

5 BUSINESS AND OPERATIONAL OVERVIEW

5.1 History of the Coastal Group

The Group ventured into vessel manufacturing and marine engineering in the early 1990s from a vessel chartering business Mr Ng Chin Heng took over in the 1980s. In the ensuing years, the potential of the vessel manufacturing business and the encouraging demand for small and medium-sized marine vessels coupled with the incentives given by the authorities led to the Group's venture into vessel manufacturing. In 1990, the Group acquired 2 parcels of land covering approximately 17.66 acres in Seguntor to build a shipyard. The construction of the shipyard was completed in 1992. By 1993, Ng and his brothers completed and delivered over 10 units of vessels. Using a hands-on management approach, Ng Chin Heng and his family continued to expand the business. In 1996, the Group obtained its PUKONSA (Pusat Pendaftaran Kontract-Kontract Kerja, Bekalan dan Perkhidmatan Negeri Sabah) license.

On 18 June 1994, having established a commendable track record in the production of marine vessels, SM was admitted as an Ordinary Member of the Association of Marine Industries of Malaysia (formerly known as Association of Shipbuilders and Repairers of Malaysia) (Membership No. OM0030/94). In 1995, SM attained the status as an approved contractor for government related bodies. Throughout the years, SM undertook ship repairing works for government vessels, such as warship and patrol boat. However, the Group increased its opportunity to serve the government when BSR was approved as a shipbuilding contractor for government related bodies in 2001.

BSR was officially granted by MITI the manufacturing license to build and repair ships in January 1998. The manufacturing license enabled the Group to launch bigger scale of shipbuilding operations as the license removed the employment constraint imposed on SM by the state authority and in order to minimise duplication in the manufacturing process as well as to promote specialisation, the Group streamlined the activities between BSR and SM, whereby BSR is solely concentrate on shipbuilding and technical portion of the vessel whereas SM concentrates on ship repairing and to produce mainly the hull of a vessel for BSR to carry out value added works.

On 16 February 1998, the Malaysian Industrial Development Authority granted approval to BSR to obtain the certificate of Industrial Pioneer Status that provides tax exemption for 85% of its vessel manufacturing statutory income for a period of 5 years. On 23 August 2001, MITI approved and granted BSR pioneer status for a 5-year period commencing from 1 April 2000 to 31 March 2005.

The Group is able to offer almost immediate delivery, subject to the need to customise vessels, as customers are given the option to select from its existing fleet of uncommitted vessels. Additionally, the ability to manufacture and deliver reliable vessels has established the Group as a reputable vessel manufacturer. Armed with the technical know-how and management capabilities, the Group offers an array of vessel designs to meet its customers' needs.

Over the years, the Group grew rapidly as it began to attract overseas customers from countries such as Indonesia, Singapore, South Korea and the Netherlands.

Two of Coastal's subsidiaries, SM and BSR were awarded the Enterprise 50 Award by the Minister of International Trade and Industries for the year 2000 and 2002 respectively.

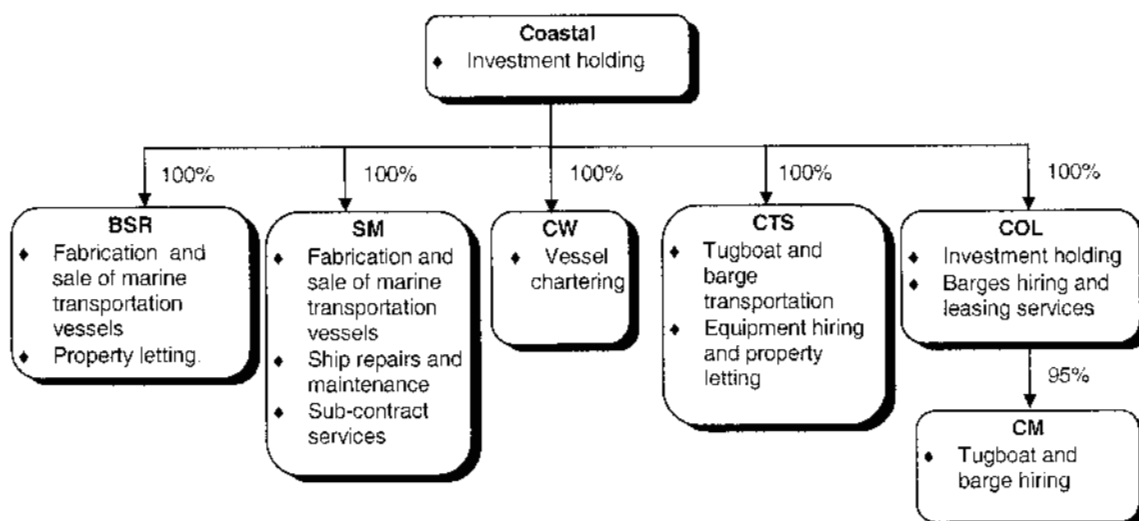
5.2 Products

The Group specialises in the manufacturing of coastal marine vessels primarily tugboats and barges. Ferries and others such as fire fighting vessels are also manufactured but to a smaller degree. In addition to manufacturing, the Group also has the expertise to provide ancillary repair and maintenance services. Complementary to its core vessel manufacturing activities, the Group offers chartering services of an array of vessels.

Specifically, the Group is engaged in the following activities :-

- manufacturing of vessels, mainly tugboats and barges;
- the provision of repairing and cleaning services for boats, ships and other vessels; and
- the provision of vessel leasing/chartering services.

The Coastal Group's structure illustrating the principal activities of the respective companies is as follows:-



The three (3) core activities of the Group are manufacturing, repair and maintenance of vessels as well as vessel chartering services.

5.2.1 Manufacturing of marine vessels

The Coastal Group manufactures vessels broadly categorised as tugboats, barges, landing crafts and ferries suitable for coastal transportation and deep sea deployment. The following table provides further descriptions on the vessels manufactured by the Group :-

Vessels	Length	Capacity*	Type Built	Functions
Tugboats	Ranges from 50 to 100 feet	Ranges from 350 to 2,400 bhp	All types	For towing ships and barges. Also for more specific use such as for fire rescue.
Barges	Ranges from 65 to 300 feet	Ranges from >100 dwt to 6,000 dwt	Oil/water barges	To transport liquid cargo such as petroleum, crude palm oil, water and soya bean oil.
			Deck cargo / Dumb barges	To transport bulk cargo such as sand, granite, logs, timber products, heavy equipment etc.
			Lighters	Perform functions similar to Deck Cargo Barge, except that cargo is not stored on deck but in shielded compartments.
			Others such as piling barges	Equipped with machinery and equipment to carry out piling work on sea bed in shallow waters.

