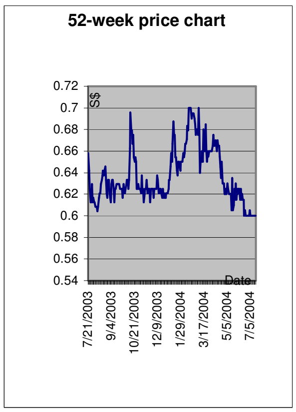
**Recommendation:**
**HOLD**

**Price (19/07/04)**
**S$0.59**

**Share Statistics**

| | |
|---|---|
| Shares | 128.2m |
| Market Cap. | S$75.6m |
| Trailing PER | 12.8X |
| Forward PER | 12.6X |
| P/NTA | 2.0X |
| 52-week Price Range | S$0.59 – S$0.70 |
| 52-week PER Range | 12.8x –15.1 x |
| Listing Bourse | Mainboard |
| Substantial Shareholders | Yap Family (51.8%) |

*Source: Bloomberg; Phillip Securities Research*




*Source: Bloomberg*

**Company Profile**
Qian Hu engages primarily in the import, export and distribution of ornamental fish, the breeding of Dragon Fish, as well as the manufacturing and distribution of aquarium and pet accessories.

**Phillip Securities Research**

Wang Hoi Min
☎ 65-6531 1245
FAX 65-6536 4435
✉ wanghm@phillip.com.sg

**Previous call: BUY on 20 April 2004 at S$0.655**

# Qian Hu Corporation Ltd

## *Lacklustre performance*

*Qian Hu reported a lacklustre set of results yesterday, which was below our expectation. Revenue increased by 3.2% to S$34.3m while the net profit dropped by 33.5% to S$2.2m. Subsequent to the acquisition of subsidiaries in Malaysia and Indonesia, Qian Hu is able to export more ornamental fish and hence the ornamental fish division registered a 27.6% jump in turnover. This was offset by lower sales in the accessories segment due to keen competition in the Singapore and Malaysia markets. Profit margin was badly hit due to:- 1) eroded yield in the accessories segment as Qian Hu stepped up its promotional activities amidst keen competition; 2) the new plant in Guangzhou has yet to operate at the optimal level and barely broke even and 3) pre-operational costs of the chain stores.*

*The earnings visibility remains poor in the short-term. In light of this, we have revised downward both of our projections for FY04 and FY05. We expect Qian Hu to post a lower net profit of S$6.1m in FY04. We thus downgrade our recommendation to a HOLD, with a revised target price of S$0.54, based on 10x PER of FY05 earnings.*

## 1. Key Financial Data

**(Financial Year Ended 31 December)**

| | 1H03 | 1H04 | %ch | FY03 | FY04F | FY05F |
|---|---|---|---|---|---|---|
| Turnover (S$ m) | 33.2 | 34.3 | 3.2 | 67.7 | 70.6 | 79.3 |
| EBITDA (S$ m) | 5.0 | 7.8 | 54.2 | 11.5 | 9.5 | 10.7 |
| EBIT (S$ m) | 4.3 | 3.6 | (15.5) | 9.8 | 6.7 | 7.9 |
| Net Profit (S$ m) | 3.3 | 2.2 | (33.5) | 7.0 | 6.1 | 7.0 |
| Net Profit Margin (%) | 9.8 | 6.3 | (35.5) | 10.4 | 8.7 | 8.9 |
| ROE (%) | 21.6* | 11.2* | (48.0) | 19.2 | 14.3 | 14.1 |
| Earnings per Share (cents) | 2.5 | 1.7 | (33.5) | 5.5 | 4.8 | 5.5 |
| Diluted Earnings per Share (cents) | 2.5 | 1.7 | (33.5) | 5.3 | 4.7 | 5.4 |
| NTA per Share (cents) | 23.5 | 29.5 | 25.4 | 31.2 | 37.0 | 43.7 |

*Source: Company; Phillip Securities Research*
**Based on annualised basis*

## 2. 1H04 Financial Results

1H results were below our expectation. Sales increased marginally, up by 3.2% to S$34.3m while net profit slid by one-third to S$2.2m. The main contributor was the ornamental fish division while the accessories division registered lower sales and profit margin.

