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SEAFOOD: A GOOD CATCH.....

We have been investing in some Norway based seafood production companies and believe that they are pretty good long-term value investments. In this article, we will shed a little light on the sector and highlight some possible investments in the industry.

Efficient Food for a Rising Population

World population is projected to reach over 9 billion by 2050, 2 billion more than currently. Demand for protein is expected to increase by 40% at the same time but it is unlikely to be possibly satisfied by current consumption pattern (69% from land animals; 31% from fish)¹ since more resources are needed to raise land animals relatively to fish. Salmon has a higher feed conversion ratio (amount of feed required to increase a unit of animal bodyweight) and hence have proportionally more edible meat. This is because, in contrast to land animals, salmon are cold-blooded, and therefore do not require energy to heat their bodies; besides, they are supported by water buoyancy whereas land animals need to expend energy to stand up and withstand gravity.² It is also a climate friendly protein source, having notably less carbon footprint and consumes less water. Atlantic salmon is also nutritious; rich in omega-3 fatty acids and vitamins. Health agencies are encouraging people to consume more fish in light of the increasing global obesity rates.

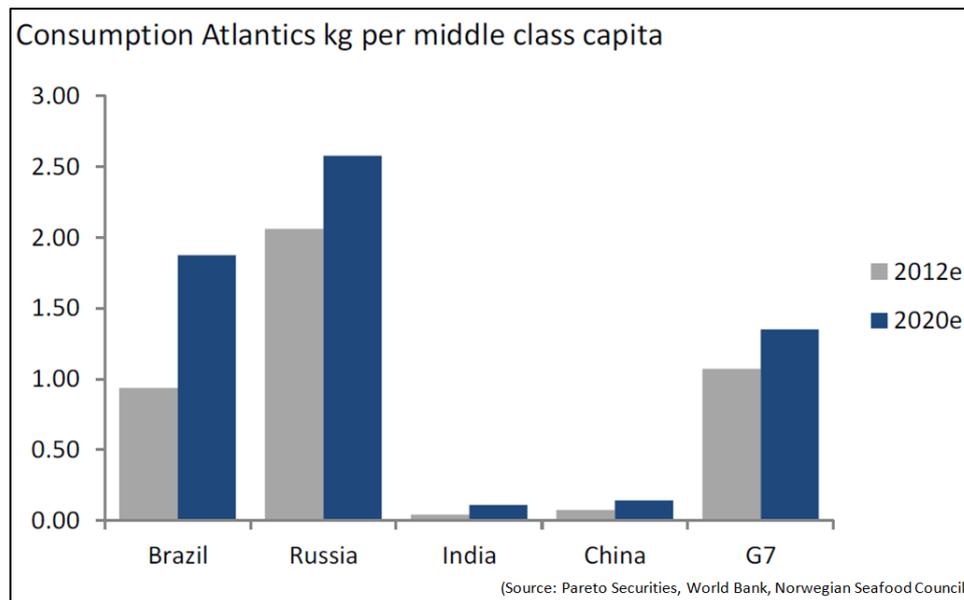
Efficient and Environmental Protein				
	Cattle	Chicken	Swine	Fish
Feed conversion kg feed/kg of animal bodyweight	4 -10 kg	2.2 kg	3 kg	1.2 kg
Edible meat per 100kg feed kg edible meat/100kg feed	4 - 10 kg	21 kg	17 kg	57 kg
Carbon footprint kg CO2/kg edible meat	30 kg	3.4 kg	5.9 kg	2.9 kg
Water consumption litre/kg edible meat	15,400 litre	4,300 litre	6,000 litre	1,400 litre

Note: Feed conversion ratio of cattle varies between 4.2 and 9.8 depending on feed (cereal or grass).
 (Source: Marine Harvest Salmon Farming Industry Handbook 2014)

Demand: Eating Habits, Middle Class and Emerging Markets

Farm raised fish will account for estimated 62% of the fish consumption in 2030, up from 49% in 2012.¹ The escalating sushi and low-carb trend will increase demand, particularly from emerging markets. Extensive growth in the retail segment and middle class typically

leads greater demand for high value products like Atlantic salmon. Massive potential lies in India and China, with virtually no consumption per middle class capita as of 2012.³ For the period 2010-2030, the World Bank predicts 30-50% increase in South and Southeast Asia, North America, Middle East, North Africa, China and Sub-Saharan Africa; whereas a decline in Japan is expected.