Vessels	Length	Capacity*	Type Built	Functions
Landing Crafts	Ranges from 70 to 250 feet	Up to 2,000 dwt	General	Designed to move cargo, machinery and equipment close to the shore.
Ferries	Ranges from 80 to 120 feet	Up to 150 dwt	Ordinary (passenger/vehicle ferry) Ro-ro double-ended ferry	To transport passengers and vehicles across rivers or other small bodies of water. As above, with additional ability to allow vehicles to roll-in and roll-out from both ends of the ferry.

* Tugboats are commonly described by their brake horse power (bhp - a measure of engine power) while barges and other cargo watercrafts are described in terms of carrying capacity i.e. deadweight tonnes (dwt - a measure of the total load which a ship can carry)

Tugboats and barges are the most frequently built vessels by the Coastal Group. A tugboat is an engine-powered vessel generally designed for towing. It is also used for towing operations in ports.

To a smaller degree, the Group also builds other specific types of motor-powered vessels for example fire rescue tugs. Apart from marine vessels, Coastal occasionally constructs buoys used as temporary parking stations in sea borne operations.

A barge, on the other hand, is a flat-bottomed steel vessel used for transportation of cargoes customarily used in commercial ship canals and in ports where larger ships are unable to load or unload at the quay due to shallow draft. It is commonly used for breaching operations for the purpose of loading and unloading cargoes in remote and shallow water inaccessible to conventional ships. But more specifically, different types of barges cater for dedicated purposes. Oil or water barges are equipped with tanks to contain and transport liquid consignments. Deck cargo or dumb barges transport bulky goods for example sand, granite, logs, timber products and heavy equipment. Lighters perform similar functions to a deck or dumb barge except that lighters provide additional cargo protection as the shipment is loaded into shielded compartments. The Group builds other types of barges made for specific purposes. A piling barge for example is used for water piling works.

The Group has proven expertise to manufacture common ferries used to transport goods and commuting purposes. The Group manufactures Ro-ro ferries that are not dissimilar to ordinary ferries except that a Ro-ro ferry is capable of rolling vehicles in and out from both ends.

5.2.2 Ship Repair and Maintenance

Due to its ability to manufacture vessels, the Coastal Group also provides a full range of vessel repair and maintenance services. These include:-

- High pressure water and steam cleaning;
- Copper slug blasting;
- Changing and painting of hull steel plates;
- Repair, repitch, rebuild and static balancing of propellers;
- Alignment of propeller shafts;
- Re-build and straightening of propeller shafts;
- Chaulking of wooden hulls;
- Refurbishment and renovation of internal hull;
- Overhaul of main engines, generators, pumps and other mechanical works; and
- All other engineering, mechanical and electrical jobs.

5.2.3 Vessel Leasing/Chartering Services

As at 31 December 2002, the Group has a fleet of 46 vessels for its vessel chartering services, comprising 19 tugboats, 9 oil barges, 17 dumb barges and 1 landing craft. The fleet of vessels is able to serve and cater for a wide range of customers with different requirements. Under a leasing or chartering arrangement, vessels are leased or chartered to customers for duration ranging from a few hours to several years. The areas of operations for the Group's chartering services are in Sabah, Sarawak, Peninsular Malaysia and Indonesia.

The chartering services provided by the Group comprise principally bareboat charter and time charter.

- ◆ Under a bareboat charter, vessels are chartered out without crew for a specific period of time and the maintenance and operating costs of the vessels are borne by the charterer;
- ◆ Under time charter, the vessel with crew and equipment, are placed at the disposal of the charterer. Chartering fee is calculated based on the actual period of time chartered by hirer. Subject to restrictions in this type of contract, the charterer normally decides the type and quantity of cargo to be carried and the ports of loading and discharging; the charterer is also responsible for fuel costs and other payments such as cargo handling operations, port charges, pilotage and towage; the technical operation and navigation of the ship remains the responsibility of Coastal.

Occasionally, the Group also provides trip chartering where the chartering fee is calculated on a rate per trip, which is based on the distance chartered. In this respect, the fuel costs and other payments such as fuel cost, cargo handling operations, port charges, pilotage and towage are borne by the Group.

The Coastal Group's vessel manufacturing contract and vessel chartering services are at times packaged together for their customers. Ships built by Coastal may be chartered by their customers with an option to buy the chartered vessels at the end of the lease period.

5.3 Location of Operations

The Group operates its activities from its shipyard at Seguntor, Off Mile 9, Labuk Road, Sandakan located within the Seguntor Integrated Timber Complex approximately 18 km away from Sandakan town centre. Situated at the river bank of Sungai Seguntor, the shipyard has a total land area of 17.66 acres.

The shipyard is equipped with, among others, the following facilities:-

- One 165 metres long building platform for ship construction and another smaller platform for smaller construction works. The platform is capable of handling vessels of up to 6,000 dwt;
- Two dry dockyards with slipways for repair and maintenance activities, both with reinforced concrete surface, rail tracks and winching system capable of hauling 3,000 dwt;
- One main fabrication building with overhead cranes for heavy steel plates storage and metal fabrication activities; and
- Two workshops with overhead cranes.

In total, the shipyard has the capacity to manufacture up to 21 vessels per annum depending on the size and complexity of the vessels.

The shipyard is well equipped with modern facilities. It has an adequate range of high precision steel cutting and welding machines, the essential tools for ship fabrication and repair activities. These include semi-auto straight-line cutting machine, semi-auto profile cutting machine, CNC cutting machine, semi-auto welding machine, roller machine, press machine and shearing machine.

In addition, the shipyard is installed with heavy lifting equipment for lifting and hoisting of heavy parts and components. This includes a 60-tonne capacity gantry crane, powered by electric motors, installed on-site for use primarily to lift completed sections or heavier components of vessels for final assembly.

Taking cognisance of the opportunities accessible abroad and also to further extend its business reach, the Company set up an office in Jakarta to monitor and facilitate its Indonesian operations.

The Coastal Group has not experienced any major business interruptions during the past 12 months.

5.4 Major Customers

The Group caters to both the local and international markets. Its customer profile is diverse ranging from large private companies to government entities. For the financial year ended 31 December 2002, there was no customer that accounted for 10% or more of the Group's revenue. Coastal's top 10 customers for the financial year ended 31 December 2002 are as follows.

