PHILLIP SECURITIES RESEARCH

Stock Update **RESTRICTED**

SINGAPORE EQUITIES

Tuesday, 13 January 2004

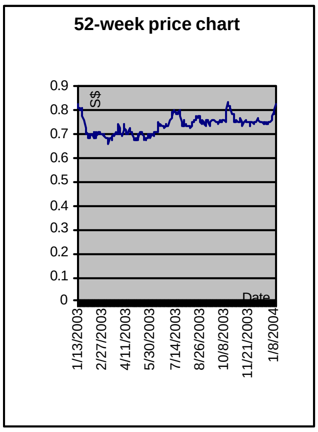
Recommendation:
BUY (Maintain)

Price (12/01/04)
S$0.825

Share Statistics

Shares	106.3 mil
Market Cap.	S$87.7 mil
Trailing PER	12.5
Forward PER	10.2
P/NTA	2.6
52-week Price Range	S$0.66 – S$0.84
52-week PER Range	12.7x – 10.2x
Listing Bourse	Mainboard
Substantial Shareholders	Yap Family (51.9%)

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.

Previous call: BUY (Maintain) on 20 October 2003 at S$0.785

Qian Hu Corporation Ltd

Better Times Ahead

Qian Hu reported an 8.0% y-o-y increase in sales for FY03. This was achieved on the back of improving sales from the two core business segments, namely, ornamental fish and accessories. Sales from domestic market dropped due to keen competition but this was offset by higher sales from the overseas markets. Net profit increased by 7.2% from S$6.5 million to S$7.0 million. Higher profit margin achieved by the ornamental fish segment was offset by reduction in profitability in the accessories and plastics segments. The net profit of FY03 would be lower if the S$1.5 million gain from the revaluation of the breeder stocks were excluded.

We expect Qian Hu to post 22.9% and 11.6% growth in net earnings for the next two years. Based on forward PER of 12x and estimated FY04 diluted EPS of 7.9 cents, we have a target price of S$0.95 on Qian Hu. We thus maintain our BUY recommendation.

1. Key Financial Data

(Financial Year Ended 31 December)

	FY02	FY03	%ch	FY03	FY04F	FY05F
Turnover (S$ m)	62.7	67.7	8.0	67.7	77.6	88.1
EBITDA (S$ m)	10.0	11.5	14.6	11.5	13.0	14.4
EBIT (S$ m)	8.8	9.8	11.5	9.8	10.9	12.2
Net Profit (S$ m)	6.5	7.0	7.2	7.0	8.6	9.6
Net Profit Margin (%)	10.4	10.4	0.0	10.4	11.1	10.9
ROE (%)	23.5	19.2	(18.3)	19.2	19.1	17.8
Earnings per Share (cents)	6.2	6.6	7.2	6.6	8.1	9.1
Diluted Earnings per Share (cents)	6.0	6.4	7.2	6.4	7.9	8.8
NTA per Share (cents)	26.5	37.5	24.4	37.5	45.2	53.9

Source: Company; Phillip Securities Research

Phillip Securities Research

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

2. FY03 Financial Results

Qian Hu reported an 8.0% y-o-y increase in sales for FY03. This was achieved on the back of improving sales from the two core business segments, namely, ornamental fish and accessories. Sales from domestic market dropped due to keen competition but this was offset by higher sales from the overseas markets. Net profit increased by 7.2% from S$6.5 million to S$7.0 million. Higher profit margin achieved by the ornamental fish segment was offset by reduction in profitability in the accessories and plastics segments. The net profit of FY03 would be lower if the S$1.5 million gain from the revaluation of the breeder stocks were excluded.

Inventory turnover has risen from 88 days in FY02 to 125 days in FY03. The brooder stocks from Kim Kang has produced more off-spring of Dragon fish in 4QFY03. These fries have not been grown into marketable sizes for sales and thus were included in the inventory. As a result of higher working capital needs, operating cash flow has also decreased from S$4.7 million to S$1 million.

Qian Hu has proposed a bonus issue on the basis of one bonus share for every five existing ordinary shares held by its shareholders and a first and final gross dividend of 6% per share.