Industry: Consolidation, R&D and Feed Costs

Historically, the industry has been made up by many small firms which consolidated during the last decade. For the period 1999-2012, the number of farming companies in Norway experienced a 64% drop and the average output from large players increased 8 times from 5 to 38 kilotons. The 15 largest global producers control 75% of the market now.¹ Considerable R&D is undertaken in areas of fish health, environment and technology. Surprisingly, R&D on fishmeal replacement alone cost more than \$175 million; but it is worth it as the industry saves \$1.3 billion in feed costs and overall industry knowledge obtained.⁴

Top 5-10 players of farmed Atlantic salmon

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	Top 10 Norway	H.Q.	Top 10 UK	H.Q.	Top 10 North America	H.Q.	Top 10 Chile	H.Q.
1	Marine Harvest	264 000	Marine Harvest	50 000	Cooke Aquaculture*	41 500	Marine Harvest	56 000
2	Lerøy Seafood	157 000	The Scottish Salmon Company	27 000	Marine Harvest	28 000	Cermaq Chile (Mainstream)	51 000
3	Salmar	128 000	Scottish Seafarms	25 000	Cermaq	21 000	Pesquera Los Fiordos*	50 400
4	Cermaq	56 000	Grieg Seafood	18 000	Northern Harvest*	16 000	Empresas Aquachile*	47 700
5	Grieg Seafood	55 000	Cooke Aquaculture	17 400	Grieg Seafood	7 000	Camanchaca	38 800
6	Nordlaks*	37 000	**		**		Salmones Multiexport	25 750
7	Nova Sea*	34 900					Australis Seafood*	24 300
8	Alsaker Fjordbruk*	29 000					Blumar	23 200
9	Norway Royal Salmon	29 000					Invertec*	16 200
10	Bremnes Seashore*	25 000					Cooke Aquaculture*	15 300
	Top 10	814 900	Top 10	137 400	Top 10	113 500	Top 10	348 650
	MH Industry guidance	1 150 000	MH Industry guidance	140 000	MH Industry guidance	130 000	MH Industry guidance	430 000

* 2013E volume

** UK and North American industry are best described by top 5 producers as production is more consolidated.

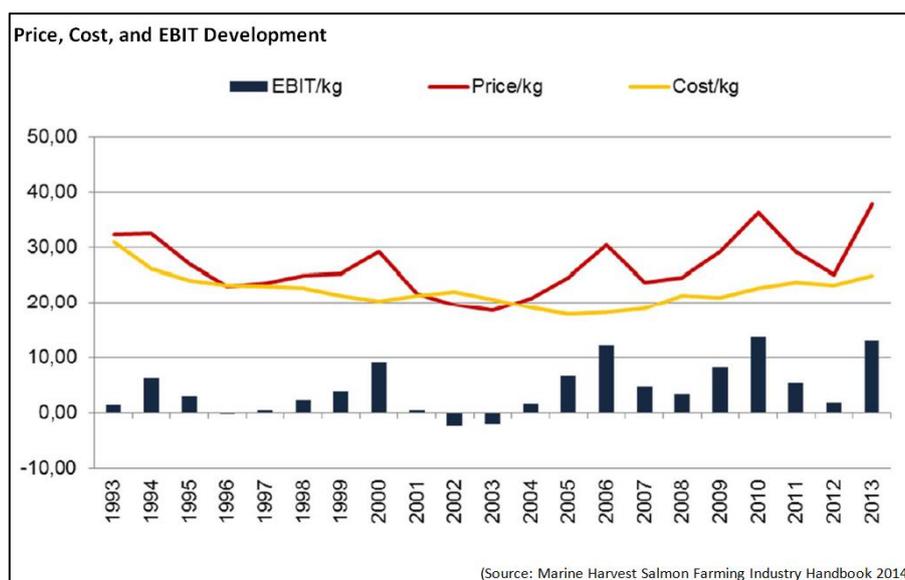
*** Joint venture between Lerøy Seafood Group and SalMar

Note: MH industry guidance does not relate to the top 10 total volume figure

(Source: Marine Harvest Salmon Farming Industry Handbook 2014)

Supply: Declining Growth, Licenses and Prices

A salmon farming production cycle is about 3 years; hence near term supply can be predicted fairly accurately. Supply of Atlantic salmon increased by a CAGR (compounded annual growth rate) of 9% since 1994 but growth diminished to 6% in the last decade and expected to lower further to 3% from 2013 to 2020, as the industry has reached a production level where biological boundaries are being pushed and growth will be limited unless there is a breakthrough in technology.² In Norway, supply growth is limited by a licensing regime and only few new licenses are expected to be issued in the near future. Production and licensing are highly regulated in Norway. A positive supply shock in 2012 resulted in prices to drop to NOK 26.6/kg⁵, a level below production costs, but it has rebounded to NOK 39.6⁵ in 2013 and estimated to reach NOK 40.7³ and NOK 41.5³ in 2014 and 2015 respectively.