No.	Customer	Country	Revenue RM	Percentage Contribution	Segment	Length of Relationship
1	Pt Asia Perdana	Indonesia	4,000,000	9.4%	Shipbuilding	3 yrs
2	Pt Lintas Global Armada	Indonesia	3,405,000	8.0%	Shipbuilding	<1 yr
3	Pt Adas Sejahtera Samudera	Indonesia	2,984,200	7.1%	Shipbuilding	<1 yr
4	Victors Dua Tiga Mega Maritim	Indoneisa	2,821,635	6.7%	Chartering	3 yrs
5	Mega Steel Sdn Bhd	Malaysia	2,348,841	5.6%	Chartering	<1 yr
6	Raythorn Technical Services Co	Australia	2,339,000	5.6%	Shipbuilding	<1 yr
7	Pt A Rasmamulia	Indonesia	2,144,803	5.1%	Shipbuilding	1 yr
8	Royal Malaysian Navy	Malaysia	2,018,947	4.8%	Ship Repairs	8 yrs
9	Onika Quarry Sdn Bhd	Malaysia	1,859,167	4.4%	Shipbuilding/ Ship Repairs	2 yrs
10	Pt Skren Sarana Samudera	Indonesia	1,571,168	3.7%	Ship Repairs/ Chartering	3 yrs

The Group's major customers differ from year to year because the business of vessel manufacturing involves a long production and delivery period. Coastal's operating capacity is also restricted by the quantum of working capital. Hence, the Board believes the Group is not heavily dependent on any of its customers as it has a diversified portfolio of customers.

5.4.1 Vessel Manufacturing

The Group's marine vessels have been exported to Indonesia, Singapore, Hong Kong, South Korea, the USA and Gabon. A snapshot of Coastal's export and local sales track record is as tabulated below:-

	1998		1999		2000		2001		2002	
	RM'000	%	RM'000	%	RM'000	%	RM'000	%	RM'000	%
Local	710	24.6	-	-	3,780	33.3	2,580	10.7	5,550	24.5
Export	2,177	75.4	12,375	100.0	7,563	66.7	21,441	89.3	17,124	75.5

The following table shows the number of vessels built, sold and delivered by country of destination from 1998 to 2002:-

Country	Unit Sold	Sales Value RM'000	%, in terms of Sales Value
Malaysia	17	12,620	17.2
Indonesia	37	43,943	59.9
Singapore	1	2,177	3.0
Hong Kong	1	1,800	2.4
South Korea	2	4,807	6.6
Gabon	1	5,614	7.7
USA	1	2,339	3.2
Total	60	73,300	100.0

* Including 16 vessels disposed by the chartering division but excluding 40 vessels acquired by the chartering division from shipbuilding division.

5.4.2 Repair

Besides constructing new vessels, the 2 slipway facilities at the shipyard serve the repair and servicing requirements of vessels plying in the surrounding regions. Malaysian vessels are the major revenue contributor to the Group's repair and maintenance activities.

The Royal Malaysian Navy is the largest contributor to the Group's repair and services division as the Group repairs and maintains their local small to medium-sized warships and patrol boats. The aggregate value of repair and services contracts awarded to the Group by the Navy from 1998 to 2002 amassed to RM12.03 million which is approximately 71% of total repair and services income of the Group. The Royal Malaysian Navy forms a large part of the repair and services income of the Group and has constantly contributed more than 10% of total repair and services income.

Nevertheless, the Board believes that the Group is not dependent on the Royal Malaysian Navy as the Group repairs and maintains other commercial tugs, barges, ferries and landing crafts from Singapore, Indonesia and various parts of Malaysia. Further, repair income contributes to less than 10% of Group revenue for the year ended 31 December 2002.

5.4.3 Vessel Chartering

As for the Group's chartering services, most of its marine vessels are presently chartered by Malaysian and Indonesian companies. Most of the vessels are currently booked for periods ranging from 6 months to 2 years.

5.5 Marketing Approach And Business Network

The Directors and key management are actively involved in marketing of the Group's products and services and procuring new businesses in identified business regions by calling on to prospective and existing business counterparts. Additionally, the Group also expands its reach by employing other methods to increase its business base. The primary methods include:-

- a) contacts provided by individual brokers. These brokers earn a commission from the business introduced to the Group;
- b) setting up of strategic marketing offices in regions of interest;
- c) private and government tenders;
- d) its website at <http://www.coastalcontracts.com> that has been set up to disseminate information pertaining to the Group's marine-related activities and to solicit inquiries from other countries; and
- e) trade fairs.

Apart from the above, Coastal has already established a network of business contacts that often lead to further business opportunities instigated by referrals and/or repeated orders or use of the Group's other services.

5.6 Source Of Raw Materials/Inputs and Major Supplier

Steel materials such as steel plate, bar and pipe are the main components of the vessels produced and repaired by the Group. They account for about 70% of the cost of the vessels particularly for barges. Steel materials are mainly sourced from trading houses in Singapore. Besides that, the Group purchases vessel hulls from China, which constitute a bulk of the Group's purchases.

Engines, an important component for the vessels produced or repaired by the Coastal, are sourced from local agents. For example, CAT engines through Tractors Malaysia (1982) Sdn Bhd, and Cummins through Scott and English (M) Sdn Bhd.

Raw materials can be sourced at competitive prices from other international suppliers. Over the years, the Group has built a good working relationship with its main suppliers. Major suppliers of the Group for the financial year ended 31 December 2002 are as tabulated below:-

Supplier Name	Place	Supply of	Length of Relationship	Percentage of purchases, %
China Communication Import & Export Corporation	China	Hulls	3 years	28.5
Nanjing Machinery, Metal, Mineral Import & Export Corporation	China	Hulls	7 years	24.6

The Group has the expertise to perform the entire manufacturing process. At times, especially at peak periods, when human resources restrict work, the Group outsources part of the manufacturing process on a "contract to contract basis". These sub-contractors are primarily involved in the manufacturing aspects of the construction process, including structural and component fabrication, closely monitored by the Group's personnel.

The main sub-contractors employed by the Group are Syarikat Jutawan Enterprise, Sanmarine Engineering Sdn Bhd, Lasco Engineering Work, Berladah Tech, Damai Jitu Marine Sdn Bhd and Yong Trading Company.

The Board believes that Coastal is not dependent on any single supplier and raw materials could be sourced from other suppliers.

