

**BUY**  
**RM0.60**

Target Price: RM0.80

# Borneo Aqua Harvest

## Golden Harvest!

**Stock data**

Market cap (RMm) :	198.0
Issued shares (m) :	330.0
52-week range:	RM0.18-RM0.615
3-mth avg daily volume:	173,932 shrs

Bloomberg code:	BORN MK
YTD price chg:	+36.4%
YTD KLCI chg:	+33.4

Est. free float:	48.4%
Major shareholders:	
Datuk Lo Fui Ming:	43.0%
Leong Kam Heng:	11.3%

KLCI	FBM70	FBM100	Syariah	Hijrah
No	No	No	Yes	No

**Consensus**

FYE 31Mar	2010E	2011E
Net profit (RMm):	n.a.	n.a.
EPS (sen):	n.a.	n.a.

**Forecast revision**

FYE 31Mar	2010E	2011E
Net profit (RMm):	12.5	25.4
EPS (sen):	3.8	7.7

**Share price chart**


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- **An integrated marine aquaculture operator specialising in rearing high value marine fish for consumption.** Key markets including Hong Kong and China offer huge potential given the size and more importantly the purchasing power;
- **Proven processes** and ready to join the big league marine aquaculture players after gestating for the past few years. With the entire value chain under control, group is now able to chart its own destiny;
- **Rising global demand with supply unable to keep pace** presents huge opportunity for the aquaculture sector. According to Food and Aquaculture Organisation (FAO), aquaculture now accounts for some 36% of total fish production in 2006 compare with 28.9% in 2001. Should the growth for aquaculture be maintained at 6.4% while fish capture stagnates at the 2006 level, aquaculture's portion of fish production is set to exceed fish capture by 2016;
- **Strategic alliance with major wholesalers** in key markets guarantee strong take-up leaving the group to concentrate on its core competencies;
- **Minimal expectations with ample room to surprise on the upside.** High level of scepticism and perception of risk means little investor interest for now. This will soon change with growing investor familiarity underpinned by strong showing in terms of financial numbers;
- **BUY with a fair value at RM0.80 based on 12x CY2010F** representing a 40% discount to the overall market's valuation which should provide some 33% upside from the current levels. Trading at an undemanding 8.9x CY2010 is unjustified given the group's unique processes, a high level of intellectual content not to mention the immense market potential that the markets in Hong Kong and China on offer.

**Earnings Estimates**

FYE 31 Mar (RMm)	2007A	2008A	2009A	2010F	2011F
Revenue	9.1	9.9	21.3	38.3	72.1
Cost of Sales	(4.1)	(5.9)	(12.4)	(17.2)	(32.5)
GP Profit	5.0	3.9	8.9	21.1	39.7
GP %	54.7%	39.8%	41.7%	55.0%	55.0%
EBITDA	4.2	3.3	7.3	16.1	29.8
EBITDA %	46.0%	33.7%	34.4%	42.0%	41.3%
Pretax	3.1	0.7	2.7	13.2	26.7
Tax	(0.3)	(0.6)	(0.6)	(0.7)	(1.3)
MI	0.0	0.0	0.0	0.0	0.0
<b>Net Profit</b>	<b>2.8</b>	<b>0.1</b>	<b>2.1</b>	<b>12.5</b>	<b>25.4</b>
EPS	0.9	0.0	0.6	3.8	7.7
Net %	30.6%	1.1%	10.0%	32.8%	35.2%
EPS Growth	-44.7%	-96.3%	1781.5%	491.3%	102.1%
PER x)	64.8	1755.5	93.3	15.8	7.8
EV/EBITDA x)	42.3	59.1	30.0	13.2	7.2
CFS (sen)	0.6	-2.4	-1.3	5.3	1.4
P/CFS (x)	97.2	-25.2	-46.4	11.3	43.2
Gross DPS	0.4	0.3	0.0	0.0	0.0
Div Yield %	0.6%	0.5%	0.0%	0.0%	0.0%

## Business Background

**Lahad Datu, Sabah is ideal for marine aquaculture given its pristine waters**

The Borneo Aqua Group is an integrated marine aquaculture operator focused mainly on the breeding, rearing and sale of high value marine fish for consumption. Located in the pristine waters off the coast of Sabah, the operation is ideally situated to undertake such endeavours that offer vast potential given the overwhelming demand.

### Silam, Lahad Datu -Marine Paradise



Source: Kenanga Research

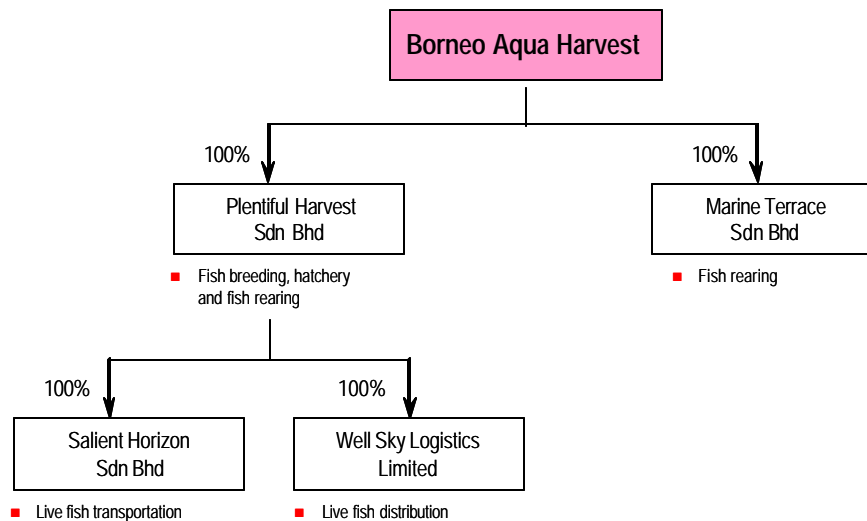
The group's hatcheries are situated in two locations in Sandakan – Pulau Palak and Mile 7 which have a combined capacity to spawn and hatch up to half a million larvae and fish fry per month with their 35 ponds. Fish rearing meanwhile is undertaken by its Lahad Datu operations in Silam which has capacity to rear up to 1m fish per annum.

