

Qian Hu Corp

Bloomberg: QIAN SP

Sector: Commerce

recommendation:
Offer Price: S\$0.30

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Y/E 31 Dec	1998A	1999A	2000F	2001F	2002F
Sales (\$m)	22.8	26.4	35.3	41.4	47.8
Net profit (\$m)	0.5	1.3	3.4	4.1	4.9
Net profit growth (%)	<i>nm</i>	<i>+149</i>	<i>+159</i>	<i>+21</i>	<i>+19</i>
EPS (cents)	0.8	1.9	4.7	5.0	5.9
Indicative PER (x)	40.0	16.0	6.4	6.1	5.1
No. of shares (m)	70.0	70.0	72.1	82.8	82.8
Major shareholders (post IPO):	%		Market Capitalisation (@S\$0.30):		S\$24.8m
The Yap Family	79.4		Issued shares :		82.8m
			Average daily volume ('000) :		n.a.

Champion of ornamental fish

Issue Statistics

Issue size:	12.75m new shares offered; 9.563m placement shares; 3.187m reserved shares
Closing date:	6-Nov-2000
Trading: ("when issued")	8-Nov-2000

Here's a little known fact - Singapore is the ornamental fish capital of the world. Last year, global exports of ornamental fish amounted to nearly a quarter billion dollars, of which Singapore accounted for a third. And Qian Hu is a leading player in this fascinating industry, with an estimated domestic market share of 11-13%.

We can all fondly remember younger days when fishkeeping was the king of hobbies. Although most people probably outgrew it as they entered working adulthood, little boys and girls around the world are still being exposed to it for the first time. Fishkeeping as a hobby is also enjoying a revival as baby boomers enter their middle age.

Use of Net Proceeds

Expansion of distribution network in Malaysia, Thailand and China	S\$1.8m
Development of e-commerce capabilities	S\$0.2m
Repayment of bank borrowings	S\$1.0m
Total	S\$3.0m

While not as glamorous or high value-added as say, semiconductor wafer fabrication, fish farming is a knowledge business that Singapore wants to cultivate as a niche industry. Another example is orchid growing. Singapore-bred fish are known for their hardiness, with a 97% shipment survival rate compared to 95% for other countries.

Started in the late 1980s as a breeder and distributor of the common guppy, Qian Hu has grown into a major exporter of over 500 species of ornamental fish, including the famous Dragon Fish or Arowana, which is consistently in high demand in Japan and Singapore for its reputation for bringing “good luck” to the owner.

Qian Hu is also a major distributor of aquarium tanks and accessories. This business, started in 1990, had grown to a significant 50% of sales and profits by 1999. The reason for this diversification was simple - for every \$1 spend on fish, the typical new fish buyer will need to spend at least \$5 on accessories. Margins are also higher.

Going forward, we expect the export and accessories markets to remain key growth areas for Qian Hu. We are forecasting a net profit CAGR of 20% from FY00 to FY02. Qian Hu has no listed comparable either in Singapore or the region. Non-tech IPOs are trading at an average prospective PER of 9.8x in 2000. Qian Hu is offering new shares at S\$0.30 or 6.4-7.2x current year forecast, depending on whether it is Qian Hu's conservative net profit estimate of S\$3m or our more aggressive S\$3.4m. We think Qian Hu is worth S\$0.35, based on our assessed fair PEG (price to growth multiple) of 0.7x and the Company's own forecast earnings.

Background

Qian Hu Corporation was founded in the late 1980s by the Yap family (79% post-IPO stake), to focus on the breeding and distribution of guppies. Over the years, the Group expanded its range of ornamental fish to include Goldfish, Koi, Discus, Gourami, among others, and subsequently moved into the local wholesale business, as well as, aquarium accessories. Import and export of ornamental fish and accessories commenced in 1992 and the Group has never looked back since.

Today, Qian Hu is one of the top 2 exporters of ornamental fish in Singapore and a major distributor in the domestic wholesale market. With more than 500 species and varieties of ornamental fish, the Group

exports directly to more than 45 countries, and distributes to over 200 retail outlets locally. Its primary markets are Singapore and South-east Asia. Dragon Fish (otherwise known as Arowana) sales are now its main stay and the Group's trading, breeding, quarantining and farming activities are carried out locally at its sprawling 450,000 sq ft compound located within the Sungei Tengah Agrotechnology Park. In fact, Qian Hu was the first fish farm in Singapore to be awarded the ISO 9002 certification in 1996 for its quality management system. Such high quality management system has enabled the Group to assure its customers a 97% survival rate upon delivery, compared to most exporting countries that guarantee only up to 95%.

