

**OCEANETHIX INTERNATIONAL HOLDINGS LIMITED UPDATE****FY 2014 REVIEW****DIRECTORS**

Chuly Lee, Chairman  
Brian Wong, Managing Director  
Nigel Wong, Executive Director  
John Dick, Non-Executive Director  
Nicole Kit Hung Tang, Non-executive Director  
John Zhong, Non-executive Director

**MARKET DATA**

NSX Code: OCX  
Current Price \$0.01  
52 week Share Price Range: \$0.01 – \$0.06  
Market Capitalisation: \$2.9 million  
Enterprise Value: \$2.8 million

**CAPITAL STRUCTURE**

Shares on Issue: 290.24 million  
Unlisted Options: 27.3 million

**FINANCIAL SUMMARY**

A\$'000 Y/E June	2013(A)	2014(A)	2015 (E)
Revenue	1,012	1,394	~600
EBITDA	387	420	breakeven
Net Profit	323	382	Small loss
EPS (c)	0.11	0.13	NA
EV/EBITDA(x)	7.2	7.3	NA
PER(x)	9.1	7.7	NA

**MAJOR SHAREHOLDERS**

Focal Creation International Holdings 10.0%  
Park Hill Management 5.2%

**SENIOR ANALYST**

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**KEY POINTS**

- Revenue up 23%; restructuring program underway
- Regional license granted in Singapore
- International and regional relationships established to secure the supply chain
- Developing fish trading operation to generate early cash flows/profits and as a pathway to develop capabilities to support large scale roll-out of the ATOLL system.
- Hong Kong facility to be downsized, Shanghai facility and a facility is planned for Shenzhen

**INVESTMENT PROPOSITION**

Oceanethix provides investors with exposure to the very large seafood market in Asia and the rapidly growing demand for high quality fresh seafood. The company's ATOLL system has the potential to transform the live seafood logistics industries in these regions where there are major issues regarding product quality and high mortality rates. The customer value proposition is compelling and the company's technology represents a radical departure from traditional growing and handling processes.

In the short term, however, a focus on seafood trading for early cash and profit generation will better place the company for a sustainable roll-out of its ATOLL system.

## Event

The table below summarises Oceanethix' FY 2014 financial performance.

(HK\$000) Year end 30 June	2013	2014	%chg
<b>Sales Revenue</b>	<b>8,060</b>	<b>9,923</b>	<b>+23.1</b>
<b>EBITDA</b>	<b>3,078</b>	<b>2,990</b>	<b>(2.9)</b>
Depreciation & Amortisation	-	(265)	
Finance Charge	-	(2)	
Pre- Tax Profit	3,078	2,723	(11.5)
Tax Expense	(508)	-	
<b>Net Profit</b>	<b>2,570</b>	<b>2,723</b>	<b>+5.9</b>
Net Operating Cash Flow	(5,798)	(2,896)	(50.0)
Total Assets	15,739	22,649	43.9
Net Cash	616	885	43.7
Shareholders' Funds	10,043	16,367	63.0
Average HKD/AUD exchange rate	7.96	7.12	(10.6)
HKD/AUD 30 June exchange rate	7.33	7.26	(1.0)

The FY 2014 results were in line with the forecasts outlined in the March 2014 investor presentation. The main contributors to revenue were the sale of the Singapore license and fees for the handling of live seafood, primarily through Shanghai. The slight fall in EBIT was attributable to increased costs associated with the ramp up of operations, business development and the employment of additional staff. Due to the significant depreciation of the HKD during FY 2014, the results translate into a significant increase in profit in AUD terms.

The company's balance sheet is strong, although small, with no debt and cash of HK\$885K. IP has not being capitalised and the only intangible is capitalised NSX listing fees (\$HK\$4.7 million) which is represents 29% of shareholder equity. Nonetheless, Oceanethix is going through a rapid growth phase and incurred an operating cash flow deficit of HK\$2.9 million in FY2014. Whilst cash resources are available to manage a similar deficit in FY 2015 should the need arise, resources are very limited in terms of being able to support working capital required for rapid growth.