### Silam HQ at Lahad Datu



Source: Kenanga Research

## Corporate Structure



Source: Company

**Growing population, rising prosperity and over fishing are key drivers for aquaculture**

**Important source of protein which has been rising**

**According to FAO, harvesting of wild fish has met its natural constraints as 70% of the oceans are overexploited**

## ■ Aquaculture is the way forward

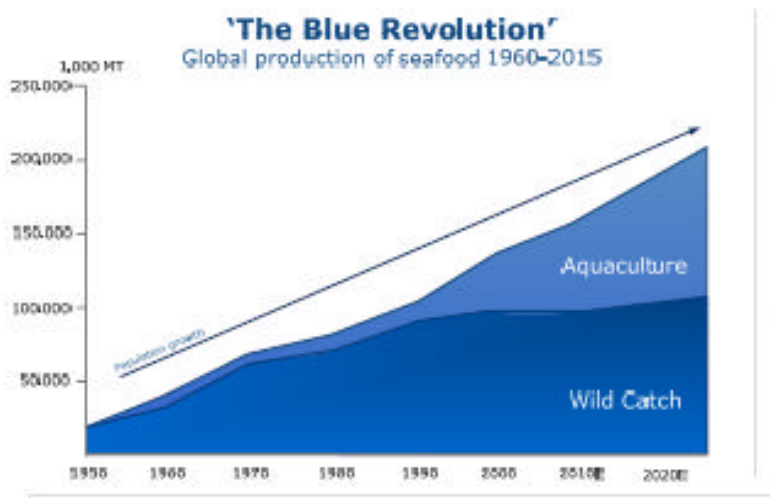
**Vast growth potential for the industry**, underpinned by the twin effects of a growing populace and rising prosperity. With fish capture stagnating for the past few years due to overfishing, aquaculture has therefore grown in prominence as an avenue to plug the supply-demand gap.

**An important source of protein**, fish provides more than 2.8b people around the world with almost 20% of their average per capita intake of animal protein. **Global per capita fish consumption has been on a steady rise over the past four decades, rising from 9.0kg in 1961 to 16.6kg in 2005** where China has been responsible for most of the increase. Population and income growth, coupled with urbanisation and dietary diversification in developing countries will continue to fuel consumption demand for fish. During periods of animal disease outbreaks such as avian influenza (bird flu), Bovine Spongiform Encephalopathy (BSE or mad cow disease) and Japanese Encephalitis affecting pigs, consumers are also more inclined to switch to alternative protein sources such as fish.

While demand is on the uptick, fish production (both capture and aquaculture) had however grown by a mere 1.9% compounded between 2001 – 2006 based on statistics compiled by Food and Agriculture Organisation (FAO). During the same period, capture fish production (both inland and marine) had contracted by 0.2% compounded while aquaculture had grown by 6.4% compounded.

**Overfishing in many of the major fishing spots** (estimated at 70%) is clearly the reason behind the flattish global fish capture which had been capped at circa 93 tonnes – 95 tonnes per annum. In fact, *Science* study predicts a collapse of all seafood fisheries by 2050. In order to satiate the growing demand, aquaculture was the only viable option which had clearly grown in importance, accounting for 36% of total fish production in 2006 compare to 29% in 2000.

## The blue Revolution



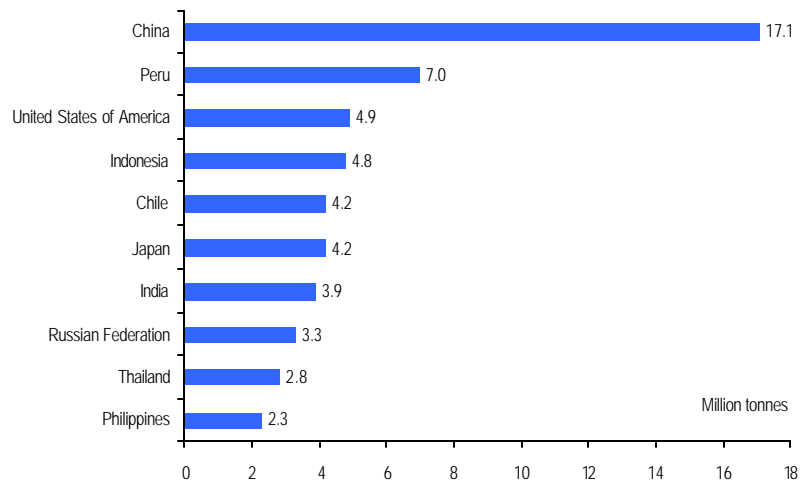
Source: Nutreco 1H08 result presentation