The accessories business has also grown strongly, and distribution of aquarium, pet and related accessories now contributes more than 50% of Qian Hu's bottomline. The group's third core business, which is the manufacture and supply of plastic bags, was initialised as an ancillary business intended for packing the Group's ornamental fish for sale and deliveries. Subsequently, this activity was extended to third parties in the ornamental fish, food and electronic businesses.

For the period FY97-99, sales and operation profit (EBITDA) grew at CAGR of 7% and 110%, to S\$26.4m and S\$2.8m respectively. The higher growth in operating profit was partly the result of a refocus on marketing of high value ornamental fish, such as Dragon Fish and Corydorus, as well as improved productivity. Accessories segment also saw improved performance from retail network expansion into the local supermarkets, as well as Malaysia. Segmental breakdown for the latest 1HFY00 results saw ornamental fish, accessories, and plastics and others contribute respective 50%, 35% and 15% to sales of S\$17.0m, and 39%, 51% and 10% to EBITDA of S\$2.7m.

Singapore - Largest exporter of ornamental fish in the world

Having been the world's leading exporter of ornamental fish over the past decade, Singapore is known as the ornamental fish capital of the world. According to the

Agri-food & Veterinary Authority (AVA), Singapore exported some 260m ornamental fish worth S\$72m to more than 70 countries in 1999. And this accounts for 30% of the world export trade. It is also one of the world's largest producers of farm-bred ornamental fish, with 100 fish farms in the country, producing about 40% of the fish exported from Singapore in 1999. Obviously, fish farming is a knowledge business that Singapore wants to cultivate as a niche industry. Another example is orchid growing. Assuming the bulk of its overseas sales pertain to ornamental fish, Qian Hu would have accounted for 11-13% of the total export market share in 1999. There are only a total of 98 ornamental fish importers/exporters licenced by AVA to date.

Key Sources of Growth

To examine its key sources of growth, Qian Hu's main business activities can be classified as follows:-

- 1) Ornamental fish;
- 2) Aquarium, pet and related accessories; and
- 3) Plastic and others.

In terms of overseas expansion, the Group's typical strategy would be to first establish its "non-live stock" accessories business upon entry into any country, and only introduce ornamental fish as at a later stage, when a credible network or perhaps a certain confidence level is gained.

1) Ornamental fish

Based on its existing businesses, a continued organic growth of 10-15% can be reasonably expected as the Group's status as a exporter, is not constrained by capacity. Granted, the Singapore market offer limited growth potential for Qian Hu, which is arguably already the biggest player in town. Increasing market share would therefore have to be at the expense of its competitors. We believe export markets remain the key source of growth for the ornamental fish segment. Already, in the current FY, Qian Hu has increased its exports to 45 countries, up from 42 in FY99, and also to new customers in existing markets. Overall retail

and export customers are expected to increase from 480 and 80 in FY99 to 500 and 100 by end 2000. In addition, the sales team are driven with specific sales target. Being the leading player in the region and through continued participation in trade shows overseas, we believe Qian Hu can reasonably maintained at least double-digit earnings' growth.

Additional bonus would come in the form of some 350 brooder stock of Dragon fish that Qian Hu has retained, with the intention of nurturing the fries to marketable size for sale. Given that Dragon Fish can typically command up to several thousand dollars apiece, and since breeding expenses incurred are minimal, new contribution to bottomline, come 2001, can be significant. Meanwhile, the number of domestic retail outlets for sale of Dragon Fish (restricted licences) is also expected to further increase from 30 as at June 2000.

Overseas, the Group has plans to start its ornamental fish business in Malaysia within the next 6-8 months and perhaps follow by Thailand by end 2001. This is expected since its accessories business was already started in Malaysia in 1999 and Thailand in early 2000. In fact, a major portion of Qian Hu's IPO proceeds would be utilised to fund the expansion of its distribution network in Malaysia, Thailand and China. Other markets in the likes of Europe, Middle East and Australasia also present vast potential especially with rising affluence levels. In Singapore, Qian Hu has set up two in-house retail outlets (House of Dragon Fish and a general retail shop) earlier this year at its farming compound to sell high value ornamental fish to both the tourists and locals, in an effort to improve margins and boost its domestic sales.