5.7 Approvals, Major Licenses and Permits

The Group has, among others, the following key approvals, licenses and permits to carry out its activities :-

Date of Approval	Authority	Licensee	Description	Duration/ Expiry	Basis of renewal
15.07.1982	Ministry of Trade and Industry	CTS	Fuel and oil carrier	30 September 2004	Bi-yearly
28.07.1993	Department of Industrial Development and Research	SM	Licensed manufacturer and repairer of steel boat and barge	N/A	N/A
09.06.1995	Ministry of Finance	SM	Import Duty Exemption under Item (92), Customs Duty Order (Exemption) 1998 and Item (85) Sales Tax Order (Exemption) 1980	N/A	N/A
25.01.1996	Sabah State Ministry of Finance	SM	PUKONSA (Pusat Pendaftaran Kontracktor Kerja Bekalan and Perkhidmatan Sabah Registered supplier and service provider*	23 July 2004	Bi-annual
16.02.1998	Malaysian Industrial Development Authority	BSR	Approval to submit application for the Industrial Pioneer Status for the East Coast Corridor of Peninsular Malaysia, Sabah and Sarawak under the Investment Promotion Act, 1986 [^]	N/A	N/A
13.04.1998	Ministry of International Trade and Industry	BSR	Manufacturing license	N/A	N/A
10.02.2001	Ministry of Finance	BSR	Approved contractor for marine and sub-marine services, boats/ships parts and equipment and vessel manufacturing.	8 February 2006	Every 3 years
12.05.2001	Ministry of Finance	SM	The Malaysian Ministry of Finance Contractor Certification Registration#	16 June 2006	Every 3 years

Date of Approval	Authority	Licensee	Description	Duration/ Expiry	Basis of renewal
16.07.2001	Ministry of Finance	BSR	Import Duty exemption under Item 78, Custom Duty Order Amendment (no.2) 2001 and item 79, Sales Tax Order Amendment (no.3) 2001 effective from 13.06.2001	N/A	N/A
07.08.2001	Ministry of Finance	SM	Import Duty exemption under Item 78, Custom Duty Order Amendment (no.2) 2001 and item 79, Sales Tax Order Amendment (no.3) 2001 effective from 12.04.2001	N/A	N/A
23.08.2001	Ministry of International Trade And Industry	BSR	Pioneer Status Certificate. Pioneer period commencing from 01.04.2000 to 31.03.2005 [^]	N/A	N/A
28.04.2003	Construction Industry Development Board Malaysia	SM	Registered Civil Engineering Construction (CE21) and Building Construction (B04) under grad G5 (not exceeding RM5million)	27 April 2006	Every 3 years

* *Provision of*

- *Parts and components of boats/ships;*
- *Manufacturing machinery equipment;*
- *Marine equipment;*
- *Boats/Ship (for docking);*
- *Workshop machinery and equipment; and*
- *Sandblasting and painting of ships.*

[^] *Conditions under the approval:-*

- *that the company must only operate in the State of Sabah*
- *that at least 25% value added is achieved for the vessel manufacturing activity*

Provision of

- *manufacturing/building*
- *marine equipment*
- *boats/ships (for docking)*
- *container/tanks*
- *machine and workshop equipment*
- *sandblasting and painting of ship*
- *buft fuel tank repair*
- *heavy machinery/transport/machine*
- *tugboats/ferry/boats/navigation boats*
- *purchase of used materials*

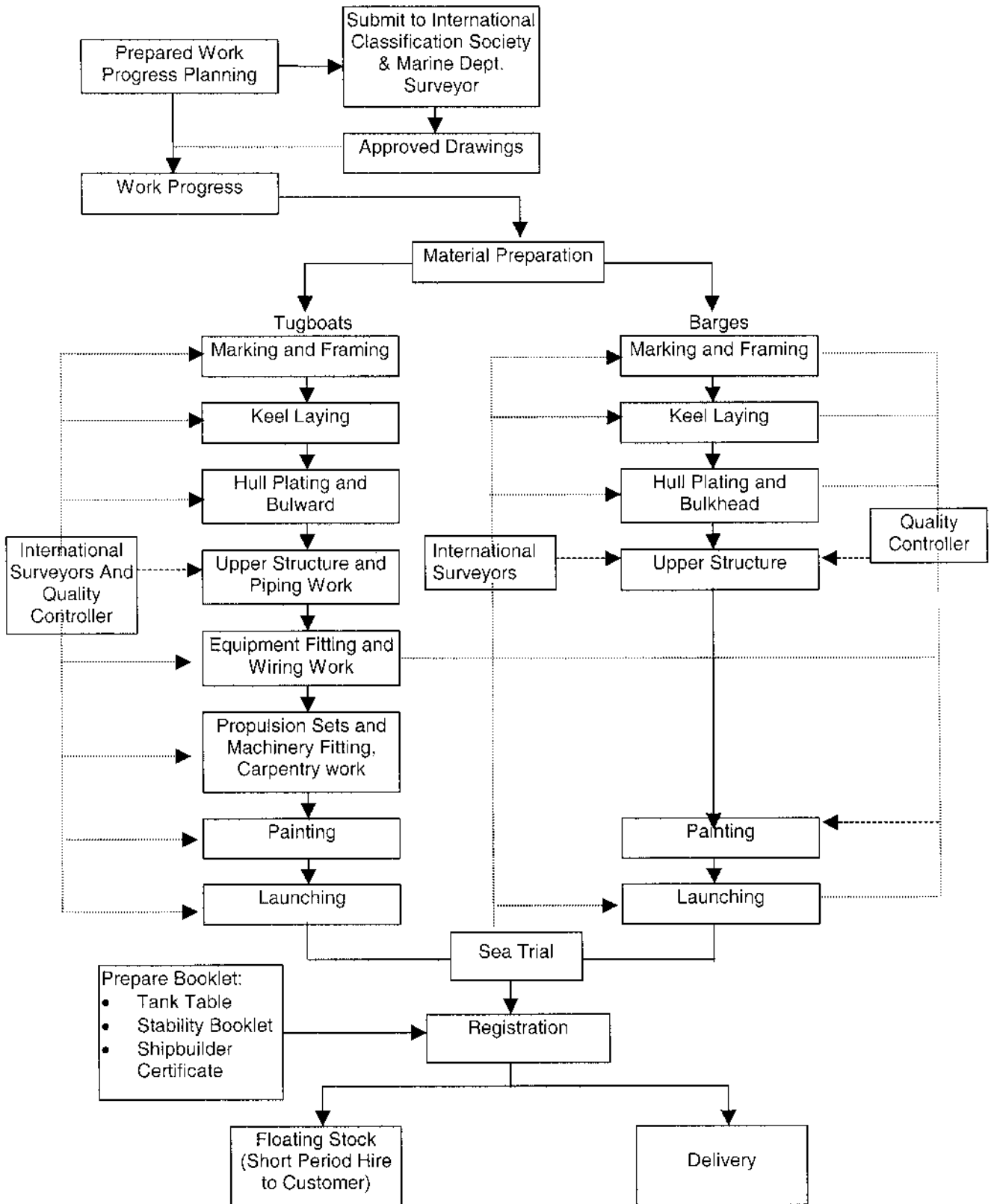
5.8 Vessel Manufacturing Process

The Group is capable of completing and delivering a standard vessel within 3 to 8 months, while the duration for customised vessels depends on the complexity and size of the vessels. The following table shows the typical construction time frame for vessels constructed by the Group.

