/marketing activities (i.e. product development, promotion, market development, etc.).

Inventory Financing (Deficiency Guarantees)

The purpose of making available to Sales Consortia working capital financing greater than that which would otherwise be available from commercial banks is twofold:

- To enable the Consortia to have a greater ability to hold product in inventory for more orderly release into the marketplace than is currently the practice in the industry.

- To enable the Consortia to attract into its membership processor companies that have been selling through brokers by providing to these companies inventory financing comparable to that provided by the broker. (It is commonly thought that the main reason many processor companies use brokers is because the broker provides financing not available from commercial banks.)

Commercial banks provide working capital financing on the basis of a percentage of the value of a company's inventory and accounts receivable at points in time. The amount advanced once product is produced but not yet sold is normally about half the actual cost of producing the product. The amount advanced once the product is sold and its market value converted to an account receivable is significantly more. Hence, there is always the incentive for companies to convert product in inventory to sales as soon as possible. The working capital line of credit available to a company is also subject to maximums which banks set based on each bank's subjective consideration of such factors as the company's track record with the bank, its balance sheet and the financial ratios derived there from, the bank's overall exposure in a particular industry, etc. Invariably, many seafood processors, especially in the crab sector, hit their maximum well before the season's production is finished. This is because their working capital requirements peak so high and so fast due to the compressed timeframe during which crab production occurs. Hence these companies have an even greater need to convert inventory into sales.

Given the current industry structure, the only way to have commercial banks relax their guidelines and provide additional working capital resources to the industry would seem to be through Government providing deficiency guarantees to the banks. Such guarantees would constitute a contingent liability of the Government and would only involve an actual cash outlay should there be a default. The deficiency guarantee would be made available only to sales consortia.

The amount of the deficiency guarantee(s) that may ultimately be required is difficult to quantify and would depend, of course, on the number and size of sales consortia actually formed. The crab sector would require the highest amount of working capital

financing. The maximum amount of deficiency guarantee(s) outstanding at any one time can be estimated using certain assumptions as follows:

1. The entire industry comes together into the desired number of consortia.

2. The amount of working capital financing needed to enable processors to be able to hold product in inventory and still be able to carry on production is 100% of the processor's direct cost of producing each pound of product. (In accounting terms, 100% of cost of goods sold, i.e. COGS).

3. The commercial banks will provide financing of 50% of the direct cost of production and the Government deficiency guarantee will be required to enable the banks to extend the remaining 50%.

4. No product is sold until after the full season's production is completed (i.e. the worst case scenario).

5. The estimated average unit direct cost of production for crab is $3.00/lb. and for shrimp $2.70/lb.

6. Inventory financing is not required for crab production going into the Japanese market because of the conventional terms of payment provided by Japanese buyers.

7. Using five year averages, the total annual crab production is about 76 million lbs of which about 65% or say 50 million lbs is for the United States market.

8. Average shrimp production has been about 57 million lbs. over past few years but given the expected reductions in shrimp quotas a more realistic production volume is likely to be about 35 million lbs.

Based on the above assumptions we can estimate the maximum amount of the Government Deficiency Guarantee outstanding at any one time to be **$ 75 million for Crab** (50 million lbs @$3.00 lb X 50%) and **$ 47 million for Shrimp** (35 million lbs @ $2.70 lb X 50%) for **a total of $122 million**.

This, as stated, is a worst case scenario since it is unrealistic (and undesirable) to assume there would be no sales of crab or shrimp during the production seasons. Once a sale of product is made, an account receivable is created and this enables the bank to extend financing of 70% of the value of the receivable (and up to 90% if it is EDC

insured) which thereby reduces the amount of Government deficiency Guarantee required.