2) Aquarium, pet and related accessories

The distribution of accessories complements Qian Hu's ornamental fish operations by providing a "one-stop" shop to meet its customers' aquarium needs. A major player in the local league, the Group distributes accessories to more than 200 retailers and its leading products are filters, fish and pet food, air pumps and fish tanks. For FY99, Singapore and Asia constitute approximately 72% and 24% of the Group's total

accessories sales.

Of the three core businesses, sale of accessories offers substantially higher profit margin for Qian Hu. Earnings growth for this segment is expected to be higher too, compared to ornamental fish, due mainly to the following:-

- i) Only commenced selling its products in local supermarkets, such as NTUC Fairprice and Cold Storage, in 2HFY99;
- ii) Malaysian operations, Guan Guan, is only in its second year of operations and this implies that the areas for expansion and growth are still largely untapped;
- iii) Similarly, Thailand operations only commenced in early 2000, while a 50-50 joint venture in China is still in the works.

A general rule of the thumb in the ornamental fish industry is, for every S\$1 purchase of ornamental fish, the customer will need to spend at least S\$5 worth of accessories.

3) Plastic and others

At present, Qian Hu's wholly-owned subsidiary, Tat Leng, manufactures plastic bags at full capacity at four separate HDB industrial units. Apart from own use, these plastic bags are sold locally to the ornamental fish, food and electronics industries. In 2001, the Group intends to consolidate its operations in a bigger factory and this would allow Tat Leng to increase production capacity and focus on higher quality plastic bags, both for local consumption, as well as exports. Manufacture of lower end plastic bags will then be channelled to its China's subsidiary, Qian Long, which is still ramping up productions at present.

Major Concerns/Risk Profiles

Outbreak of diseases and infection

Inevitably, the first concern that comes to mind for

many on Qian Hu, is that any outbreak of diseases and infection could materially and adversely affect its operations. Although infection across breeds is uncommon, it is possible that a rare and virulent strain of bacteria or virus may infect many of the fish at the farm, thereby causing a depletion of the stock.

Growing dependency on Dragon Fish

In 1HFY00, Dragon Fish constitutes close to 17% of ornamental fish sales and an estimated 10% of Group's total PBT. Of which, the Japanese and Singapore markets accounted for some 90% of sales. Therefore, should there be any changes in consumer perception and preferences towards Dragon Fish, again earnings could be adversely affected.

Issues on requisite approvals and licences

In Singapore, the import and export of ornamental fish are regulated by AVA and yearly licenses are issued for such purposes. In the event of any failure to comply with the terms and conditions of the licence, AVA is empowered under the law to revoke or suspend the licence. Similarly, for overseas operations, it can be assumed that Qian Hu would require the necessary licenses issued by relevant authorities to operate and at the same time, subject to their rules and regulations. A case to point is Qian Hu (Thailand) which commenced its pet food and accessories operations without obtaining the relevant licence (which came into effect in March 2000) from the Ministry of Commerce, Thailand and the Foreign Business Board. Although an application has been made, the company and its directors may face penalties for failure to comply and a possibility of not able to carry on its pet food and accessories distribution activity without the licence. We have not factored in any contribution from Qian Hu (Thailand) in our earnings forecasts.

Earnings Forecasts

For FY00, Qian Hu forecast a 33% and 124% increase in sales and PBT to S\$35.3m and S\$4.0m respectively. Based on the same topline guidance, our PBT forecast

is more aggressive at S\$4.5m, as we believe margins would be more or less maintained in 2H00. Consequently, our forecast CAGR for FY00-FY02 sales and net profit are 16% and 20% respectively.

No direct listed comparable company

Qian Hu is the first of its kind to be listed on the Singapore Exchange or even regional exchanges. Hence, there is no listed comparable. At present, non-tech IPOs in 2000 are trading at an average prospective PER of 9.8x. Qian Hu is offering new shares at FY00

PER of 7.2x, based on its own net profit forecast of S\$3.0m. Our higher FY00 net profit estimate of S\$3.4m, based on firmer margins in 2H00, would yield a more attractive PER of 6.4x (FY01: 6.1x).

The STI is trading at PE to growth multiple (PEG) of about 1.0x now. Based on FY00-FY02 EPS CAGR of 12%, Qian Hu would be offered at PEG multiple of 0.61x. Our assessed fair PEG of 0.7x would yield a price of S\$0.35, or weighted FY00 PER of 8.3x. This would translate to a 51% discount to the broad market FY00 PER of 17x. Subscribe.