Type of Vessel	Typical Construction Period Required (Months)
Tugboats	6 - 8 months
Barges	3 - 6 months
Landing Crafts	4 - 6 months
Ferries	4 - 6 months

A general description of the vessel manufacturing process is depicted in the diagram below.

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Ships begin their lives in drawing designed by in-house designers or external designers depending on the customer's requirements. At times, customers provide the drawings and specifications as part of the manufacturing contracts. The vessel drawings are then submitted to one of the international ship classification societies and the Marine Department for their approvals. International ship classification societies and the vessel manufacturing standards boards that are experienced and reputable societies worldwide that undertake to arrange inspections.

Upon approval, ship construction will commence soon after the required materials have been sourced and prepared. Vessel construction begins with the marking and framing, followed by keel laying to produce and form the skeletal framework of the ship.

The next stage of work is on hull plating and bulwark, to complete the lowermost portion of a ship i.e. the floating body structure of the ship. Thereafter, the upper deck structure of the ship will be built. In the case of a tugboat and self-powered barges, other works such as piping, equipment fitting, propulsion settings and machinery fitting are carried out at this stage. The quality of the work done is thoroughly checked by International Surveyors at every stage of construction from marking and framing right up to the launching of the ship to ensure adequate quality control and adherence to international standards.

For registration purposes with the authorities, the local vessels are classed by one of the following main ship classification societies:-

- ◆ Ship's Classification Malaysia;
- ◆ Bureau Veritas;
- ◆ Germanischer Lloyd;
- ◆ Nippon Kaiji Kyokai; and
- ◆ American Bureau of Shipping.

Upon the issuance of various certifications by the authorities and the certification bodies, the completed vessels are deemed seaworthy and can proceed with its registration according to the customers' preference.

5.9 Quality Control And Quality Assurance

Coastal places great emphasis on quality control and quality assurance procedures. It is the policy of the Group to manufacture products to the highest practical standards of quality that meets the contracted customers specifications as well as the established standards with respect to user and product safety performance and acceptable quality requirements. Lapses in quality control could therefore not only result in unnecessary costs being incurred but could also severely affect Coastal's reputation. The Group thus cannot afford to have a lax internal quality control system in the production process.

Within the shipyard, experienced supervisors serve as a focal point and nucleus for all quality-monitoring activities. The Group's vessels are subject to certain tests, which include among others air test, hydro test, thickness test and stability test. In addition to the internal quality procedures, external surveyors are involved at every stage of the building process right from the initial drawing stage to the actual launching of completed vessels.

The vessels must meet the stringent international quality and safety standards in the certification process. The vessels are deemed seaworthy only upon issuance of all the required certificates.

The details of the certification issued by the respective authority are as follow:-

Certification Bodies	Certificates Issued
International Classification Societies	Class Certificate for Hull and Machinery; International Loadline; International Tonnage Certificate; Cargo Ship Safety Construction Certificate; Cargo Ship Safety Equipment Certificate; Records of Cargo Ship Safety Equipment Certificate; and International Oil Pollution Prevention Certificate.

To enhance the quality of its leasing services, the Coastal Group has in place a maintenance programme for its fleet of vessels. The programme emphasises the importance of preventive maintenance by spelling out a set of standard guidelines, which include change of lubricant oil, servicing and equipment overhaul, vessel inspection by external surveyors and routine inspection by ship crew etc.

5.10 Track Record of Vessels Produced

As illustrated below, the Group has manufactured and delivered some 84 vessels from 1998 to 2002 with a total sales value of about RM113.0 million.

Year	Type of Vessels	Total Sales Value (RM'000)
1998	3 barges 1 tugboat	
	4 units	5,052
1999	12 barges 1 tugboat	
	13 units	16,502
2000	10 barges 6 tugboats	
	16 units	17,192
2001	14 barges 11 tugboats	
	25 units	40,894
2002	15 barges 11 tugboats	
	26 units	33,405
Total	84 units*	113,045

* Production from 1998 to 2002 include 40 vessels acquired by the hiring division from shipbuilding division. During the said period, 16 vessels were disposed by the chartering division to 3rd parties.

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6 OVERVIEW OF THE MARITIME INDUSTRY AND THE STRATEGIC OVERVIEW OF COASTAL

6.1 Overall Malaysian Economy

The Malaysian economy entered 2002 on a stronger footing, after recovering from a downturn experienced in the last two quarters of 2001. Riding on the back of an earlier-than-expected recovery of the United States (US) economy and a stronger outturn in the later half of 2002, the Malaysian economy is expected to register a higher but moderate growth in gross domestic product.

The year began with optimism as world economy recovered, led by the US on account of better demand for housing, motor vehicles, increased public expenditure on defense and turnaround in demand for electronics. The high expectations of a strong recovery for the year were, however, marred by a series of uncertainties, particularly a weak second quarter performance, reflecting a slower US GDP growth and lower corporate earnings. Billion dollar corporate scandals, involving gross mismanagement and fraudulent accounting practices in the US, coupled with rising Middle East tensions, had also adversely impacted equity prices and depressed investor and consumer confidence. Nonetheless, the continuation of an easy monetary policy and swift government regulatory measures to improve corporate governance and accountability, however, helped arrest further declines in sentiments. Elsewhere, the euro area's moderate expansion and Japan's recovery from recession are envisaged to remain on track, despite increasing risks. With global economic growth intact and supported by a strong domestic sector, Malaysia's economy is expected to further strengthen, particularly during the second half of 2002. Real GDP is projected to grow at 4%-5% as targeted in Budget 2002, within an environment of low inflation and stronger economic fundamentals, supported by both prudent fiscal and accommodative monetary policies. With more employment created due to better all-round economic performance, unemployment will be contained with the economy continuing to operate under full employment.

