

Qian Hu Corporation

Reuters: QIAN.SI
Bloomberg: QIAN SP

Sector: Commerce

Rating:

Price S\$0.325

Upgrade to **Market Perform**

Y/E 31-Dec	2003A	2004A	2005F	2006F
Net Profit (S\$m)	7.0	1.6	2.0	3.8
EPS (S cent)	5.5	1.3	1.6	2.9
EPS Growth (%)	-	-77	+26	+85
Consensus EPS	-	-	2.3	3.9
PER (x) @ S\$0.325	5.9	25.6	20.4	11.0
NTA (S\$)	0.31	0.32	0.34	0.37

Performance (%)	1mth	3mth	12mth	Market Capitalisation :	S\$	42m
Absolute	+8	-27	-52	Issued Shares :		128m
Relative against STI	+5	-33	-67	30-day avg daily vol ('000) :		41

Initial signs that the worst may be over

- Qian Hu registered **S\$146,000 net profit in 4Q04**
- Improvement seen in its retail operations in 4Q04
- Capacity utilisation rate at China plant improved by 10 percentage points QoQ to 50%
- Our fair value estimate remains **S\$0.32**

Summary. Qian Hu recovered from a third quarter loss to register a slight S\$146,000 net profit in 4Q04. Despite suffering a massive 76.8% YoY drop in FY04 net profit to S\$1.6m, it is still slightly better than our net profit forecast of S\$1.4m. More importantly, we saw consistent improvement in its China plant operations, which achieved 50% capacity utilisation rate in 4Q04, as compared to 30% in 2Q04. At this utilisation rate, the plant had achieved operational breakeven level. Also, Qian Hu's Accessories Division had a turnaround within a quarter to register S\$133,000 in operating profits in 4Q04. This can be attributed to lower retail store set-up costs and improved business conditions for its existing retail outlets. Currently, more than half of its 10 retail stores is profitable. Whilst Qian Hu is not expected to return to its former earnings growth path in our forecast period, we view the fourth

quarter performance as an initial sign that the worst is over for Qian Hu. The stock has fallen quite significantly over the past quarter from 40.5c to 32.5c. The price is now near our fair value estimate — and this is nothing to get excited about. But we feel that things are getting better and we are upgrading Qian Hu to **MARKET PERFORM**. Note that our FY05 net profit forecast and fair value estimate remains at S\$2m and S\$0.32 respectively.

Qian Hu made a return to the black in 4Q04. Qian Hu recovered from an S\$682,000 third quarter loss to register a slight S\$146,000 net profit in 4Q04. Revenue dipped 6.9% YoY to S\$15.5m in 4Q04, due to weakness in its Accessories Division. As a result, Qian Hu's FY04 revenue declined 3.2% YoY to S\$65.5m. While Qian Hu's net profit crashed 76.8% YoY to S\$1.6m in FY04, we note that it was still better than our net profit forecast of S\$1.4m.

On a segmental basis, Qian Hu's Accessories Division suffered a massive 94.5% YoY drop in operating profit to S\$287,000 in FY04, while its Plastics Division registered 20.7% YoY jump in operating profit to S\$309,000 in FY04. The weakness in the Accessories Division can be attributed to Qian Hu's venture into new retail operations and the under-utilisation of its

manufacturing facilities in FY04. Qian Hu's Fish Division surprised with a 62.3% YoY dip in operating profit to S\$719,000 in 4Q04, as it embarked on an aggressive marketing scheme to lure new customers. As a result, the Fish Division suffered 19.3% YoY drop in net profit to S\$4.3m in FY04. Still, management guides that net profit margin for this business division should be back above 10% in 1Q05, as promotional offers in the fourth quarter expire.

Accessories Division showed sign of improvement in 4Q04. Qian Hu's Accessories Division had turned around within a quarter to register operating profit of S\$133,000 in 4Q04, as compared to a S\$916,000 loss in 3Q04. Qian Hu's retail stores had experienced better business conditions in 4Q04. Other than the three retail outlets in China, and the new store set-up in Thailand in 4Q04, the remaining six retail outlets were profitable. Start-up costs were drastically reduced in 4Q04, as Qian Hu opened only one new outlet, as compared to six new stores in 3Q04. We note that Qian Hu's growing business experience has also resulted in a significant drop in start-up cost to about S\$40,000 for the new Thailand outlet, as compared to about S\$100,000 for the first Thailand store (which is of comparable size). In FY05, Qian Hu has undertaken to fund new retail outlets through operational cash flows generated by subsidiaries in their respective geographical markets.

We also saw a consistent improvement in Qian Hu's China plant operations. It achieved 50% capacity utilisation rate in 4Q04, as compared to 30% in 2Q04 and 40% in 3Q04. Encouragingly, much of the increase was due to rising OEM orders. Besides supporting its own accessories operations, part of the reasons for management's decision to double its China plant capacity is the anticipation of OEM orders from its suppliers. Even though expected sales volume did not materialise, the steady QoQ increase in OEM orders did point towards better days ahead. We understand that Qian Hu's manufacturing plant has achieved operational breakeven at the utilisation rate of 50%.