## Analysis and Comment

Fiscal 2014 was a year of transition for Oceanethix as it ramped up commercialisation strategies for its ATOLL technology for the handling, storage and distribution of live seafood. During the year, considerable effort was directed to bringing together the various elements of the supply chain for the distribution of live seafood from around the world into the vast China market. The key achievement was the granting of a country licence in Singapore for the sale, distribution and support of ATOLL equipment and technology in that market.

Aside from the Singapore licence, the company continued to develop relationships with distributors, producers and exporters of live seafood in Australia, the Middle East and elsewhere; and assessed a range of potential distribution and holding facility locations in land locked cities throughout China.

Since the end of the financial year, there has been a change in management and strategic direction. New management, which is associated with the company's largest shareholder, formed the view that the strategic plan based on securing country licences and selling and supporting ATOLL systems was unsustainable. Essentially, Oceanethix does not presently have the technical or financial capacity to support a roll-out of systems at the pace projected in the original plan. The market analysis that underpinned the original plan remains valid; that is that there is a large untapped market in inland China for high quality, live seafood and the closed loop ATOLL system is ideal for managing live seafood through the distribution system. However, Oceanethix lacks the capacity to support demand for as many as 100 systems, at a time, from potential customers. In other words, the business case remains valid but the potential market is beyond the company's capacity to support in the short to medium term. Accordingly, the new plan is focussed on short to medium term cash and profit generating opportunities whilst building capacity to support the longer term demand potential for the ATOLL system.

The new management team is committed to the ATOLL system but will slow down the sales roll-out with a view to building up technical support capacity over the next year or two. Smaller sales opportunities will be pursued as they arise and will be invaluable in demonstrating the company's ability to manage the system and to provide technical support but larger opportunities will be left for the time being. In the meantime, cash flows will be generated from the development of a fish trading business.

The fish trading business will be centred on Hong Kong, which will be re-balanced, and nearby Shenzhen whilst the Shanghai facility will be sold. Shenzhen will be a new facility which will be owned by a third party and will operate 8 to 12 ATOLL modules. Oceanethix will receive between 20% and 30% equity in this venture for supplying the modules and will receive management fees for providing technical support. Hong Kong will be downsized from its current 16 modules to about 8 modules substantially reducing operating costs. It is expected that processing capacity will rise from 2 tonnes per month to about 10 tonnes per month over the next year.

Management expects this new strategy to markedly reduce pressure on Oceanethix's financial resources, enabling it to move towards sustainable profitability whilst developing technical support capacity ahead of a managed build-up in sales.

The March 2014 investor presentation argued that revenue and profitability will ratchet up in FY 2015 with a rapid escalation in equipment sales and the volume throughout of live seafood being managed. The company reports that agreements and MOU's have been signed and deposits taken for a number of projects, which are now in the design phase. In view of the change in strategy and the slower pace of the sales roll-out, the company is now expected to generate a breakeven result or a small operating loss in FY 2015 ahead of a return to profitability in FY 2016. The FY 2015 forecast is based solely on fish trading operations with no expectations

regarding the sale of ATOLL modules. The company's major shareholder, Focal Creation Group has issued a statement of support and a commitment to meet all liabilities for 12 months.

The business case which underpins Oceanethix' strategies is powerful; poor storage and handling of live seafood throughout the China supply chain results in high mortality, low quality and limited supply beyond the coastal regions. Accordingly, the company's closed loop technology is gaining considerable interest. But strategies will continue to evolve in response to requirements of the target market as well as its own technical and financial capabilities.

## BUSINESS OVERVIEW

NSX listed, Oceanethix is commercialising an innovative technology for the handling, storage and distribution of live seafood into China. After more than ten years of development, Oceanethix launched in 2014 its unique closed loop system which promises to vastly improve the quality and efficiency of the live seafood supply chain from grower to the table.

The company's ATOLL technology is a modular system designed primarily to address the problem of handling and transport of live seafood in Asia, and China in particular. The specific problems addressed by the technology are polluted growing and handling environments, poor storage and transshipment capabilities and high mortality rates.