## World Fisheries and Aquaculture Production and Utilisation

	2001	2002	2003	2004	2005	2006	5-yr CAGR
<b>Production</b>							
INLAND							
Capture	8.9	8.7	9.0	8.9	9.7	10.1	1.7%
Aquaculture	22.5	24.0	25.5	27.8	29.6	31.6	7.0%
<b>Total Inland</b>	<b>31.4</b>	<b>32.7</b>	<b>34.5</b>	<b>36.7</b>	<b>39.3</b>	<b>41.7</b>	<b>5.8%</b>
<b>Marine</b>							
Capture	84.2	84.5	81.5	85.7	84.5	81.9	-0.6%
Aquaculture	15.4	16.4	17.2	18.1	18.9	20.1	5.5%
<b>Total Marine</b>	<b>99.6</b>	<b>100.9</b>	<b>98.7</b>	<b>103.8</b>	<b>103.4</b>	<b>102.0</b>	<b>0.5%</b>
Total Capture	93.1	93.2	90.5	94.6	94.2	92.0	-0.2%
Total Aquaculture	37.9	40.4	42.7	45.9	48.5	51.7	6.4%
<b>Total World Fisheries</b>	<b>131.0</b>	<b>133.6</b>	<b>133.2</b>	<b>140.5</b>	<b>142.7</b>	<b>143.7</b>	<b>1.9%</b>
% Capture	71.1%	69.8%	67.9%	67.3%	66.0%	64.0%	
% Aqua	28.9%	30.2%	32.1%	32.7%	34.0%	36.0%	
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	
<b>Utilization</b>							
Human Consumption	99.7	100.7	103.4	104.5	107.2	110.4	
Non-food uses	31.3	32.9	29.8	36.0	35.6	33.3	
Population (billions)	6.1	6.3	6.4	6.4	6.5	6.6	
Per Capital Food Fish Supply (kg)	16.2	16.0	16.3	16.2	16.4	16.6	

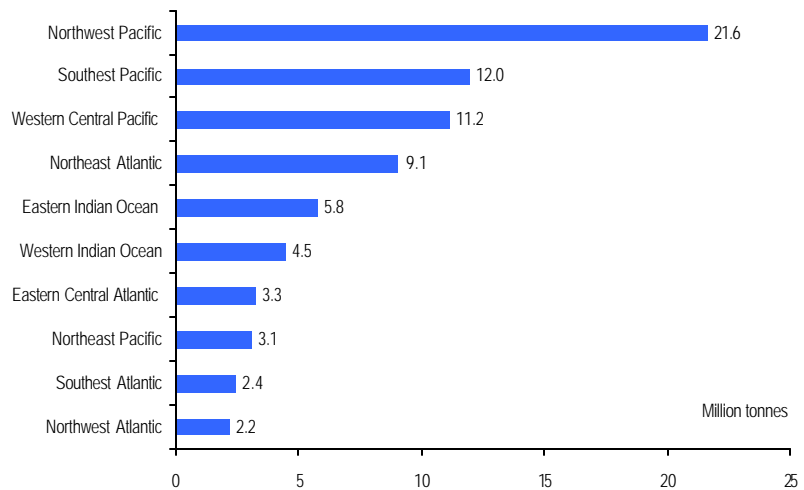
Source: Food and Agriculture Organisation (FAO) - United Nation

## Marine and inland capture fisheries: top ten producer countries in 2006



Source: The State of World Fisheries and Aquaculture 2008

## Capture fisheries production: principal marine fishing areas in 2006



Note: Fishing areas listed are those with a production quantity equal to or more than 2 million tonnes in 2004  
Source: The State of World Fisheries and Aquaculture 2008

### ■ Average selling prices is on the up

From corn to beef and nearly all the food groups, prices have been on the rise. Based on data supplied by CEIC, prices of beef and pork in Hong Kong had risen by more than 60% since 2005 while fish is up by at least 20% on average during the same period. The higher percentage increase for pork and beef is we believe due to a low base effect.

*Rising demand, stretched supply couple with the tendency to flaunt one's social status are driving prices higher*

Fish prices are on the rise especially the high commercial value marine fish, reflection of strong demand from both Hong Kong and China. A confluence of factors including rising population and rising economic prosperity are fueling a surge in demand for fish especially the high value ones including those produced by Borneo Aqua Group. A culture to flaunt one's strong financial and economic status does help to explain to a certain extent the tendency for Asians and in particular the Chinese for higher value food items including fish. Moreover, a change in dietary preference towards healthy alternatives such as fish is also spurring demand.

*Smaller fishes are at times accepted on a per head basis due to the overwhelming demand!*

The rise in demand had put pressure on production (both capture and aquaculture) which had found increasing difficulty in satisfying market demand. As a result, average table fish had shrunk in size while prices per fish had remained unchanged. From an accepted benchmark of 1.3 kg per fish previously, the bar can be lowered to as low as a mere 750g per fish due to a combination of strong demand and restricted supply. On a per kg basis, this represents a rise of some 73%.

### ■ Perception of risk should be dispelled soon

*Perception of risk is overwhelmingly high and not reflective of reality*

Noted that most of the local aquaculture undertakings have failed to gain traction due to various factors, Borneo Aqua stands out as a different proposition all together given their proven R&D capability, proven processes, strong in depth knowledge of the marine conditions and more importantly, the strong knowledge gained during the past 7 years of the entire value chain from feed to rearing of grouper fish to commercial size.