Upgrade to MARKET PERFORM. Whilst Qian Hu is not expected to return to its former earnings growth path in our forecast period, we view the fourth quarter performance as an initial sign that the worst is over for Qian Hu. The stock has fallen quite significantly over the past quarter from 40.5c to 32.5c. The price is now near our fair value estimate — and this is nothing to get excited about. But we feel the business has bounced off the bottom and we are upgrading Qian Hu to a **MARKET PERFORM**. Note that our FY05 net profit forecast and fair value estimate remains at S\$2m and S\$0.32 respectively.

Qian Hu Corporation Ltd's Key Financial Data Income Statement

Year to 31 Dec (In S\$ m)	FY03	FY04	FY05F	FY06F
Revenue	67.7	65.5	61.0	64.0
Cost of sales	(42.3)	(42.5)	(36.9)	(38.5)
Gross profit	25.4	23.0	24.1	25.5
Other operating income	0.2	0.2	0.2	0.2
Selling & distribution expenses	(1.8)	(2.5)	(3.0)	(2.9)
Administrative expenses	(14.0)	(16.8)	(16.9)	(16.5)
EBIT	9.8	3.9	4.3	6.3
Net interest	(0.2)	(0.4)	(0.6)	(0.7)
Share of associates' income	-	(0.1)	-	-
Pre-tax profit	9.6	3.4	3.7	5.6
Tax	(1.8)	(1.2)	(1.1)	(1.2)
Minority Interest	(0.8)	(0.6)	(0.5)	(0.6)
Net profit	7.0	1.6	2.0	3.8
Earnings per share (cents)	5.5	1.3	1.6	2.9
Profitability Ratios				
EBIT margin (%)	14.4	5.9	7.1	9.8
PBT margin (%)	14.1	5.2	6.0	8.8
EAT margin (%)	10.4	2.5	3.3	5.9

Balance Sheet

As at 31 Dec (In S\$ m)	FY03	FY04	FY05F	FY06F
Cash	4.2	4.2	2.7	7.2
Other current assets	31.8	37.9	37.8	38.4
Non-current assets	20.2	21.0	20.4	19.2
Total assets	57.2	64.9	62.8	66.6
Current liabilities less debt	13.4	12.4	13.9	13.9
Debt	1.5	8.5	2.3	1.6
Other long term liabilities	1.6	1.6	1.7	1.7
Total liabilities	16.5	22.5	17.9	17.3
Shareholders equity	36.6	37.6	39.7	43.4
Total equity and liabilities	57.2	64.9	62.8	66.6
NTA per share (cents)	31.1	31.6	33.6	37.0

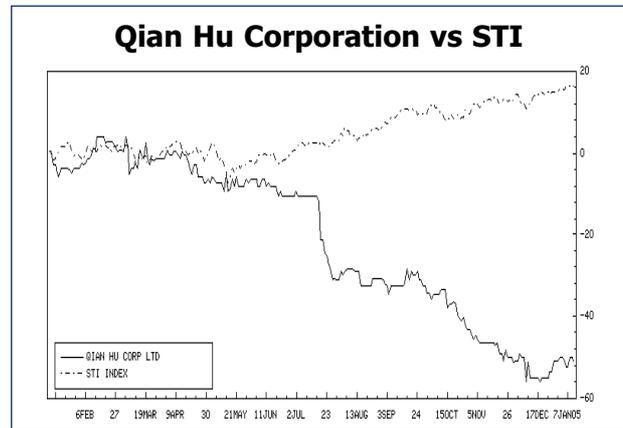
Cash Flow Statement

Year to 31 Dec (In S\$ m)	FY03	FY04	FY05F	FY06F
Operating profit before working cap. changes	10.0	6.0	5.7	7.6
Working capital changes	(7.1)	(8.0)	1.4	(0.6)
Taxes Paid	(1.9)	(1.1)	(1.0)	(1.1)
Net cash from operations	1.0	-3.1	6.1	5.9
Capex	(1.5)	(2.9)	(1.5)	(1.5)
Other investing flows	(2.2)	(0.0)	0.0	0.8
Investing cash flow	(3.7)	(2.9)	(1.5)	(0.7)
Net change in debt	1.5	6.8	(5.9)	(0.8)
Proceeds from share issuance	(1.0)	0.1	-	-
Dividends paid	(1.0)	(0.5)	-	-
Financing cash flow	(1.0)	6.0	(6.1)	(0.7)
Net cash flow	(3.7)	0.0	(1.5)	4.5
Cash at beginning of year	7.8	4.1	4.2	2.7
Cash at end of year	4.1	4.2	2.7	7.2

Key Ratios

	FY03	FY04	FY05F	FY06F
PER (x)	5.9	25.6	20.4	11.0
Price/Book (x)	1.0	1.0	1.0	0.9
EV/EBITDA (x)	3.4	11.9	6.5	4.4
Dividend yield (%)	1.2	0.0	0.0	0.0
ROIC (%)	18.4	3.5	4.9	8.4
ROE (%)	19.2	4.3	5.1	8.7
Gross Gearing (x)	0.0	0.2	0.1	0.0
PE to growth (x)	0.6	nm	0.8	0.1

Source: Company data, OIR estimates



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Lim Say Boon
Research Director