ATOLL is a closed loop system designed for both the aquaculture and logistics markets. It incorporates a storage tank with 100% water and waste recycling together with filtration and feeding systems controlled through a sophisticated monitoring platform. The system enables seafood to be stored and warehoused inland and away from coastlines but close to markets and it can also be used in logistics management for the handling of seafood in transit to and through markets.

The technology delivers markedly lower mortality rates (to as low as 5%), much better quality and access to new markets previously too remote for live seafood. Accordingly, higher quality, higher value product is more accessible and will gain share from lower quality chilled and frozen product..

The business model is based on building and managing production /handling facilities for distribution or logistics customers; a turnkey solution. Revenue will be generated through the sale of the modules which have a holding capacity of about 500kg, and a management fee based on volume throughout.

To demonstrate the functionality of the ATOLL system, Oceanethix has fully operational demonstration facilities in Hong Kong and Shanghai, where live seafood is managed for third party wholesalers/distributors. The Hong Kong facility has 16 ATOLL modules, with a holding capacity of 5 to 7 tonnes, operating on the 15th floor of a logistics facility, in an industrial area, whilst the Shanghai facility, which is operating within the Xi Jiao International Fresh Food Logistics Market, has two ATOLL modules.

Following a change in management in August 2014, the company has slowed its commercialisation strategy following a review of its progress which concluded that the company had neither the technical or financial resources to support a rapid build in sales of ATOLL modules. The company is now developing a live seafood trading business as a pathway to early, reliable cash flows and profits whilst also providing the opportunity to build technical support capabilities ahead of a more managed build up in ATOLL sales over the next few years.

To support this new strategy the Shanghai demonstration facility will be sold, Hong Kong will be downsized and a new specialised facility will be developed in nearby Shenzhen, of which Oceanethix will own 20% to 30%.

## **BUSINESS DRIVERS AND GROWTH PROFILE**

East and South East Asia (including China and Japan) dominate the world's seafood industry and account for nearly two-thirds of the annual 126 million tonnes of fish consumed globally as food (FAO). Aquaculture is the source of about 40% of global fish production, however, it contributes in excess of 70% of China's annual production.

Seafood has long been a food staple and the primary source of protein in Asia with the industrialisation of China over the past 20 years and the steep rise in the middle class driving substantial growth in the level of consumption of live seafood. Annual per capita consumption of live seafood is expected to increase from under 20kg in 2004 to nearly 36kg in 2020. However, the Chinese the production and supply chain is ill prepared for this growth.

Leaving aside poor growing conditions and weak quality control, the handling and distribution system is poor and inefficient resulting in high mortality rates. Poor handling conditions also adversely affect the large volume of imported seafood from Australia, North America and elsewhere. Whilst fresh seafood is readily available in the main cities and coastal regions, inland provinces and lesser cities mostly have access to only lesser quality chilled and frozen seafood. These issues are also typical of much of east and south east Asia.

With rising incomes, demand for higher quality product will rise as will demand for newer, imported "exotic" varieties.

Oceanethix' ATOLL system has the potential to transform the production and supply chains for fresh live seafood. As a growing system it will open up vast areas of land locked China and elsewhere to high quality fresh seafood. The system will enable aquaculture to be industrialised and transformed from a rural land/water intensive industry into an urban industry. Oceanethix has demonstrated the potential by locating its own modules on the 15<sup>th</sup> level of an industrial building in Hong Kong, whilst The Korea Maritime Institute has a vision to develop vertical aquafarming centres of 15-20 storeys and selected ATOLL in 2012 as its preferred technology due to its 100% water recycling and zero waste discharge. Notwithstanding, strong interest in this area, Oceanethix is focussed on logistics applications of its technology.

In the short to medium term, however, the high demand for fresh seafood coupled with the development of the ATOLL marketing chain has created an opportunity to directly trade fresh seafood rather than manage inventory for third parties. Whilst there are additional risks in managing and trading its own inventory, capital is turned over much faster than compared with the original strategy of selling and managing ATOLL systems.

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