**Even aquaculture experts from established countries acknowledge the group's outstanding success**

**Secret to success is simple – replicate the natural habitat!**

**Huge demand couple with strong purchasing power spells good news**

**Huge premium for freshness**

During our visits to the farm and exchanges with some of the aquaculture experts coming as far as Taiwan to see the operations themselves agree that the group had made significant progress in the aquaculture industry especially in the rearing of grouper. While luck could have played a role in the group's stunning success in terms of introducing new species and make viable the business, a lot of hard work and common sense have been applied throughout the past few years. While not wanting to divulge too many trade secrets, suffice to note that the group's ability to customize the rearing environment as close to nature has helped to ensure the viability of the business model. More importantly, we noted that the group's high propensity to try out alternatives could partly explain their phenomenal success compare to their peers which seemed comfortable enough to be cocooned under the traditional processes which have hus far failed to generate breakthroughs.

### ■ Booming markets in Hong Kong and China

Main markets including Hong Kong and China are earmarked not only because of the huge demand but the relatively higher purchasing power as well. The China economic boom over the past few years had a cascading effect on the surrounding economies including Hong Kong which had experienced robust growth over the past few years underpinned by a steady rise in tourist arrivals especially from Mainland China.

Pampered with the best in life on the back of the booming economic growth of the past few years, preference and demand for life fish remained as strong as ever. Due to this, premium for life fish of 100% at least compare with the frozen variety is normal.

### Destined for the tables



Source: Kenanga Research

### ■ Key Operations and Capacity

The spawning and hatchery operations are currently situated in two locations in Sandakan namely Pulau Palak and Mile 7 which have a combined 500,000 monthly spawning capacity or 6m per annum with 36 ponds. Besides hatching and larvae rearing, the operations in Sandakan are also responsible to produce live feeds including rotifer and copepod for the young.

**Area gazetted solely for marine aquaculture**

Meanwhile, group has fish rearing capacity of up to 1m per annum at its operation in Silam, Lahad Datu has its future cemented with the gazetting of some 80,000 acres for marine aquaculture. This is to ensure that no developments will be undertaken that will pose significant threats to the pristine environment so conducive for marine aquaculture.

Contract farmers can also be leveraged upon should the need arises but their participation is minimal at the moment given adequate capacity for the time being.

**Ambitious plans to grow rearing capacity from 1m to 10m eventually!**

### ■ Grand Plans for expansion

Given the successful spawning track record and the insatiable demand for quality table fish, group is in the midst of raising their rearing capacity to cater for a longer gestation period. Instead of rearing the fish up to table size or what the Chinese would call as “Tou Tiu” which is approximately 1.2 kg – 1.5 kg in size depending on supply and demand, there is the intention to grow the fish to up to 8kg – 10kg in size which will involve a mere 12 months on top of the traditional 12 month cycle for a return which is much superior in terms of selling prices. Compare with a “tou tiu” of 1.2kg– 1.5kg which can fetch selling prices of approximately RM65 per fish, a 8kg fish in fact can see selling prices jumping up to even RM500 – RM800 depending on species. With incremental cost of rearing low, absolute return is therefore very attractive.

To undertake the above, group has in fact planned for the setting up of an additional 20 farms with rearing capacity of 500,000 fish per annum each. Capital expenditure of RM2m per farm is likely. Time line for the project is expected to be stretched over a period of two years.

### ■ Capital expenditure

The Group had spent RM40m over the past years to beef up its overall capacity after gaining confidence with the key-steps in the entire value chain. Going forward, the group intends to invest circa RM5m additional capacity especially rearing cages from the current 1m to 2m by FY2010.

### ■ Controls the entire value chain now

Ability to control the entire value chain is very important especially on the front end beginning with broodstock. With a good selection of broodstock, group is now able to chart their own course in terms of the best species to spawn and breed and not be at the mercy of others. Without the control of this critical part of the value-chain, the fry that any fish breeders will get from their source (likely to be another breeder) is likely to be inferior given that no one would ever want to give away their best fry / broodstock so as to maintain one's competitive edge.

The setting up of a 30 tonne holding capacity in Hong Kong is strategic at the end of the value-chain as well. With the holding capacity, group is unlikely to be forced to make a sale immediately upon landing at the shores. The luxury accorded with the holding ponds will greatly improve group's bargaining power vis -à-vis the wholesalers.

### ■ Quality controls begin from day one

The luxury of being in control of the entire value chain means that quality control starts from day one i.e. from the broodstock itself. With quality broodstock, probability of spawning quality fry will be higher which in turn helps to lift not only survival rate but their growth rate as well.

**Broodstocks hold the key**



## Filtration systems at a nursery



Source: Kenanga Research

## Advantage of marine biology

Through technology, the group is able to enhance the following:

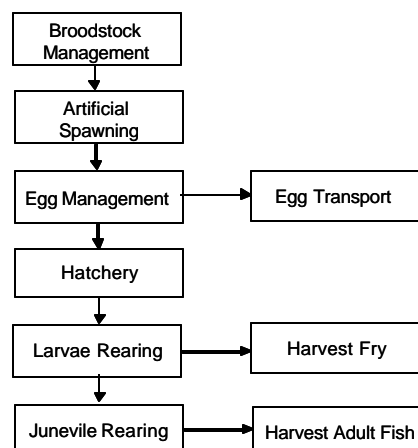
- Ability to **hasten sexual maturity** which helps the fish to breed much earlier;
- Ability to **mass produce healthy and better quality fish fry**; and
- Ability to control **production timing** according to seasonality and demand.