With the mild recovery intact in 2002 and expected to gather momentum in 2003, the world economy is projected to register output growth of 3.7% with trade expanding at 6.6%. The US is forecast to chart a stronger GDP growth of 2.6%, while the euro area is expected to further improve by 2.9%. Japan, which has shown further signs of bottoming out, has entered into a recovery mode and is projected to grow by 1.1% in 2003. The Malaysian economy, with the stronger macroeconomic fundamentals already in place and complemented by more resilient corporate and financial sectors, is now poised to benefit from the much-improved global economic environment projected for 2003. Output expansion is anticipated in all sectors of the economy, with GDP envisaged to chalk 6%-6.5%, arising from a broader based economy with growth emanating from a more pronounced role of a revitalized and dynamic private sector. *(Economic Report 2002/2003)*

6.2 The Overview of the Maritime and Manufacturing Industry

The Eighth Malaysian Plan (The Plan) period will witness a new phase in the country's industrial development. The overriding objective will be to strengthen the resilience and growth of the manufacturing sector. In this regard, the Government will continue to provide support for the development of infrastructure facilities for industries and efforts will be made to increase investments in the sector by providing a conducive environment for business.

The manufacturing sector is targeted to grow by 8.9 per cent per annum during the Plan period, contributing 35.8 per cent to the share of GDP by 2005. The growth of the sector will be export-led, with export of manufactures projected to grow by 8.9 per cent per annum, accounting for 89 per cent of the nation's export earnings by 2005. While the electrical and electronic products industry will continue to be the major contributor to exports, the growth of new sources of exports, especially resource-based industries, will be enhanced to increase the country's exports. Taking cognizance of the changes in global and regional developments, the policy thrusts during the Eighth Plan will be as follows:

- positioning industries to take advantage of the opportunities arising from globalisation;
- strengthening the manufacturing base by developing strong industrial clusters;
- sustaining the momentum of growth by strengthening manufacturing-related services;
- providing more focused incentives for high value-added industries;
- increasing the use of technology and developing strong domestic capability;
- enhancing the local production of capital and intermediate goods to reduce;
- import intensity and foster industrial development;
- enhancing competitiveness through productivity improvements;
- developing new initiatives in export promotion;
- increasing the use of ICT; and
- developing resilient SMEs.

Port development will continue to focus on improving capacity, upgrading equipment and facilities as well as enhancing the efficiency and productivity of port and port-related services. In terms of capacity, an integrated approach to develop a comprehensive range of inland-related support facilities and services will be adopted. Accessibility to ports, especially road and rail links will be upgraded. Simultaneously, multimodal transport operations that offer door-to-door services will be in place. In addition, various measures will be undertaken to further promote the expansion of Malaysian shipping lines including ferry services, preserve marine environment and upgrade navigational safety.

In the shipping subsector, greater emphasis will be given to further expand the local shipping companies including ferry services carrying cargo and passengers. Greater investment through leasing, joint venture, chartering and purchase of additional vessels will be made by the private sector. To enhance productivity and efficiency in shipping operations, the Government will encourage shipping operators to modernize their operations and form strategic alliances. In addition, local shipping companies, particularly those involved in the operations of off-shore logistics support services will be encouraged to utilize the Shipping Fund to expand their capacity.

During the Plan period, MISC will continue to be the main ship owner and operator and is expected to acquire two additional ships, thus increasing the total fleet to 127 ships and raising its capacity from 3.3 million grt to 3.4 million grt. Other shipping companies such as the Global Maritime Ventures Berhad, Nepline Bhd and Halim Mazmin Bhd are expected to increase their investments, especially roll-on roll-off vessels and oil tankers with tonnage ranging between 2,526 to 104,449 grt. In terms of ferry services, Star Cruise will increase its fleet from three ferries to four in 2005. With the increased investment made by all the local shipping companies, the total number of vessels registered in Malaysia is expected to increase from 3,200 ships or 6.5 million grt in 2000 to 3,800 ships or 8.8 million grt in 2005 (Source: The Eighth Malaysian Plan).

Coastal operates in a well regulated environment and is governed by the following relevant laws and regulations: -

1. Merchant Shipping Ordinance 1952,
2. Merchant Shipping (Oil Pollution) Act 1994,
3. Factories & Machinery Act 1967,
4. Occupational Safety and Health Act 1994,
5. Environment of Quality Act 1974,
6. Control of Supplies Act 1961,
7. Customs Act 1967,
8. Industrial Designs Act 1996,
9. Promotion of Investments Act 1986,
10. Sale of Goods Act 1957,
11. Exchange Control Act 1953,
12. Industrial Relations Act 1967,
13. Small & Medium Industries Development Corporation Act 1995,
14. Workmen's Compensation Act 1952, and
15. Immigration Act 1959.

6.3 Outlook and Growth of the Industry

The vessel manufacturing, repairing and vessel chartering industries can expect to continue to grow due to the following factors:-

- The Malaysian Government will continue to expand regional co-operation among the ASEAN members in promoting strategic business alliances to increase trade and mutual prosperity in the region.
- The maritime transport and engineering industry has the strong support from the Malaysian Government. The sector has been identified as the crucial foreign exchange saver in the efforts to reduce the country's balance of payments deficit. The sector also possesses technological and economic spin-off potentials. It is therefore the Government's policy to continuously promote greater use of Malaysian shipping for the carriage of products and to encourage Malaysian shipowners to use local shipyards for their shiprepair and shipbuilding requirements. Tax and fiscal incentives for ship fabrication and repair activities have also been introduced to precipitate the growth of the industry. The Government is also actively pursuing the development of world class port facilities in the country to promote Malaysia's position as a transshipment hub.
- The advent of BIMP-EAGA regional co-operation, home to about 30 million people has given rise to further trade opportunities between member countries. Intra-regional communication between member countries through sea linkages will set to increase in tandem with the rise in intra-regional activities in BIMP-EAGA. This augurs well for the shipping and maritime sector especially in the Sabah region which is centrally located in the regional grouping.
- Malaysia will continue to be a leading global player in palm oil and this commodity will remain as a major contributor to the Malaysian economy.

The performance of the Malaysian oil palm industry is expected to be sustained and improve further in the year 2003. The production of CPO is expected to be around 12.2 million tonnes and export demand is forecast to further improve arising from higher world demand and a further depletion of world oils and fats stocks by 11.8% to a low of 13.1 million tonnes. Consequently, the prices of oil palm products is expected to strengthen further in 2003 (*Source: Overview of the Malaysian Oil Palm Industry 2002, Malaysian Palm Oil Board*).

Coastal is expected to benefit from this natural setting, as coastal transportation is an essential and economical mean of transportation for bulk supply.

- In Sabah (where the Coastal Group is based), the state government is actively promoting and developing the State. The Board believes that with the state government's efforts, the economy of Sabah will improve resulting in the rise of the maritime industry.

6.4 Competition

The Board believes that the Coastal Group is regarded as one of the more established small and medium-sized coastal marine vessel manufacturers and repairers in Sabah. Based on the records obtained from the Department of Industrial Development & Research, as at 20 March 2003 there are only 11 active private companies in Sabah, including SM, that have been granted the license by the Sabah State Government to manufacture and repair boats and ships. Only 3 of the 11 licensed operators in Sabah are members of the Association of Marine Industries of Malaysia, which has 56 members and 7 associated members.