A more likely scenario is that the peak amount of the deficiency guarantee will be in the range **of $45 to $50 million for crab and $25 to $30 million for shrimp for a total in the range of $70 to $80 million** as depicted in the table below.[3]

Estimated Inventory Financing (Deficiency Guarantees)

	FY 2011/12	FY 2012/13	FY 2013/14
Government	$ 80,000,000	$ 80,000,000	$ 80,000,000

Assuming appropriate terms can be negotiated with commercial banks there should not be a significant risk of default on the Government deficiency guarantee. The spread between the cost of producing a pound of product and its final market value is normally enough to cover market price exposure as well as other more normal risks such as nonpayment, quality claims etc. Additionally, the provision of the Deficiency Guarantee is in itself designed to increase overall returns from the marketplace and reduce volatility. Nevertheless, prudence would dictate that some provision for default be recognized.

[3] A more statistically based estimate could be obtained using a conventional cash flow model incorporating historic (or anticipated) production volumes, historic actual sales by month data and the actual average unit cost of goods sold as per the financial analysis of the processing sector carried out by the MOU Working Group for that sector. It must be reiterated that this $80 million represents a deficiency guarantee - not an outlay.

Annex 19
Glossary of Terms

Anticipated (moderate) scenario: the most likely scenario assumed when forecasting the financial models, by using the most appropriate forecast for variables such as fish quota, shore price, labour cost, fuel cost, exchange rate, etc.

Assets: items of ownership convertible into cash; total resources of a person or business, as cash, notes and accounts receivable, securities, inventories, goodwill, fixtures, machinery, or real estate (opposed to liabilities).

Buddy-up: the "buddy-up" arrangement allows two fish license holders to form a temporary partner ship and to fish two quotas from a single vessel.

Capital: the factor of production, used to create goods or services, that is not itself significantly consumed (though it may depreciate) in the production process.

Combining: the combining arrangement allows individual independent core enterprise holders to buy another core enterprise for the purpose of combining licenses and quotas on a permanent basis.

Direct labour: a variable estimated in the income analysis for the processing sector. It is comprised of the labour and benefits to those workers directly involved in the processing of fish.

EBT (Earnings before taxes): an indicator of a company's financial performance calculated as revenue minus expenses (excluding tax). EBT provides a level measure to compare companies in different tax jurisdictions.

EBITDA (Earnings before interest, taxes, depreciation, and amortization): EBITDA measures cash earnings without accrual accounting, canceling tax-jurisdiction effects, and canceling the effects of different capital structures.

Enterprise: a fishing enterprise is the fishing unit comprised of all licenses, vessels, gear and facilities held by the license holder.

Equity: the monetary value of a property or business beyond any amounts owed on it in mortgages, claims, liens, etc.

Fleet sector: analysis of the harvesting sector in this report covers the inshore sector (< 40' fleets), and the near shore sector (>40' fleets).

Gross margin: the excess of sales over cost of sales, which represents the direct costs of producing the fish products sold. It is expressed as a percentage of sales.

Highliner: a fishing enterprise that is regarded as a high-revenue enterprise as compared to other fishing enterprises in the sector and/or fishing area.

Independent Core Enterprise: Core Enterprise is a fishing unit composed of a fish harvester (head of enterprise), registered vessel(s) and the licenses he or she holds, and which has been designated as such in 1996 under the approved criteria. Head of a Core Enterprise is the person

who is named on the license and is in charge of a core enterprise. Independent Core (IC) is the category assigned to the head of a Core enterprise who is not party to a Controlling Agreement with respect to the licenses issued in his or her name. (Controlling Agreement means an agreement between a license holder and a person, corporation or other entity that permits a person, other than the license holder, to control or influence the license holder's decision to submit a request to DFO for issuance of a "replacement" license to another fish harvester (commonly referred to as a "license transfer"). Agreements between the license holder and a Recognized Financial Institution (RFI) are not Controlling Agreements if (1) there is no third party involved in the Agreement or (2) any co-signor, guarantor or other surety involved in an agreement does not control or influence the license holder's decision to submit a request to DFO for the issuance of a "replacement" license to another fish harvester.)