## Sexual maturity is hastened

Grouper Species	Under natural environment		With Borneo Aqua's Technology	
	Weight (Kg)	Age (Years)	Weight (Kg)	Age (Years)
Marble Grouper	20	10	8	5
Coral Trout Grouper	4	5	2.5	2
Giant Grouper	40	12	20	6

Source: Company

## Steps and processes



Source: Company



### ■ Broodstock Acquisition and Initial Treatment

The first of many steps to successful fish rearing starts with spawning which in turn is very much dependent on the availability of strong and healthy mature brooders. After a few cycles of experimenting and successful domestication of the brooders, the group is now able to spawn up to 500,000 larvae monthly on a consistent basis.

*Ample broodstock to sustain production cycles*

*Domestication necessary and time consuming*

Over the last two years, the group had built up a good inventory of broodstock of various species numbering some 2,000 which should be more than able to sustain the required production cycle.

Broodstocks acquired from the wild or wild fishes have to be conditioned to captivity, a process known as **domestication**. For this purpose, an appropriate density in the cage for broodstock is observed and the oxygen saturation around 100% is maintained. Then, the broodstock will be bathed to disinfect the fish from parasites.

The conditions and behaviour of the fish during the domestication process will be closely monitored to minimise stress to the fish as such stress will inhibit their sexual maturity for a certain time. All data obtained from the monitoring will be properly recorded for research purposes.

### “Happy Fish” - Broodstocks which weigh up to 50kg each!



*Source: Kenanga Research*

### ■ Artificial Spawning

Before artificial spawning, the fish will be assessed for their readiness and suitability. Once the eggs in the female broodstocks reach the size of maturity, the female broodstocks are considered suitable to be induced for spawning. As for the male broodstocks, sexual maturity is reached when they are able to release white milt from the genital. These broodstocks will then be grouped together for artificial spawning.

Artificial spawning is a process wherein exogenous hormones are injected into the broodstocks to stimulate mass spawning for commercial purpose which usually happens either during a new or full moon, depending on the species. Thereafter, most of the broodstocks will release the eggs within three to six days.

### ■ Egg Management

Broodstock spawning usually takes place at night, and the eggs produced are normally collected with a fine mesh net at the early embryonic stage between morning hours. The net is specially designed to suit the environment of the broodstock spawning cages.

*Egg management a delicate process*

Once harvested, the eggs are treated with treated seawater to prevent disease that may occur during larvae rearing. After the bath, the eggs are placed in a tank filled with treated seawater where the dissolved oxygen level, salinity, temperature and pH are constantly monitored while randomly selected samples are taken for examination to analyse the percentage of eggs that will hatch for record purposes.

## ■ Hatchery

When the fertilised or healthy eggs are received, they are placed in an incubation tank filled with treated seawater and another round of segregation process. Once the hatchery pond is ready, these eggs will be relocated into a sac within the pond for incubation.

### Hatching ponds at 7 Mile, Sandakan

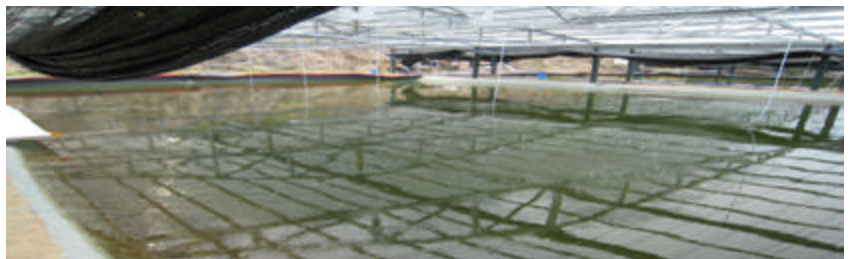


Source: Kenanga Research

Before it is stocked with eggs, designated pond is carefully examined for its cleanliness and appropriate steps are taken to ensure it has been disinfected. The designated pond will be filled with filtered and sterilised seawater where the temperature and salinity are constantly monitored and controlled to ensure that they are in accordance with the established formulae to ensure success hatching and to increase the survival rate of the larvae.

As this is a very critical and sensitive stage for the success of the entire breeding process, the water quality and condition in the designated pond are closely monitored throughout the process. The temperature, salinity and pH of the pond will be monitored and controlled throughout the period to ensure suitability for the larvae growth.

### Hatching ponds at Pulau Palak, Sandakan



Source: Kenanga Research

## ■ Larvae Rearing

**Feed is important in addition to water quality**

**R&D success in feed cultivation as well**

The success of this stage very much depends on the live feeds to be fed to the larvae in addition to the quality and conditions of the water. Through R&D, the group had successfully acquired the technology in cultivating 2 different types of live feeds namely, Rotifer and Copepod, in different sizes and in large quantity for the larvae. Without the relevant skill sets and technology to grow the live feed, it will be virtually impossible to grow the fishes / larvae. No fish food, no fish.

Copepod is an essential feed as it contains high nutrition and Omega 3 HUFA, which will increase the survival rate of the larvae.

The larvae will be harvested and segregated according to their size to prevent cannibalism during the nursery stage. The larvae will then be transferred to nursery tanks, whereby they are cultured to 10 to 20

millimetres ("mm") (for internal fish culture or rearing) and between 20 to 50 mm (for commercial sale purposes), depending on customers' requirement. It will usually take about two weeks to grow to the length of 20 mm and an additional two weeks to grow to the length of 50 mm.