For the Plate and the Portfolio

Strong demand, limited supply (at least short to medium term) and high prices will most likely cause good profits for seafood production companies in the future, provided no big shock on the demand side occurs. Current EBIT/kg for the sector is at NOK 7 and Pareto Securities expects it to be around NOK 11.8 and NOK 13.8 in 2014 and 2015 respectively. The following are some of the ways to gain exposure to this exciting industry.

Marine Harvest: Largest Fish in the Pond

Ticker	MHG NO
Mkt Cap	NOK 34.6 bn
Shrs Out	410.4 mn
EPS '13	NOK 5.95
PE '13	12.41
Div '13	4.67%
EPS '14e	NOK 8.30
PE '14e	9.10
Div '14e	11.90%

* As per 30 June 2014

Marine Harvest ASA is the world's largest producer of Atlantic salmon. It employs 10,200 people and is represented in 22 countries.⁶ The company is listed in Oslo and New York. Marine Harvest is significantly vertically integrated, providing a good exposure towards the industry and has higher margins than the average industry player. Current asset-over-liability ratio and payout ratio is high at 3.2 times and 55% respectively.⁸ A total dividend of NOK 21.4 per share is expected to be paid from now until 2016, indicating a yield of 28%.³

Lerøy Seafood Group: Good Value Protein

Ticker	LSG NO
Mkt Cap	NOK 12.3 bn
Shrs Out	54.6 mn
EPS '13	NOK 31.78
PE '13	5.57
Div '13	5.65%
EPS '14e	NOK 29.21
PE '14e	7.0
Div '14e	4.9%

* As per 30 June 2014

Lerøy Seafood Group ASA is the second largest producer of Atlantic salmon and has 1,900 employees. It has 14 processing facilities located in different European countries.⁷ The company is 63% owned by Austevoll Seafood, another Norwegian seafood company. With a strong operational track record (5Y net income growth of 69%), Lerøy is relatively cheap compared to other companies considering it at a PE of 7 and a dividend yield of 4.5% as per 30 June 2014.⁸ Based on an analysis done by Pareto Securities, Lerøy is expected to be valued at NOK 289 and NOK 326 per share for 2014 and 2015 respectively.

Bonafide Global Fish Fund: Seasickness Minimized

Ticker	BONASTR LE (CHF) BOGLFFE LE (EUR)
Assets	CHF 14.5 mn
Fee	1.50% / 10.00%
Liquidity	Weekly
Inception	CHF: 30 April 2009 EUR: 30 June 2012
YTD Rtn	CHF: 9.60% EUR: 9.48%
2013 Rtn	CHF: 20.95% EUR: 17.45%
Type	Accumulation

* As per 30 June 2014

Although seafood is an attractive industry, it is not for the faint-hearted. Volatility is high, even the blue chip stock in the industry, Marine Harvest, has a 100-day volatility of 29.7% and an average daily high-low spread of 5.85% vs. the opening price.⁸ Bonafide Global Fish Fund provides investors with exposure to the industry at a lower volatility of 14.3% and a Sharpe ratio of 1.43.⁸ The fund keeps 30-50 different positions along the fish production chain, in essence a diversified portfolio of the industry. The managers are close to the industry and meets regularly with key decision makers. A USD tranche will be launched in the coming months.



1 Year Performance of mentioned investments (Source: Bloomberg Finance L.P.)

Conclusion

We remain that the seafood industry poses a good opportunity for investors to increase returns and obtain yield in this low interest rate environment. However, investments in this sector should be taken with a grain of salt and given the risk profiles of some investors it

may not be suitable due to high level of volatility. We prefer market leading companies with a strong track record and good dividends. Granted, it is a volatile industry, but over the long term we believe it would be rewarding and we have so far seen healthy returns in our first investment in the sector. Aside from that, once invested in the sector, it might not be too off-putting to see escalating sushi and sashimi prices the next time visiting the Japanese restaurant.

Happy to discuss further and provide more info for our accredited investors.

Bon Appétit and good health.

Your Helvetic Team/Yang

References:

1. World Bank, Fish to 2030 and Some Other Perspectives, 2014.
2. Marine Harvest, Salmon Farming Industry Handbook 2014.
3. Pareto Securities, Seafood Quarterly Preview, June 2014.
4. BioMar Group, IntraFish Seafood Investor Forum, May 2014.
5. Fish Pool ASA, List Spot Prices. www.fishpool.eu
6. Marine Harvest Website, www.marineharvest.com
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