Inshore: refers to the fishing sector where fishing activities are carried out close to shore. Fish harvesters in the inshore sector are restricted to using vessels less than 40 feet in length.

Interest & Principal: periodic loan payment, usually paid monthly, that includes the interest charges for the period plus an amount applied to amortization of the principal balance.

Nearshore: refers to the fishing sector where fishing activities are carried out between inshore and offshore zones. Fish harvesters in the nearshore sector are restricted to using vessels of 40 feet to 64 feet in length.

Net Benefit to Cost Ratio: Net Benefit is equal to the value of benefit minus the value of cost. Net Benefit to Cost Ratio = Net Benefit / Cost.

Net margin gain (or net income): the money left over after paying all the expenses of an endeavor.

Net sales: total sales revenue less any selling expenses. Selling expenses include freight out for finished products, Export Development Canada (EDC) insurance, customer expenses, outside storage for finished products, brokerage and inspections and commissions on sales.

Optimistic scenario: the best scenario assumed when forecasting the financial models, by using the most favorable estimations for variables such as fish quota, shore price, labour cost, fuel cost, exchange rate, etc.

Other variable costs: this category represents the grouping for all the other remaining direct production costs. Some of the more significant accounts include bait and change in inventory.

Owner compensation: reasonable compensation for the owner's work effort as an employee/manager/skipper.

Pessimistic scenario: the worst scenario assumed when forecasting the financial models, by using the most unfavorable estimations for variables such as fish quota, shore price, labour cost, fuel cost, exchange rate, etc.

Plant overhead: this category includes costs incurred for fuel, electricity, repairs and maintenance, municipal taxes, rentals, indirect plant labour and factory supplies. After various discussions with plant management these costs were allocated as a percentage of species revenue. This was completed on a plant by plant basis.

Production capacity: volume of products that can be generated by a production plant or enterprise in a given period by using current resources.

Raw Material: this cost category includes the purchases of raw materials (fish) for processing, dockside grading, discharging and wharfage, freight in of raw materials, ice, fisherman's payroll and benefits, and finished goods purchased for resell, however finished goods is not consistently incurred in all species processed and represents an extremely small portion of the actual costs incurred in this cost category.

Return on Capital Employed: this ratio measures profitability and how well management has used the assets, by calculating the percentage return on total capital provided by the owners (ie. equity) and lenders (ie. debt).

Return on Equity: measures the rate of return on the ownership interest (shareholders' equity) of the common stock owners. It measures a firm's efficiency at generating profits from every unit of shareholders' equity (also known as net assets or assets minus liabilities).

Return on investment: is the ratio of money gained or lost on an investment relative to the amount of money invested.

Return on Net Operating Assets: it is defined as income (loss) for the period plus interest and income taxes divided by net operating assets (or a company's assets used to generate sales). Net operating assets are defined as capital assets (including intangible assets such as licenses) plus net working capital.

Selling, General & Administrative: this cost category includes administrative salaries, office expense, licenses and fees, consulting, legal and accounting fees, insurance and bad debts. Various sources of other income including local sales, raw material sales, discharge / wharfage revenue, ice sales, interest income, unrealized and realized foreign exchange profit and loss and miscellaneous income were deducted from the selling, general and administrative expenses. These costs were allocated as a percentage of species revenue. This was completed on a plant by plant basis.

Tail costs: is most often referred to by processors as the additional cost incurred to purchase and transport the raw material back to the plant for processing. These costs include freight costs to the plant, dockside grading of the raw material purchased, discharging and wharfage fees, ice and fishermen's payroll and benefits.

Viability: in general terms, viability is defined as "being financially sustainable". This report described four alternative approaches to assessing the viability of the fish harvesting sector. (See Table 4.2)

Working capital: is a financial metric which represents operating liquidity available to a business, organization, or other entity.


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