**Qian Hu Corporation Ltd**

### A Temporary Setback

Sales in 1Q04 increased by only 1.9%, from S$15.9m to S$16.2m. This was mainly attributable to lower domestic sales as a result of stiff competition and industry consolidation. Sales of both ornamental fish and accessories in Singapore dropped by S$S$1.0m and S$0.7m respectively. This was however, offset by higher sales in its overseas subsidiaries and the export market. Net profit of the group tumbled from S$1.3m to S$1.2m, mainly due to lower profit margin of the accessories division. Keen competition, coupled with production disruption in its plants in Guangzhou, caused the profit margin of this division to reduce from 18.1% to 9.2%. The lackluster performance of this division was partially offset by better profit margin brought in by the ornamental fish division, as the Group sold more Dragon Fish subsequent to the acquisition of Kim Kang.

We maintain our FY04 and FY05 sales and earnings forecasts for Qian Hu. Based on forward PER of 12x and estimated FY04 diluted EPS of S$0.064, we peg the fair value at S$0.76. We thus maintain our BUY recommendation.

### 1. Key Financial Data

*(Financial Year Ended 31 December)*

<table>
<thead>
<tr>
<th></th>
<th>1Q03</th>
<th>1Q04</th>
<th>%ch</th>
<th>FY03</th>
<th>FY04F</th>
<th>FY05F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover (S$ m)</td>
<td>15.9</td>
<td>16.2</td>
<td>1.9</td>
<td>67.7</td>
<td>77.6</td>
<td>88.1</td>
</tr>
<tr>
<td>EBITDA (S$ m)</td>
<td>2.1</td>
<td>3.5</td>
<td>68.0</td>
<td>11.5</td>
<td>12.5</td>
<td>13.7</td>
</tr>
<tr>
<td>EBIT (S$ m)</td>
<td>1.7</td>
<td>1.6</td>
<td>(9.4)</td>
<td>9.8</td>
<td>10.3</td>
<td>11.5</td>
</tr>
<tr>
<td>Net Profit (S$ m)</td>
<td>1.3</td>
<td>1.2</td>
<td>(8.8)</td>
<td>7.0</td>
<td>8.5</td>
<td>9.6</td>
</tr>
<tr>
<td>Net Profit Margin (%)</td>
<td>8.2</td>
<td>7.3</td>
<td>(10.5)</td>
<td>10.4</td>
<td>10.9</td>
<td>10.9</td>
</tr>
<tr>
<td>ROE (%)</td>
<td>17.9*</td>
<td>12.7*</td>
<td>(29.1)</td>
<td>19.2</td>
<td>19.0</td>
<td>17.9</td>
</tr>
<tr>
<td>Earnings per Share (cents)</td>
<td>1.0</td>
<td>0.9</td>
<td>(8.8)</td>
<td>5.5</td>
<td>6.6</td>
<td>7.5</td>
</tr>
<tr>
<td>Diluted Earnings per Share (cents)</td>
<td>1.0</td>
<td>0.9</td>
<td>(8.8)</td>
<td>5.3</td>
<td>6.4</td>
<td>7.2</td>
</tr>
<tr>
<td>NTA per Share (cents)</td>
<td>22.7</td>
<td>32.3</td>
<td>42.4</td>
<td>31.2</td>
<td>37.4</td>
<td>44.4</td>
</tr>
</tbody>
</table>

*Source: Company; Phillip Securities Research*

*Based on annualised basis*
2. 1Q04 Financial Results

- **Sales were rather flat**

Revenue in 1Q04 increased marginally, from S$15.9m to S$16.2m. Lower sales in one market/division were being offset by better results in another market/division:

First, lower local sales were being offset by higher overseas sales. Prior to 2003, increasing popularity of Flower Horns has attracted a lot of players into the industry. This has caused the competition in this industry became stiffer, and starting from 2H 2003, some players have exited the industry. As the industry is undergoing consolidation, Qian Hu is losing some of its local customers. Sales in Singapore dropped by 21.7% in 1Q04, compared to the corresponding period. Sales of its overseas subsidiaries, as well as export sales, however, improved significantly. Sales to other countries in South East Asia, Europe and other countries grew by 24.9%, 29.4% and 18.4% respectively. Local sales now accounted for only 38% of the Group sales, compared to 49% in 1Q03.