### Juniors looking happy at the nursery



Source: Kenanga Research

**6 to 8 months to reach commercial size from juvenile to adult**

**12 months the norm for the entire process from spawning to adulthood**

### Juvenile Rearing

The juveniles are fed with tiny shrimps and minced fish. Special attention is provided to the deterioration of culture water to avoid any mortality occurring during this stage. The feed for the juvenile is chosen with care for their size of particles and protein level. Depending on the specie, it usually takes about six to eight months to grow the juvenile to adult for trading purposes.

All in, the whole cycle from spawning to eventual sale will take approximately 12 months.

### Nursery at Pulau Balak, Sandakan



Source: Kenanga Research

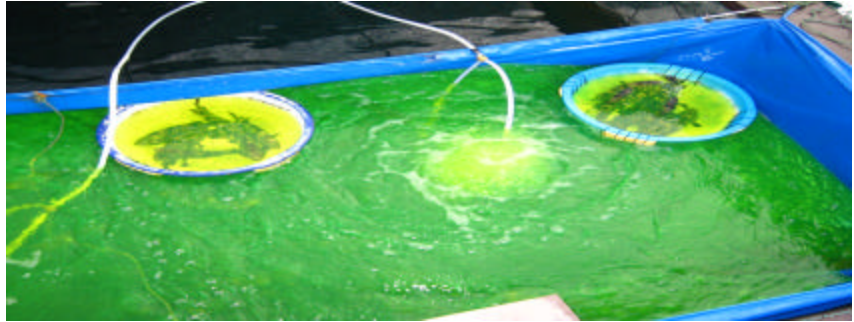
### More nursery ponds at Silam, Lahad Datu



Source: Kenanga Research



### Bath treatment to prevent diseases



Source: Kenanga Research

**Feed and labour accounts for major part of the cost of operations**

### Major costs of operations

Major costs are the norms including food and wages which accounts for the bulk of the cost of operations. Based on guidance, the cost of feed is a mere RM6 per fish to rear it to table size which is mainly trash fish mixed with fish meal.

### Dinner is being prepared



Source: Kenanga Research

### Part of the successful portfolio

1.1: Giant Grouper



1.2: Humpback Baramundi Cod Grouper



1.3: Coral RockCod



1.4: Speckled White Grouper



1.5: Marble Grouper / Flowery Grouper



1.6: Tiger Giant Grouper



1.7: Camouflage Grouper



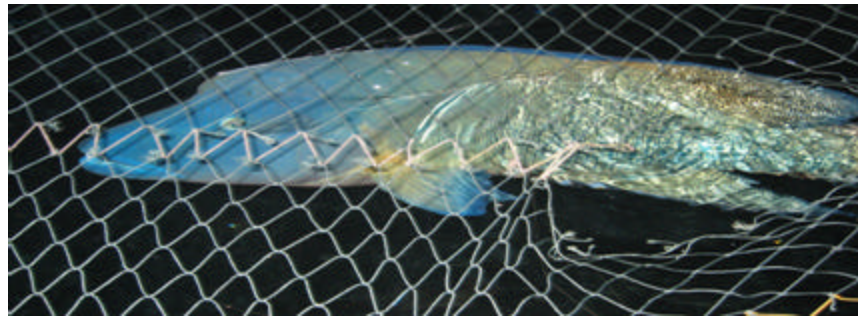
1.8: Coral Tiger



Source: Kenanga Research

Management is always undertaking R&D to improve not only on the survival rate but on the variety of fishes as well. The ability to reduce mortality and to constantly come out with new species will help towards improving profitability and ensure pricing power remain with the group.

## Napoleon alive in Lahad Datu? A protected wrasse – prototype perhaps?



Source: Kenanga Research

### ■ Transportation

Group has 2 fish transporters with a combined 60 tonne capacity to deliver live fish from Lahad Datu to Hong Kong which will involve some 4 – 5 days on a single trip. In view of the growing fish stock, group is seriously looking to add another 40 tonne carrier before the end of the year.

## Fish carrier at the second site at Salim, Lahad Datu



Source: Kenanga Research

## Competition

While competition is inevitable especially from the more established and advanced countries including Japan and Taiwan, the huge demand for food and in this case grouper should to a huge extent mitigate a substantial part of the risk.

Pristine environment, strong brood stock inventory, proven processes and proximity to key markets including Hong Kong and China are some of the key advantages that the group possesses.

**Recent typhoon in Taiwan was inventory destructive including broodstock which may take years to replenish**

To note is that the recent typhoon in Taiwan had destroyed many of the aquaculture ventures including the all-important broodstock. According to industry players, it will be many years before the existing capacity can be rebuilt but demand continues to grow on the back of rising population and a general improvement in living standards across the world.

**Technology is not easily transferable between different regions**

#### ■ High entry barriers

Fish breeding technology is not easily transferable from one country to another due to the different water condition and quality as well as weather. A long gestation period is therefore required in order to understand the water condition, behavior of different species as well as to acquire sufficient broodstock not to mention the time involved in domesticating them.

#### ■ Alliance with the wholesalers

Tie up with key wholesalers in Hong Kong / China should create a win-win for all. While the wholesalers are assured of supply, breeders such as Borneo should enjoy relatively stable pricing not to mention an instant marketing network.