The Group regards its local competitors to be Oceanic Engineering Sdn Bhd (Shipbuilding) and Weldan Marine Services Sdn Bhd (Shipbuilding). Other public listed companies involved in similar activities include PSC Industries Berhad ("PSC") (heavy engineering and construction, shipbuilding and ship repair, and commissioning of offshore installations for the oil and gas industry). The Board however believes that the Group serves a different niche market and hence it is not directly comparable to PSC.

6.5 Market Opportunities : The General Overview

Below outlines the Director's discussion on the market opportunities in the maritime industry.

Ever since the evolution of barter trading and the subsequent phenomenal growth in international trade activities, sea transportation has been an essential means for movement of cargoes and people. This is particularly evident in the South East Asian region where most countries have sea facing boundaries entailing travels by the water an inevitable way to reach the outside world. Furthermore, most of the countries in South East Asia and Australasia such as Indonesia, the Philippines, Singapore, the Pacific Islands, Australia and New Zealand are islands or compose of groups of islands. Air transportation on the other hand, would be prohibitively expensive for movement of a wide range of bulk cargo and people. Besides trading activities, the discovery of oil fields in many parts of the region's waters over the last few decades has also spawned an array of marine transport infrastructure to facilitate oil exploration and production operations.

In a nutshell, there exists potential long-term business opportunities in the marine transportation and engineering industry in this part of the region. The transportation needs of the coastal economies in specific are quite diverse. They range from fishing boats to vessels that transport human and general cargo such as ferries and barges to law enforcement vessels such as patrol boats. Tugboats are also required for the towing of larger ships at ports, and other supporting purposes such as fire fighting. In addition, oil-producing countries would need vessels to support the operations of sea-based oil rigs.

General coastal transportation services are provided by a multitude of small to medium-sized companies, small partnerships or owner-operated concerns. These companies in turn need to be served. In particular, they would require vessel repair and servicing, and the supply of vessels. The supply of vessels would vary depending on the needs of the businesses. For example, businesses that have good cashflows and require the vessels on a long-term basis would usually purchase them outright. On the other hand, businesses may also consider charters and hire for example, if the requirement is for a short time span, or they require the services to be provided by a third party. Due to the diversity of the requirements of these service providers, there exists an opportunity for an entity to provide the full range of vessel related services. The existence of the Coastal Group is precisely to take advantage of the rich market opportunities offered by the marine transportation industry particularly in the South East Asian region.

6.6 The Coastal Solution

The Coastal Group is a vertically well-integrated marine transportation services group of companies. The Group manufactures and repairs vessels on a 17.66 acres site in Sandakan, Sabah. A greater portion of the Group's manufacturing activity is focused on building two types of vessels namely tugboats and barges. Nonetheless, the Group also has the requisite expertise to construct other vessels such as fishing boats, landing crafts and ferries. Needless to say, the Group has the necessary skills and equipments to provide other related services, such as repairing and cleaning services that come as part and parcel of its manufacturing activity.

The Group, in addition, leases out a wide range of coastal marine vessels to complement its main activity of ship fabrication. As ships are constantly built to maintain productivity and minimise idle time, unsold ships are transferred to the chartering division of the Group to generate revenue. This gives the option to prospective buyers to purchase readily available vessels, which command a premium for its immediate delivery, or to have vessels built based on personal requirements. Hence, lead time for delivery is kept competitive.

The interconnectivity of the businesses of the Group provides a one-stop centre to address coastal transportation needs. The Group specialises in coastal marine transportation services enabling them to serve a wide range of customers in different industries within this market segment.

The performance of the Coastal Group was given due recognition when its flagship company SM and BSR were awarded the Enterprise 50 for year 2000 and 2002 respectively. Enterprise 50 is an annual award programme organised by Andersen Consulting and the Small and Medium Industries Development Corporation. The yearly award, endorsed by the Federation of Malaysian Manufacturers and the National Chamber of Commerce and Industry of Malaysia, recognises the achievements of Malaysia's top 50 enterprising home-grown companies that are well positioned for the future. The evaluation is based on among others the company's financial performance, export capability, management outlook, market presence and innovations.

6.7 Prospects of the Coastal Group

Geographically, Sabah (where the Group is based) lies central to the South-eastern Pacific and the BIMP-EAGA. This gives Sabah the geographical advantage to strategically complement and service this rapidly developing economic region. Sabah stands to gain through Malaysia's regional co-operation in ASEAN, AFTA, and BIMP-EAGA. With a total population of 30 million people, the BIMP-EAGA will be the new emerging market in the near future. This augurs well for the Group's marine transportation activities in this region.

Promotion of the maritime sector

It is the vision of the Sabah State Government to promote and develop Sabah into a world-class maritime service centre that provides vital economic linkages within BIMP-EAGA and with other dynamic regions around the world. This commitment is part of the overall effort to boost the maritime sector in the State. In view of the above, the Group believes that the maritime business will have a bright future.

Backed by good track record

Having been in the marine manufacturing business for over 20 years since 1982, the Group has established a good track record in the industry. The Group has a fair share of repeat customers from a wide range of industries including the plantation industry, timber products industry, import and export industry, the oil and gas industry, the construction industry and other general users.

Many businesses were badly hit by the 1997 economic crisis and some were crippled during that period. The Group as with other businesses was not spared by the economic onslaught. However, the Group still managed to maintain a decent profit position and recorded an upward trend in 1997. Profit after tax in 1997 was about RM4.6 million. In 1998, the Group began to feel the pinch of the crisis and suffered a drop to RM2.9 million. In the following year, profit after tax of the Group rebounded and registered a record of almost RM11.0 million, outperforming its pre-crisis level. In 2000, the Group managed to maintain its performance ending the year with RM10.5 million in profits. In 2001, the Group recorded an approximate growth of 20% ending with a net profit after tax of RM12.2 million. In 2002, the Group changed its market focus to the chartering division as the marketplace showed a shift in preference from ship ownership to chartering. As income from chartering of vessels is distributed over a period, as opposed to immediate recognition in an outright sale arrangement, the Group ended the year with a profit after tax of RM11.7 million.

The extensive experience in the trade enables the Group to face future challenges. And for the same reason, the Group is certainly poised to take advantage of future opportunities.

