Corporate Visit

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Pacific Andes: Fishing for the future

Recommendation: Not Rated | **China Agriculture**

Price	**HK$2.44**	**Yield (3/07A)**	1.7%
12 mth range	HK$1.20-3.03	**ROE (3/07A)**	16.7%
Market cap.	US$564m	**Net gearing (3/07A)**	136.6%
No. shares o/s	1,802.6m	**Net debt/sh. (3/07A)**	HK$2.70
Daily t/o, 3 mth	<US$0.2m	**BV/sh. (3/07A)**	HK$1.55
Free float %	56.7%	**Consensus EPS**	
Major shareholder	N.S. Investment (BVI) Ltd. – 51.4%	**- 3/08F**	HK$0.265
Ticker	1174.HK/ 1174 HK	**- 3/09F**	HK$0.325

Key points:

- Fish prices to climb due to China's rising food prices and limited supply of wild-caught fish.
- Fishing division expansion – increased stake in CFGL to 40.8% from 18.4% in June 2007 and added vessels (from 14 in FY3/06 to 23 in FY3/07 and 34 in early FY3/08).
- Capacity boost - new Hongdao plant to launch trial production in December 2007. Fish processing capacity to increase to around 120,000 – 130,000 tonnes p.a. from 90,000 currently.
- Trading at high discount to fair value - the aggregate market value of the company's shareholding in its two Singapore-listed subsidiaries is around HK$8,126m or HK$4.51 per PAIH share.

Leading integrated seafood supplier. Pacific Andes International Holdings (PAIH), with its Singapore-listed subsidiaries, 40.8%-owned Pacific Andes (Holdings) Ltd. (PAH) and 65.0%-owned China Fishery Group Ltd. (CFGL), is one of the world's largest integrated seafood companies. It offers ocean-caught fish, fishmeal and value-added products. Its revenue rose 37.7% YoY to HK$8,478.6m in FY3/07A and net profit 69.8% to HK$310.8m, as the operating margin widened to 11.6% from 9.1% one year ago, thanks to strong global demand for seafood and the company's aggressive capacity expansion, especially in its high-margin fishing division.

Table 1: Business summary

Business division	Principal activities	Overview
Industrial fishing	Ocean trawling and fishmeal processing	Via CFGL, PAIH operated 46 fishing vessels in Peru and Russia at end-FY3/07. It currently has 57.
Frozen fish supply chain management	Resource development, global sourcing & supply, transportation & shipping agency	Via PAH, PAIH captured almost 20% of China's frozen fish import market in FY3/07. It plans to double the number of transportation ships to four by end-2007.
Processing & distribution	Seafood processing, global marketing & distribution, food testing	New 333,000 sqm Hongdao Plant in Qingdao completed bringing its total processing capacity to 120,000 – 130,000 tonnes p.a. from 90,000. Trial operation to start in 2007.

Source: Company data

Table 2: Growth by business segment

Year to Mar (HK$m)	2006	2007	Change (% YoY)
Turnover			
Industrial fishing	620.2	1,789.3	188.5
Frozen fish supply chain management	2,981.9	3,496.7	17.3
Processing & distribution	2,537.2	3,176.7	25.2
Others	17.7	15.8	(10.8)
Total turnover	6,157.0	8,478.6	37.7
Segmental result			
Industrial fishing	275.6	522.1	89.4
Frozen fish supply chain management	200.5	286.2	42.7
Processing & distribution	106.1	148.0	39.5
Others	(22.3)	(4.5)	(79.6)
Aggregation of segmental results	560.0	951.7	70.0

Source: Company data

Rising meat price may stimulate fish demand. China's overall food price index rose 18.2% YoY in August, with the meat price up 49.0%, which should boost demand for substitutes such as aquatic products, whose prices increased 6.2% in the month. We expect PAIH to benefit from this trend. The company had almost 20% of China's frozen fish import market in FY3/07 and generated 48.9% of its sales domestically.

Solid price trend. Most countries have induced quota systems to protect their fish resources. With the output of wild-captured fish capped, demand increases are met mainly through aquaculture. The Food & Agricultural Organization expects China's demand for seafood to rise from the current 25.6kg per capita to 34.3kg in 20 years, which should support the price of wild-caught fish in the long term.

Expanding fishing business. PAIH increased its stake in CFGL from 18.4% to 40.8% in June 2007. CFGL operates mainly in Peru and Russia, which have different quota systems. Peru caps the number of all fishing vessels while in Russia each company has a separate quota. To grow its fishing business, PAIH increased the number of vessels in Peru from 14 to 23 in FY3/07 and added another 11 in 1Q FY3/08. In Russia, it purchases or leases quotas from other finishing companies. To better utilize its 23 vessels in Russia, PAIH plans to send up to six ships to South Pacific this fiscal year, compared with three last year. We expect the industrial fishing division's revenue to increase 104.0% YoY to HK$3,650.3m in FY3/08F, compared with 188.5% in FY3/07.