Second, higher sales from the ornamental fish division offset the lacklustre performance of the accessories division. Ornamental fish sales increased by 13.7%, from S$6.3m to S$7.2m, mainly due to contribution from Kim Kang, a subsidiary that was acquired in 2H03. This was, however, partially offset by lower fish sales in Singapore. On the other hand, accessories sales were lowered by 6.8%, from S$8.0m to S$7.5m, mainly due to lower demand in the domestic market.

- **Drop in profitability**

As Qian Hu acquired Kim Kang, the third largest exporter of Arowana in Malaysia, sales of this higher margin fish increased and this has positive impact on the bottom line of the Group. Operating profit of the ornamental fish division increased from S$0.6m to S$1.0m, representing a 59.6% growth. Profit margin, hence, improved from 9.9% to 14.2%. This was however, more than offset by lower profit of the accessories division. This division had a double whammy in 1Q04: 1) Due to the keen competition in Singapore, Qian Hu were having more promotions in 1Q04 and this has eroded the profit margins; 2) the relocation of the factory in Guangzhou has caused some disruption in the production and thus both the sales and profitability were affected. The operation in Guangzhou incurred losses in the first two months of the year and only returned to profitability in March. Hence, profit margin of the accessories division shed from 18.1% to 9.2%.

Mainly due to the losses in the Guangzhou plant and lower selling prices of the accessories, gross profit margin of the Group dropped from 36.7% to 34.5%. The management has put a lot of effort in containing the operating costs. Operating expenses dropped by 1.9%, and this has cushioned the fall in the gross margins. Net profit margin of the Group dropped from 8.2% to 7.2%.
Stock Update – Qian Hu Corporation Limited

• Cash flow remained healthy
The cash flow statement of the group remained healthy with the operating activities generating positive cash flow of S$0.5m. Gross gearing ratio remained low at 0.1x. Compared to December 2003, trade debtor turnover days dropped from 69 days to 66 days but inventory turnover increased from 125 days to 129 days, as Qian Hu stock up inventory for retail outlets that are slated to open in 2Q.

3. Outlook
As the local industry is still undergoing consolidation, Qian Hu will see more customers leaving the industry this year. This will affect the sales and bottom line negatively. However, we believe that poorer results in the domestic market will be more than offset by better overseas sales. Subsidiaries in Malaysia, Thailand and China could contribute positively to the group. Furthermore, factory in Guanzhou is operating at 80% utilization rate now and was already profitable in March. We believe that the wild card comes from the retail operation. The success or failure of the retail operation will affect the profit margin of the Group this year. Qian Hu has thus far opened two retail outlets in Shanghai during end of March and beginning of April. Another 4 outlets are slated to open in 2Q04. The start-up costs of these retail outlets may affect the profit margin negatively in the short-term.

4. Recommendation
We maintain our FY04 and FY05 sales and earnings forecasts for Qian Hu. Based on forward PER of 12x and estimated FY04 diluted EPS of S$0.064, we peg a fair value of S$0.76 on Qian Hu. We thus maintain our BUY recommendation.

Signed

Phillip Research Stock Selection System

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>BUY</td>
<td>&gt;15% upside from the current price</td>
</tr>
<tr>
<td>HOLD</td>
<td>Trade within ±15% from the current price</td>
</tr>
<tr>
<td>SELL</td>
<td>&gt;15% downside from the current price</td>
</tr>
</tbody>
</table>

Note: With effect from 1st April 2004, we have streamlined our stock selection system to three primary recommendations of Buy, Hold and Sell. In the previous stock selection system, “SELL” was defined as >35% downside from the current price. We have also removed our “Strong Buy” & “Take Profit” recommendations.

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