6.8 Competitive Advantage

Focus on Small and Medium-Sized Vessels Market Segment

The vessel manufacturing and repair sector, being a heavy and capital-intensive industry, is dominated by big corporations typically initiated by state governments as part of their development programmes to push for greater industrialisation. As such, these corporations, with strong financial backing, are mostly involved in manufacturing large vessels and repair

projects. They build huge ships of more than 4,000 dwt, container ships and/or floating and submersible oil drilling or production platforms.

The Group on the other hand, focuses on the manufacturing and fabrication of small and medium-sized steel marine vessels typically used for coastal transportation. Thus, the Coastal Group serves a different market niche i.e. coastal transportation sector that is relatively untapped by the majority large corporations. The market in this region is huge considering that marine transportation such as ferries, tugboats and barges are the basic transportation mode in this region made up of islands and interior areas.

In addition, the Group started in the 1980s at a time when the marine engineering and transportation sector in Malaysia was considered still at the nascent stage. In those days, most tugboats and barges were sourced mainly from Singapore where repair and maintenance services were also carried out. Over the years, Coastal has established a strong foothold in the small and medium-sized vessel manufacturing and repair business segment and is in position to tap into this market effectively.

Vertically Integrated Sea Transport Services

Coastal is a vertically integrated marine transportation group of companies providing a wide range of marine transportation services to local and overseas customers. The Group builds, repairs, services and charter a wide range of coastal marine vessels and therefore, provides a one-stop centre to address customers' marine transportation needs. With the integrated activities, the Group has the ability to carry out its own vessel repair and servicing for its fleet of vessels deployed for chartering and transportation services.

Specialising in coastal marine manufacturing and transportation services, the Group serves customers of different industries including producers of CPO, timber, logging, construction companies and import and export agencies. By having a diverse fleet of vessels to cater for this variety of customers, the Group is neither exposed nor dependent greatly on any single industry for business. In addition, the Group also provides lease and purchase option that has been well received by its customers.

Besides having the facilities to build tugboats and barges, the Group also has the ability to build supply boats, standby utilities boats, anchor handling tugs and other supporting ships for oil exploration activities, demand of which is expected to increase in tandem with increased interest in the mineral. In a nutshell, with its varied capabilities, the Group is able to adapt to changing market demands.

Good Business Network

The Group's extensive presence in the vessel and manufacturing business coupled with its accommodative chartering facilities has helped to establish a good business network especially in Malaysia and Indonesia. The Group's success in developing a satisfactory rapport with its customers is attributable to the reliability and prompt delivery of its products and services.

In line with the expansion process, the Group has set up a branch office in Indonesia. This is firstly, to widen its marketing reach and operation network and secondly, to create a physical locality in its foreign operations in order to provide better value-added services to its customers.

Experienced Management Team

A hands-on management team who is well experienced in the business leads the Coastal Group. The Executive Director, Ng Chin Heng, who is the principal founder of the Group, has been in this line of business for over 20 years while majority of the other executive directors, on average, has over 15 years experience in the Group. Their management capabilities are evidenced by the continuing growth of the Group's operations over the years.

High Quality Products, Services And Competitive Pricing

The vessels produced by Coastal comply with international safety and quality standards. They are classed and certified by reputable international ship classification societies such as Nippon Kaiji Kyokai, American Bureau Services and Germanischer Lloyd. The Group also constantly strives to provide quality and value-added services to ensure customer satisfaction. These include on-time delivery of vessels, discussions with clients on their shipping requirements and the provision of shipping advice to customers.

Through a prudent management style fortified with experience in the industry, the Group has managed to yield higher productivity and thus able to provide shipbuilding, ship repairing and vessel chartering services at competitive prices without sacrificing safety and quality standards.

Established Reputation

The Coastal Group has established themselves in this region as a capable shipbuilder and repairer. Coastal's vessels comply with international quality and safety standards and are well accepted by ship buyers. Its repair and maintenance services are well received as evidenced by the recurring maintenance contracts with the Royal Malaysian Navy and Marine Police Department. Its chartering services are also recognised as reliable due to the implementation of stringent operating policies and has fruitfully penetrated into the competitive Indonesian market.

6.9 Future Plans and Business Strategies***Manufacturing Of Vessels With Higher Capacities And Products***

It is intended that part of the proceeds from the listing exercise be used to construct an additional shielded factory and platform, and to purchase the required machinery, heavy vehicles and other facilities to increase its shipyard manufacturing capacity. The shielded factory is expected to complete by the 4th quarter of 2004.

The additional shielded factory is necessary to minimise weather interruption and thus ensuring continuous workflow throughout the year. This would increase the shipyard's production level and at the same time, enhance cost-efficiency of the shipyard. Furthermore, the additional shipyard capacity will allow Coastal to manufacture higher-powered tugs and larger capacity barges, and to build specialised high-end vessels such as supply boats, utility anchor and anchor handling tugboat for oil exploration. The Group plans to gradually increase the number of vessels, with varying capacities and power, for chartering alongside the existing vessel renewal programme.

Penetration Into New Markets

To keep the growth momentum, Coastal plans to take advantage of the global potential of its business. The Group has had experience in exporting its products as well as its chartering services beyond the boundaries of Malaysia but has yet to take full advantage of the global opportunity of the business. The Group aims to widen its chartering operations geographically, from the present South East Asian region to span to the Asia-Pacific region including Australia, Papua New Guinea, Hong Kong, Korea and the Pacific Islands as these markets are maritime nations where sea transportation is essential given their natural topography. Coastal also intends to go into vessel customisation, which typically offer higher margins, targeting the European and other Asian countries. Coastal recognises the potential opportunities available and plans to expand to their market reach to the said countries within the next five years. To achieve this end, Coastal uses its various marketing channels including constant contact with individual brokers, trade fairs and via its website. In 2002 for example, Coastal sold a vessel to the Navy of the USA brokered by its ship brokers.

In the vessel chartering business, the Group aims to service a wider range of industries to prevent over dependence on any industry. As at 31 December 2002, the Group has a diverse fleet of 46 vessels comprising tugs, dumb barges, crude palm oil barges, fuel and oil barges. The Group will diversify its fleet into various types and capacities to cater for a wider spectrum of customers.

Focus On Cost Effectiveness And High Quality Products

The Group aims to be competitive in vessel manufacturing and repair by producing cost effective and high quality products. Thus, more qualified and experienced workers, designers, engineers and management personnel will be recruited to maintain the Group's competitiveness. With the deployment of the right personnel, it is believed that the overall cost of Coastal would be reduced and at the same time improves quality.

The Group will also focus on the construction of higher-powered tugboats and greater capacity barges in the future in respond to the demand from various industries in the region. The Group intends to venture into more precision and high quality marine vessel manufacturing that generally offers higher margins.

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