#### ■ New hybrids to distant from the competitors

**First in Asia to successfully mass produce new species including Sabah Giant Grouper and Coral Rockcod**

Not contented with the traditional species, group had been busy experimenting with cross breeding to produce newer and more robust species. Currently, the group is the first company in Asia to successfully mass produce cross-breed species of Sabah Giant Grouper and Sabah Coral Rockcod.

With the ability to produce new species, the group is not only able to distant themselves from the competition but to improve on their bargaining power as against the wholesalers as well. With competition most intense in the Hong Kong restaurant market, the ability to offer new dishes including new variety of fish will go to a large extent in helping to improve the restaurant's competitiveness.

### Sewerage treatment facilities at the farm



Source: Kenanga Research

#### ■ Competitive Advantage

**Location, location, location.** Operation is strategically located in the pristine waters off Lahad Datu, Sabah. Famous for its crystal clear waters and rich marine life, Lahad Datu is ideally suited for marine aquaculture. Mother nature has indeed given the place an unfair advantage over others including Taiwan which is subject to weather vagaries including typhoon.

**Logistical advantage over its competitors.** Due to the shorter distance to key markets including Hong Kong, group is therefore able to save on transportation charges and at the same time ensure a high survival rate.



**Lower cost.** Direct cost of fish breeding in Sandakan is generally much lower compare to countries such as Taiwan. Land and labour costs are undoubtedly much lower while the easily available thrash fish at competitive prices will be an added advantage.

**Weather.** Fish will only breed during the warmer period of the year and hence spawning in temperate countries including Taiwan is only limited to approximately 6 months a year compare to Sandakan whose weather is conducive for all-year spawning.

**Proven R&D successes and capability.** The ability to have a firm grasp of the entire value chain from spawning, feed culture and rearing for high commercial value fish such as the giant grouper is a very important breakthrough. The research and technology are specifically focused on high commercial value species for commercial purpose.

**Broodstock availability.** Due to its rich marine life and more conducive water condition, it is much easier to obtain new wild broodstock of various species in Sabah's coastal area for R&D and commercial breeding purposes.

**Integrated operation** helps to ensure consistency in terms of production and quality. This in turn helps to instill customer confidence and loyalty. As mentioned earlier, the need to rely on fry purchase from other breeders are usually fraud with risk as fry of inferior quality are usually sold to other breeders.

#### ■ Fuel hike a boon?

*Higher energy prices makes fish catching a risky proposition*

Fishermen pressured by dwindling catch previously is now under even more pressure as a result of the fuel price hike. With the hike, prospects of making profit on a per trip basis have dimmed, deterring many from venturing out into the open seas. This will constrict supply further, making aquaculture that much more important.

## Financials

Admitted that the group has not been able to register much meaningful financial performance during the past few years due to the initial gestation but prospects are about to change drastically.

During the past few years, the group has been undertaking substantial R&D activity to further fine tune its processes as well as to develop new hybrid species. Topline all these years have been sustained from only selling mainly fry and juvenile fish which masks the latent potential of the group. With the processes and the necessary infrastructure now in place, the group is expected to experience phenomenal growth over the next few years.

## Risks

Like all businesses, group is subject to the typical risks including rising competition, human capital management and the risk of theft and pilferage.

The greatest risk we believe lies in the operation itself whose entire value chain is most delicate. Given the unpredictability of mother nature, it is sometimes very difficult to mitigate the risks associated with marine aquaculture. Numerous variables including water quality, on-set of diseases, failure of a rearing cycle or cycles for reasons unknown cannot be discounted.

*Strong and robust operating system in place to minimize risk of untoward incidents*

Given the delicate nature of the value-chain, a robust and proven operating system has been set in place to minimize such untoward incidents. For example, careful monitoring of water quality by its QA department as well as chemical bath to minimize incidences of disease outbreak is only routine. Moreover, with the surrounding waters off Lahad Datu now gazetted for dedicated marine aquaculture, risk of uncontrolled development we believed is mitigated.

## Investment Case

**Integrated marine aquaculture specialist** with scale and proven processes to produce on a consistent basis high-value quality table fish.

**Exposure into a fast growth sector.**

**Proven processes and scalable operation to see off competition in the near to medium term.** A combination of strong R&D capabilities couple with the pristine waters in Lahad Datu, Sabah provides for an idyllic aquaculture environment especially grouper rearing.

**Control of the entire value chain** reduces the odds for a failed harvest as weak spots are identified and remedied before it could amplify and impact negatively on the entire operation. Besides, it also gives them an edge over their competition which is less integrated and lacks scale.

**Gestation over soon** with earnings set to quantum leap over the next few years. With the processes proven to be robust after the initial trials and errors, we are expecting the group to pleasantly surprise to the upside.

**Perception of risk and scepticism to reduce over time.** We believe that investors' high perception of risk and scepticism of the entire business model means little expectations in the share price. With growing investor familiarity and improving earnings, rerating is only to be expected.

## Valuations

Fair valuing the counter at **RM0.80 based on 12x CY2010F** represents a 40% discount to the overall market's valuation should provide some 33% upside from the current levels. Trading at an undemanding 8.9x CY2010 is unjustified given the unique processes, a high level of intellectual content as well as the immense market potential of the group's products mainly in Hong Kong and Greater China. BUY.