3. Segmental Review

- ***A strong surge in the profit margin from the ornamental fish segment***

Turnover from the ornamental fish segment increased by 14.3% while the profit jumped 117.7%. If we exclude the S$1.5 million gain from the revaluation of the breeder stocks, the profit would have jumped by 56.7% while the profit margin improved from 10.2% to 14.0%. The increase in profit margin was mainly attributable to higher sales of own-bred Dragon fish as Qian Hu acquired Kim Kang in 2HFY03. Kim Kang has more than a thousand brooder stocks of Dragon fish, compared to 350 brooder stocks owned by Qian Hu.

- ***Keen competition in the domestic accessories market***

Turnover from the accessories segment increased marginally from S$31.9 million to S$33.6 million while profit dropped by 26.6% from S$7.1 million to S$5.2 million. Hence, the profit margin has dropped form 22.3% to 15.6%. This was mainly due to the keen competition in the Singapore market coupled with reduction in demand during the SARS period. On the other hand, the reduction in the efficiency in the plants in Guangzhou has also dragged down the profit margin.

4. Outlook

- ***Broader base of supply of ornamental fish***

By setting up the subsidiaries in Thailand, Malaysia, China and the recent joint venture in Jakarta, Qian Hu is now able to source for fish from five countries that supply about 60-70% of ornamental fish in the world market. The acquisition of Kim Kang, the third largest Arowana exporter in Malaysia, will increase the sales of this high value fish going forward.

In order to enhance the group's sales and profitability in the long-term, Qian Hu has entered into a collaboration with Temasek Life Sciences Laboratory to conduct research on the breeding behaviour of the Arowana. The aims are to enhance the production rate of the brooder stocks as well as the quality of the future generation of the Dragon Fish. We believe that the research will further strengthen Qian Hu's position as one of the leading Arowana exporter in this region.

- ***Forward Integration***

Having set up showroom and retail outlets in Kuala Lumpur, Shanghai and Bangkok last year and by leveraging on the experience gained, Qian Hu will pursue a more aggressive plan in the retail front starting from FY04. It plans to set up its new chain store concept, Qian Hu – The Pet Family, in Jakarta, Bangkok, Shanghai, Tianjin, Beijing, Penang and Johor Bahru. It will start with 10-20 stores in FY04 and target to have 100 outlets in five years' time. Qian Hu will be selling ornamental fish, pet accessories (house brands as well as third-party brands) in its retail outlets with some outlets also conducting pet grooming activities.

By being involved directly in the retail operation, Qian Hu will be able to reduce its reliance on wholesalers and other retailers in expanding its sales and market share in the respective country. By setting up retail chains that provide one-stop service to the pet owners, Qian Hu will also be able to enhance its brand name in these countries. On the flip side, operating own retail outlets means higher operating costs and hence erosion of profit margin if the sales do not increase proportionately with the expenses.

5. Recommendation

We expect Qian Hu to post 14.6% in sales and 22.9% in earnings in FY04. With full year contribution from Kim Kang, we expect more sales coming from the Arowana and this will also enhance the gross profit margin going forward. The inefficiency problem in the factories in Guangzhou has been solved and the capacity in the new plant (which will start operation in January 2004) has more than doubled. Hence, we envisage increasing sales from both the fish and accessories segments. The increase in the gross margin resulting from higher Dragon fish sales, however, will be partially offset by the higher operating expenses from the retail operation.

Based on forward PER of 12x and estimated FY04 diluted EPS of 7.9 cents, we have a target price of S$0.95 on Qian Hu. We thus maintain our BUY recommendation.

Signed

Disclaimer

This publication is solely for information and private circulation only. It should not be construed as an offer or solicitation for the subscription, purchase or sale of the securities mentioned herein. Whilst we have taken all reasonable care to ensure that the information contained in this publication is accurate, it does not guarantee the accuracy or completeness of this publication. Any advice contained in this publication is made only on a general basis and is subject to change without notice. We have not given any consideration to and have not made any investigation of the investment objectives, financial situation or particular needs of any specific person or group of persons, as we are not in possession of any such information. Accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of any person or group of persons acting on such information and advice.

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.