- **Ornamental fish**

*Ornamental fish sales boosted by newly acquired subsidiaries.*

Sales increased by 27.6% to S$16.7m, mainly contributed by two newly acquired subsidiaries in Malaysia and Indonesia, Kim Kang Aquaculture Sdn Bhd and PT Qian Hu Aquarium & Pets. Kim Kang was acquired in 3Q03 and it is the third largest dragon fish exporter in Malaysia. PT Qian Hu was acquired in January 2004 and it is engaged in breeding, rearing and trading of fish, as well as distribution of aquarium and pet accessories. The positive contribution from the new subsidiaries, was however, partially offset by lower sales in another subsidiary in Malaysia, due to the keen competition there.

Profit margin gained by 3-percentage point to 18%. After the acquisition of Kim Kang, Qian Hu is now able to sell more dragon fish, which commands higher profit margin.

- **Accessories**

*Keen competition in the Singapore and Malaysia markets affected the performance of the accessories division.*

Sales of the accessories division dropped by some 15.7% to S$14.2m. This was mainly attributed to lower sales in Malaysia and Singapore markets. Due to the popularity of Flower Horn and low barriers to entry, a lot of players entered this industry in 2002. According to Agri-Food & Veterinary Authority, ornamental fish shops in Singapore increased form 153 in 2001 to a peak of 497 in 2002. However, as the Flower Horn lost its shine recently, so did the fish retailers and distributors. The competition among the retailers is getting keener and the crowded industry has caused some players to exit the market. The number of ornamental fish shop has dropped to 408 last year. The consolidation activities and keen competition continue in 2004. Qian Hu's sales were affected since 2H03 as some of its customers have exited the industry.

*The production inefficiency in the Guanzhou plant and the set-up costs of the chain stores also eroded the profit margin.*

Profit margin of this segment took a severe beating, dropping from 16.3% to 7.5%. Due to the keen competition, Qian Hu also has to step up its promotional activities and the profit margin was thus eroded. The profit margin of this division was also being affected by the relocation of the Guangzhou plant in January 2004. The plant is operating at 80% utilization rate currently but the efficiency has not picked up yet. It barely broke-even in 1H04, compared to profit of S$0.2m in the corresponding period. The third factor that caused the erosion in the profit margin was the start-up costs incurred by the chain stores. Qian Hu has opened 4 retail outlets in 1H04 and some of the pre-operational expenses incurred were being written off.

- **Plastic**

*The loss-making subsidiary was being divested.*

Although sales increased marginally, profit dropped by 21.9% to S$0.2m. This was mainly due to losses incurred in one of the subsidiaries, Fujian Anxi Qianlong Plastics, which was being disposed of in 1H04.

- **Higher working capital requirement**

*Higher working capital needs affected the operating cash flow.*

Inventory turnover days increased from 125 days to 140 days, as Qian Hu increased its inventory level for the new outlets. Due to this higher working capital requirement and lower profit, the negative operating cash flow enlarged from S$0.04m to S$0.6m. Gearing ratio has also increased slightly to 0.5x.

## 3. Outlook

- **'Qian Hu – The Pet Family" Concept**

*Qian Hu will roll out another 6-7 chain stores by end of 3Q04.*

Qian Hu has started to roll out the chain store concept, "Qian Hu- The Pet Family" in March 2004. In 1H04, a total of 4 outlets were opened in China (2 in Shanghai, 1 each in Guangzhou and Nanjing). At least 6-7 outlets are slated to open in Beijing, Kula Lumpur, Johor Bahru, Bangkok and Bandung. These chain stores sell ornamental fish, aquarium accessories and other pet accessories. The average size of each store ranges from 300 meter square to 500 meter square, with the exception for the outlet in Beijing, which occupies an area of 800 meter square. Set up cost for each store amounts to S$0.2m, and part of this amount will be expensed off. Each store is expected to break-even within 1-2 years time. Qian Hu will also incur higher promotional expenses in order to create awareness for the chain stores. All these expenses will erode the profit margin of Qian Hu in the near future, before the sales volume kick-in.