### Earnings Estimates

FYE 31 Mar (RMm)	2007A	2008A	2009A	2010F	2011F
Revenue	9.1	9.9	21.3	38.3	72.1
Cost of Sales	(4.1)	(5.9)	(12.4)	(17.2)	(32.5)
GP Profit	5.0	3.9	8.9	21.1	39.7
GP %	54.7%	39.8%	41.7%	55.0%	55.0%
EBITDA	4.2	3.3	7.3	16.1	29.8
EBITDA %	46.0%	33.7%	34.4%	42.0%	41.3%
Pretax	3.1	0.7	2.7	13.2	26.7
Pretax %	34.4%	7.5%	12.7%	34.5%	37.0%
Tax	(0.3)	(0.6)	(0.6)	(0.7)	(1.3)
Tax %	-10.8%	-84.8%	-21.8%	5.0%	5.0%
MI	0.0	0.0	0.0	0.0	0.0
<b>Net Profit</b>	<b>2.8</b>	<b>0.1</b>	<b>2.1</b>	<b>12.5</b>	<b>25.4</b>
EPS	0.9	0.0	0.6	3.8	7.7
Net %	30.6%	1.1%	10.0%	32.8%	35.2%
EPS Growth	-44.7%	-96.3%	1781.5%	491.3%	102.1%
PER x)	64.8	1755.5	93.3	15.8	7.8
EV/EBITDA x)	42.3	59.1	30.0	13.2	7.2
CFS (sen)	0.6	-2.4	-1.3	5.3	1.4
P/CFS (x)	97.2	-25.2	-46.4	11.3	43.2
Gross DPS	0.4	0.3	0.0	0.0	0.0
Div Yield %	0.6%	0.5%	0.0%	0.0%	0.0%

## Cash Flow Statement

FYE 31 Mar (RMm)	2007A	2008A	2009A	2010F	2011F
Pretax Profit	3.1	0.7	2.7	13.2	26.7
Deprn & Non Cash Adj	1.5	2.4	3.3	2.9	3.1
Working Cap Chgs	(2.5)	(11.0)	(9.9)	1.5	(24.9)
Cash Tax Paid	(0.1)	(0.0)	(0.0)	(0.7)	(1.3)
Others	(0.1)	0.0	(0.4)	0.5	1.0
<b>CF from Op</b>	<b>1.9</b>	<b>(7.9)</b>	<b>(4.3)</b>	<b>17.5</b>	<b>4.6</b>
Capex	(12.2)	(7.5)	(17.2)	(5.7)	(6.5)
Net Inv & Sale of FA incl broodstk	(1.4)	(0.7)	(0.6)	(0.5)	(1.0)
Others	0.0	0.0	(0.8)	0.0	0.0
<b>CF from Investment</b>	<b>(13.6)</b>	<b>(8.3)</b>	<b>(18.6)</b>	<b>(6.2)</b>	<b>(7.5)</b>
Debt Raised/(Repaid)	0.0	0.0	19.4	1.9	(5.0)
Equity Raised/(Repaid)	0.0	15.8	0.0	0.0	0.0
Div Paid	(1.1)	(1.1)	0.0	0.0	0.0
Cash Int & Others	0.1	0.0	(0.2)	0.0	0.0
<b>CF from Financing</b>	<b>(1.0)</b>	<b>14.7</b>	<b>19.2</b>	<b>1.9</b>	<b>(5.0)</b>
Change in Cash	(12.7)	(1.4)	(3.7)	13.1	(7.9)
Cash C/F	16.1	3.4	2.0	(1.8)	11.3
Forex Diff on Open Bal	0.0	(0.0)	(0.1)	0.0	0.0
<b>Ending Net Cash / (Debt)</b>	<b>3.4</b>	<b>2.0</b>	<b>(1.8)</b>	<b>11.3</b>	<b>3.4</b>

## Balance Sheet

FYE 31 Mar (RMm)	2007A	2008A	2009A	2010F	2011F
Fixed Asset	21.8	25.4	40.0	43.4	47.8
Biological Assets	2.9	3.7	4.1	4.6	5.6
Other LT Assets & Intangibles	0.8	2.4	3.0	3.5	3.5
<b>Total Non Current Asset</b>	<b>25.5</b>	<b>31.4</b>	<b>47.1</b>	<b>51.5</b>	<b>56.9</b>
Cash & Equivalents	3.4	5.1	1.7	11.3	3.4
Stocks	4.8	13.4	17.6	26.8	50.5
Trade Debtors	4.0	6.6	14.7	6.3	11.9
Other Current Assets	0.9	1.4	2.1	4.7	3.2
<b>Total Current Assets</b>	<b>13.1</b>	<b>26.5</b>	<b>36.1</b>	<b>49.1</b>	<b>69.0</b>
Trade Creditors	1.1	1.3	2.6	5.0	9.4
ST Borrowings	0.0	3.4	23.1	25.0	20.0
Other Current Liab	0.1	0.6	1.8	2.0	2.0
<b>Total Current Liab</b>	<b>1.3</b>	<b>5.2</b>	<b>27.6</b>	<b>32.0</b>	<b>31.4</b>
LT Borrowings	0.0	0.2	0.2	1.0	1.0
Other LT Liab	0.4	0.7	1.3	1.0	1.5
Total LT Liab	0.4	1.0	1.5	2.0	2.5
MI	0.0	0.0	0.0	0.0	0.0
Share Cap	30.0	33.0	33.0	33.0	33.0
Reserves	7.1	18.8	21.1	33.6	59.0
Dividend / G'will on Consol	0.0	0.0	0.0	0.0	0.0
S/H Fund	37.1	51.8	54.1	66.6	92.0

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