Better efficiency. PAIH will add two transportation vessels to its fleet of two by end-2007 to improve the overall operating efficiency of its frozen fish SCM division. Its segmental revenue should grow at its normal rate of about 10% YoY. The division's gross margin should increase almost 1pcp in FY3/08 and FY/09, from 8.18% in FY3/07.

New processing plant. The company's new 333,000 sqm Hongdao Processing Complex (60,000 tonne p.a.) in Qingdao has been completed and trial production will start by end-2007. With plans to restructure and consolidate its existing capacity (around 90,000 tonnes p.a.) and shut down inefficient plants, we estimate that PAIH's total processing capacity will increase to 120,000 – 130,000 by end-2008. We expect major growth in the contribution of the processing & distribution business in FY3/09, with some segmental gross margin expansion.

Gross margin may improve in FY3/08. Positive factors for the blended gross margin include changes in the sales mix (higher-margin fishing business) and operating efficiency improvements in the frozen fish SCM and processing & distribution division. They should offset pressure from the fishing division brought on by higher leasing fees in PAIH's fourth VOA (signed in January 2007 to lease six supertrawlers) and possibly lower output of each vessel due to competition.

Large-scale investment to cease in 2008. The company spend around US$730m to acquire 16 vessels and two fishmeal processing plants in 1H of 2007 (calendar year). It expects to spend US$50m in 2H07 to settle all new acquisitions, which will be satisfied through internal resources. (PAIH had HK$6,060.0m in cash in hand at end FY3/07A). Thereafter, capex will be about US$5m a year, mainly for maintenance.

Undemanding valuation. The total market value of PAIH's interest in its two Singapore subsidiaries is about HK$8,126m (US$1,042m), or about HK$4.51 per PAIH share, suggesting that PAIH is trading at a significant discount to its fair value. According to our preliminary estimates, the company's revenue will increase 29.0% YoY to HK$10,935.3m in FY3/08F and EPS will be flat at HK$0.279 due to dilution caused by a share placement in June 2007. The current share price represents 8.7x forward P/E, undemanding for a Chinese food-related stock.

Corporate issues. PAIH's major shareholders include N.S. Hong Investment (BVI) Ltd (51.37%), Value Partners

(9.04%) and Leung Hok Pang (8.61%). The company issued 601m new shares at HK$1.55 each in June 2007 to existing shareholders on a two-for-one basis. In December 2006, the company issued guaranteed senior fixed-rate notes with an aggregate nominal value of US$225m, which a carry fixed annual interest rate of 9.25% and will be fully repayable by 19 December 2013.

Table 4: Major growth drivers

FY08	FY09	FY10
1. Organic growth of the industry	1. Organic growth of the industry	1. Organic growth of the industry
2. Rising food prices in China	2. Two new transportation ships	
3. Four new fishing vessels added in 2H FY3/07 and 11 in 1Q FY3/08	3. Trial operation of Hongdao plant - start Dec 2007	
4. Increased stake in CFGL from 18.4% to 40.8% in July 2007		

Source: Company data and SBI E2-Capital

Table 5: P&L

Year to Mar (HK$m)	2005	2006	2007
Revenue	5,298.3	6,157.0	8,478.6
Cost of sales	(4,675.0)	(5,226.5)	(7,156.5)
Gross profit	623.2	930.5	1,322.0
Other income	10.5	50.0	132.4
Selling and distribution expenses	(116.5)	(145.8)	(138.2)
Administrative expenses	(155.0)	(240.0)	(321.2)
Other expenses	(16.3)	(32.9)	(10.5)
Gain on dilution of interest in a subsidiary	-	220.0	385.1
Loss on deemed disposal of interest in a subsidiary	(1.2)	(12.7)	-
Finance costs	(97.7)	(204.2)	(357.3)
Share of results of associates	(0.7)	(0.4)	0.4
Profit before taxation	246.3	564.5	1,012.5
Taxation	(3.3)	(14.3)	(19.3)
Profit for the year	243.0	550.2	993.3
Minority interests	(79.8)	(367.1)	(682.5)
Net profit	163.2	183.1	310.8
Final dividend proposed	54.4	55.9	73.9
EPS – Basic (HK$)	0.163	0.183	0.270
EPS - Diluted (HK$)	0.163	0.182	0.268

Source: Company data