Pacific Andes

Tue, 02 Jun 2009

Target raised for CFG

Not Rated

Ticker:	**1174 HK**	12 mth range:	HK$0.34-1.53
Price:	**HK$0.86**	Market cap:	US$304.6m
Target:	**n.a**	Daily t/o, 3 mth:	US$0.5m
		Free float %:	25.0%

Financial summary

Year to Mar	07A	08A
Turnover (HK$m)	6,157.0	8,478.6
Net Profit (HK$m)	183.1	310.8
EPS (HK$)	0.183	0.270
EPS Δ%	12.3	47.5
P/E (x)	4.7	3.2
P/B (x)	0.55	0.48
EV/EBITDA (x)	6.9	5.3
Yield (%)	6.0	4.8
ROE (%)	12.3	16.7
ROCE (%)	10.9	12.7
N. Gear. (%)	124.6	136.6

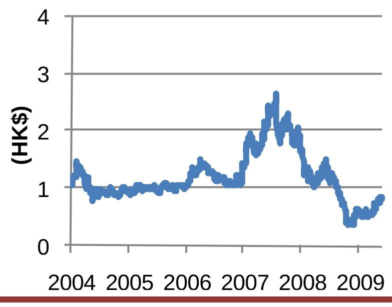
Source: Company data

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	-4.5	+3.5	-24.1
Actual price changes (%)	+16.2	+58.8	-42.3

	08F	09F	10F
Consensus EPS (HK$)	n.a.	n.a.	n.a.
Previous forecasts (HK$m)	431.8	568.4	733.8
Previous EPS (HK$)	0.236	0.311	0.401

Price Chart



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Key points:

- Trawling ASP jumped 23.3% in 1Q.
- Bunker cost declined 2.6pcp as percentage of segmental sales.
- Less anchovy catch by coincidence.
- Fishmeal price rebounding.
- Operation in South Pacific to commence in Jul.
- Positive on the outlook for China Fishery.

To roll out updates. We are reviewing our model for Pacific Andes (PAIH) and, therefore, temporarily remove both forecasts and recommendation for the counter for the moment. Nevertheless, our stage work on China Fishery (CFG), PAIH's key assets, yields positively, which will also materially impact our view on PAIH. In 1H FY03/09A, CFG contributed 32.0% of PAIH's total revenue while 66.8% of operating profit.

China Fishery

Trawling in good shape. Segmental turnover surged 38.5% in 1Q FY12/09A to US$135.0m, thanks to: 1) 12.1% increase in sales volume, which, in turn, is backed by the 10% growth in Russia's TAC for Alaska Pollock in 2009; 2) 23.3% ASP enhancement to US$1,854/tonne, explained by solid selling prices (flat QoQ but ~11% rise YoY) and change of delivery from "at sea" to "at port", which geared up realized ASP only by ~12% but had minimal impact on profitability. Despite some adverse effect from old expensive inventories, fuel cost, following declining crude oil price, dropped from 14.5% of the segmental turnover in 1Q FY12/08A to 11.9% this quarter. The management expects more saving to be observed in the 2Q and estimates this percentage expense ratio, assuming crude oil price stabilizes at present level, can be controlled at ~15% on a full-year basis (FY12/08A: 21.1%).

Less fishmeal production in 1Q. Production volume, including both fishmeal and fish oil, reduced 73.8% to 3,949 tonnes in 1Q FY12/09A because the anchovy school in the South Peru water region was occasionally a bit distant from CFG's plant this quarter, resulting in less catch under the Olympic Quota system. Nevertheless, the catch volume ramped up quickly to ~90,000 tonnes in May after fishing season opened (for the North part) in Apr. The company sold total 39,925 tonnes fishmeal and fish oil in the 1Q, up 48.0% YoY, which came mainly from inventory. As the inventory produced last year is at a relatively high cost basis, together with more fixed expenses due to expansion of fleet (from 34 vessels to 38) and processing capacity (from 549 tonnes/hour to 655) during FY12/08A, segmental gross profit squeezed substantially (our estimates: down from US$12.6m to US$3.7m). A good sign is that fishmeal price (Peru broker SA prime fishmeal spot price) rebounded from US$920/tonne in 4Q 08 to US$940 in 1Q 09 and it is now standing at US$990, suggesting an improving business outlook.

South Pacific operation on schedule. Four trawlers (freezing capacity: 150 tonnes/day each) are on their way to the South Pacific (one more ship under upgrading) and operation is expected to commence in Jul. A factory vessel (freezing capacity: 1,500 tonne/day), responsible for transportation and delivery of fish, will join later by Aug. The company anticipates an annual harvest of 200,000 – 300,000 tonnes jack mackerel, which is much higher than industry average (data from South Pacific Regional Fisheries Management Organization: ~10,000 tonnes/vessel in 2007, Kaichuang Marine: 18,516 tonnes/vessel in 2008), backed by the operating efficiency enhancement from deployment of the factory vessel. An agreement has been reached to sell all catch at US$700/tonne. Thus, the management expects this new business to breakeven this year and generate 25-30% EBITDA margin thereafter under normal conditions.

Forecast adjustment. We have detailed our estimates on the South Pacific operation by assuming an annual catch volume of 28,875 tonnes/vessel, which is 30% discount to theoretical 41,250 tonnes/vessel (150 tonnes/day times 275 operating days). This number, of cause, carries high uncertainty and we try to minimize potential impact on our valuation by adopting a high beta of 2.0. Meanwhile, we adjust our sales forecast for Alaska Pollock to factor a higher ASP due to the change in delivery method. Overall, our new earnings projection has been lift by 0.2%, 4.2% and 6.3% for FY12/09F, FY12/10F and FY12/11F, respectively. The recovering equity market has brought down market risk premium. Accordingly we raise our target for the counter from S$1.12 to S$1.44, which is 20% discount to the fair value derived from our DDM model based on 18.0% required rate of return on equity. PAIH owns 42% interest in CFG, which can translate into a market value of US$377m versus PAIH's market capitalization of US$304.6m at present.

Table 1: China Fishery's P & L

Year to Dec (US$m)	07A	08A	09F	10F	11F
Revenue	406.4	460.1	620.0	712.5	757.6
Cost of sales	(32.7)	(41.8)	(59.0)	(74.0)	(81.7)
Charter hire expenses	(77.9)	(77.3)	(91.4)	(92.9)	(94.4)
Vessel operating costs	(154.5)	(194.7)	(269.1)	(305.0)	(325.7)
Gross profit	141.3	146.3	200.5	240.6	255.8
Other operating income	3.3	1.6	3.7	3.4	4.6
Selling expenses	(11.8)	(15.6)	(36.7)	(41.5)	(44.0)
Administrative expenses	(15.7)	(12.5)	(12.5)	(13.7)	(17.5)
Finance costs	(26.8)	(31.2)	(32.7)	(31.7)	(28.9)
Profit before tax	90.3	88.6	122.1	157.1	170.0
Income tax expenses	(1.8)	5.7	(4.1)	(4.7)	(5.2)
Profit for the period	88.5	94.3	118.0	152.4	164.8

Source: Company data and SBI E2-Capital