- **The keen competition in the accessories industry**

*The drop in sales and profitability accelerated in 2Q04.*

Sales and profit margin of Qian Hu were affected by the keen competition in the accessories industry since 2H03 and the impact was worse than our expectation. We notice that the drops in the sales and margins were accelerated in 2Q04, whereby the y-o-y drop in sales and profitability were 23.8% and 69.1% respectively. 2Q is typically a stronger quarter compared to 1Q but in 2Q04, both the sales and profitably dropped q-o-q. The consolidation activities may continue for the rest of the year and hence we may see further erosion of profit margin in this division.

- **Ornamental Fish division will be the profit contributor**

*Qian Hu is the only company in the world which is able to export ornamental fish from 5 countries*

With the acquisition of the subsidiary in Indonesia, Qian Hu is now able to export more fish from Singapore, Malaysia, Thailand, China and Indonesia. It is the only company in the world which is able to export 60-70% of the world's ornamental fish supply from these 5 countries. With the acquisition of Kim Kang, it is also able to export more own-bred dragon fish, which fetches higher profit margin.

## 4. Recommendation

*We revised our earning forecasts downward.*

In the short-term, Qian Hu's profit margins will be affected by the keen competition in the Singapore and Malaysian markets and start-up costs of the chain stores. The consolidation is still going on with the weaker players exiting the industry. Qian Hu may thus lose more customers while at the same time having to continue with the promotional activities in order to maintain market shares. The "Qian Hu – The Pet Family" chain store concept is still at its infancy stage and Qian Hu has to step up is advertising activities in order to create awareness. The higher profit margin from the ornamental fish division may not be sufficient to cover the higher expenses in the accessories division.

*We downgrade our recommendation to HOLD.*

In light of the poor earning visibility, we have revised downward both of our projections for FY04 and FY05. We expect Qian Hu to post a lower net profit of S$6.1m in FY04. We thus downgrade our recommendation to a HOLD, with a revised target price of S$0.54, based on 10x PER on FY05 earnings.

Signed

**Phillip Research Stock Selection System**

| | |
|---|---|
| BUY | >15% upside from the current price |
| HOLD | Trade within ± 15% from the current price |
| SELL | >15% downside from the current price |

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.

has not verified this information and no representation or warranty, express or implied, is made that such information or Research is accurate, complete or verified or should be relied upon as such. Any such information or Research contained in this publication are subject to change, and Phillip Securities Research shall not have any responsibility to maintain the data and services made available or to supply any corrections, updates or releases in connection therewith. In no event will Phillip Securities Research be liable for any special, indirect, incidental or consequential damages which may be incurred from the use of the data or services made available, even if it has been advised of the possibility of such damages.

**Non-applicability of Section 27 of the Financial Advisers Act (Act 43 of 2001) and the MAS Notice on Recommendations on Investment Products**

Section 27 of the Financial Advisers Act (Act 43 of 2001) and the MAS Notice on Recommendations on Investment Products of 1 October 2002 do not apply in respect of this publication.

This material has been prepared for informational purposes only, and opinions contained in this publication have been made on a general basis. In the preparation of this publication, no consideration has been given to any particular individual or specific investment objectives, financial situations or other circumstances. As such, this publication should not be relied upon as authoritative without further being subject to the recipient's own independent verification and exercise of judgment. The fact that this publication has been made available constitutes neither a recommendation to enter into a particular transaction nor a representation that any product described in this material is suitable or appropriate for the recipient. Recipients should be aware that many of the products which may be described in this publication involve significant risks and may not be suitable for all investors, and that any decision to enter into transactions involving such products should not be made unless all such risks are understood and an independent determination has been made that such transactions would be appropriate. Any discussion of the risks contained herein with respect to any product should not be considered to be a disclosure of all risks or a complete discussion of such risks.

Nothing in this report shall be construed to be an offer or solicitation for the purchase or sale of a security. Any decision to purchase securities mentioned in this research should take into account existing public information, including any registered prospectus in respect of such security.

**Disclosure of Interest**

Statement Pursuant to Section 36 of the Financial Advisers Act. Phillip Securities Research Pte Ltd and its directors and employees may have interest in the securities recommended herein from time to time, and its associates and connected persons may also have positions from time to time. Opinions and views expressed in this report are subject to change without notice.

**Availability**

The information, tools and material presented herein are not directed, intended for distribution to or use by, any person or entity in any jurisdiction