Prospective PERs for Non-tech IPOs in year 2000

Company	Price (S\$)	EPS (cts)	PER (X)
Sembawang Kimtrans	0.180	2.2	8.0
Medi-Rad	0.515	1.2	44.0
Ban Joo & Co	0.105	1.4	7.6
Airocean Group	0.255	2.0	12.8
Hor Kew Corp	0.125	2.5	5.0
Ong Asia	0.195	4.6	4.3
Parkway Laboratory Svs	0.655	2.1	31.6
Food Empire Holdings	0.110	1.4	7.7
Hua Kok International	0.195	3.0	6.6
Hong Lai Huat	0.315	4.0	7.9
TT International	0.430	3.5	12.2
Jadason Enterprises	0.140	1.6	8.5
BRC Asia	0.160	4.0	4.0
SMRT	0.675	5.5	12.4
Eu Yan Sang	0.205	2.6	7.9
Osim International	0.345	4.5	7.7
Transview Hldgs	0.190	2.5	7.6
VibroPower	0.240	4.0	6.0
Federal Int'l	0.175	3.1	5.7
Sing Lun Hldgs	0.185	4.0	4.6
Sim Lian Group	0.220	4.7	4.7
Craft Print	0.175	2.0	8.8
MAE Engineering	0.200	3.3	6.1
Lee Metal	0.125	2.2	5.6
Thai Village Holdings	0.180	2.2	8.2
Average			9.8

Note: Prices as at 27 October 2000

Earnings Forecasts

Year ending Dec (S\$m)	1997A	1998A	1999A	2000F	2001F	2002F
Turnover						
- Ornamental fish	12.8	12.2	12.5	15.2	17.7	20.4
- Accessories	6.5	6.7	9.6	14.1	16.7	19.2
- Plastic & others	3.9	4.0	4.3	6.0	7.0	8.3
Total	23.1	22.9	26.4	35.3	41.4	47.8
Operating profit margin (%)						
- Ornamental fish	1.4	3.6	6.6	12.2	12.7	13.2
- Accessories	4.7	14.5	16.7	21.5	21.5	22.0
- Plastic & others	3.9	4.3	8.5	11.5	11.8	12.0
Overall margin	2.7	6.9	10.6	15.8	16.1	16.5
Operating profit						
- Ornamental fish	0.2	0.4	0.8	1.9	2.3	2.7
- Accessories	0.3	1.0	1.6	3.0	3.6	4.2
- Plastic & others	0.2	0.2	0.4	0.7	0.8	1.0
EBITDA	0.6	1.6	2.8	5.6	6.7	7.9
Depreciation	-0.9	-0.8	-0.8	-0.9	-1.0	-1.0
Interest expense	-0.0	-0.0	-0.2	-0.2	-0.3	-0.4
Associates	0.0	0.0	-0.0	0.0	0.1	0.1
PBT	-0.3	0.7	1.8	4.5	5.5	6.5
PBT Growth (%)	na	nm	152	152	21	19
PBT margin (%)	-1.2	3.1	6.8	12.8	13.2	13.6
Taxation	-0.0	-0.2	-0.5	-0.3	-0.5	-1.2
Tax Rate (%)	-0.7	26.5	27.2	25.5	25.5	25.5
Minority Interest	0.0	0.0	0.0	0.0	0.0	0.0
Net Profit	-0.3	0.5	1.3	3.4	4.1	4.9
Net profit growth (%)	na	nm	149	159	21	19
EPS (cts)	-0.4	0.8	1.9	4.7	5.0	5.9

Historical Balance Sheet

Balance Sheet (S\$'000)	1997A	1998A	1999A	1H00A
Fixed assets	4,554	4,207	6,541	6,683
Others	282	282	744	977
Current assets	8,260	7,131	9,426	12,043
Total assets	13,096	11,620	16,711	19,703
Current liabilities	10,760	8,250	9,012	9,265
Non-current liabilities	43	3	1,056	999
Total liabilities	10,803	8,253	10,068	10,264
Net assets	2,293	3,367	6,643	9,439
Shareholders' equity	2,293	3,367	6,643	9,421
Minority interests	0	0	0	18
	2,293	3,367	6,643	9,439
Book NTA per share (cts)	2.87	4.41	8.66	12.55

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