

SGX Research Incentive Scheme



CIMB Research Report

Qian Hu Corporation

Ornamental fish leader

QIAN SP

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INITIATING COVERAGE

27 August 2008

RECOM	Buy
PRICE/TARGET PRICE	S\$0.13/S\$0.22
MKT CAPITALISATION	S\$54m
BOARD	Main
SECTOR	Life style

SINGAPORE

A leading ornamental fish exporter. Qian Hu is one of Singapore's leading ornamental fish exporters, accounting for more than 10% of Singapore's ornamental fish exports. According to Qian Hu, it is also one of the few fish companies in the world able to export fishes from four countries in Asia, namely Singapore, Malaysia, Thailand and China. Qian Hu intends to increase its export markets from 70 countries to more than 80 over the next few years.

Four pillars of growth. Qian Hu is uniquely positioned as an integrated ornamental fish service provider, providing one-stop services to domestic and international wholesalers, retailers and consumers. It has four growth engines: 1) the export of ornamental fish and accessories; 2) distribution of ornamental fish and accessories; 3) manufacturing of aquariums and pet accessories; and 4) the breeding of dragon fish.

Initiate with Buy recommendation and target price of S\$0.22. Qian Hu trades at 8x CY09 P/E and 4.5x EV/EBITDA, which are not lofty given its rather unique business and strong brand name, in our opinion. We have a target price of S\$0.22, applying 10x CY09 P/E, or the low end of its 6-year P/E band. Given the 69% upside potential, we initiate coverage with a Buy recommendation. We see potential catalysts from its successful expansion into the accessories business and positive contributions from a new farm in 2009.

Financial summary

FYE Dec	2006	2007	2008F	2009F	2010F
Revenue (S\$ m)	76.1	92.1	96.2	103.4	111.2
EBITDA (S\$ m)	7.4	10.1	11.7	13.2	14.4
EBITDA margins (%)	9.8	11.0	12.1	12.8	13.0
Pretax profit (S\$ m)	5.3	4.3	9.0	10.5	11.6
Net profit (S\$ m)	2.6	4.8	5.4	6.6	7.3
EPS (S cts)	0.7	1.3	1.3	1.6	1.7
EPS growth (%)	+25%	+78%	-1%	+22%	+11%
P/E (x)	17.6	9.9	10.0	8.2	7.4
FD EPS (cts)	0.7	1.3	1.2	1.4	1.6
FD P/E (x)	17.6	9.7	11.0	9.0	8.1
Gross DPS (S cts)	0.18	0.20	0.26	0.32	0.35
Dividend yield (%)	1.4	1.5	2.0	2.4	2.7
P/NTA (x)	1.1	1.0	1.1	1.0	0.9
ROE (%)	6.3	13.7	10.8	12.1	12.2
Net gearing (%)	3.8	3.4	9.4	5.8	4.3
P/CF (x)	9.4	6.8	6.6	5.7	5.2
EV/EBITDA (x)	8.0	5.9	5.1	4.5	4.1
CIMB-GK/Consensus (x)	-	-	1.1	1.1	NA

Source: Company, CIMB-GK Research estimates

Market capitalisation & share price info

Market cap	S\$54.0m	Share price perf. (%)	1M	3M	12M
12-mth price range	S\$0.13/S\$0.21	Relative	(5.5)	3.9	(27.0)
3-mth avg daily volume	S\$0.01m	Absolute	(7.1)	(10.3)	(33.3)
# of shares (m)	415.2	Major shareholders	% held		
Est. free float (%)	45	Qian Hu Holdings Pte Ltd	26.4		
Wrts/ICULS o/s (m)	65.0				
Conv. price (cts)	3.5				

Source: Company, CIMB-GK Research, Bloomberg

Background

Qian Hu is a one-stop ornamental fish service provider. It breeds dragon fish, farms, imports, exports and distributes ornamental fish as well as makes aquariums and pet accessories. Qian Hu has a presence in Singapore, Malaysia, Thailand, and China.

Its business can be classified into:

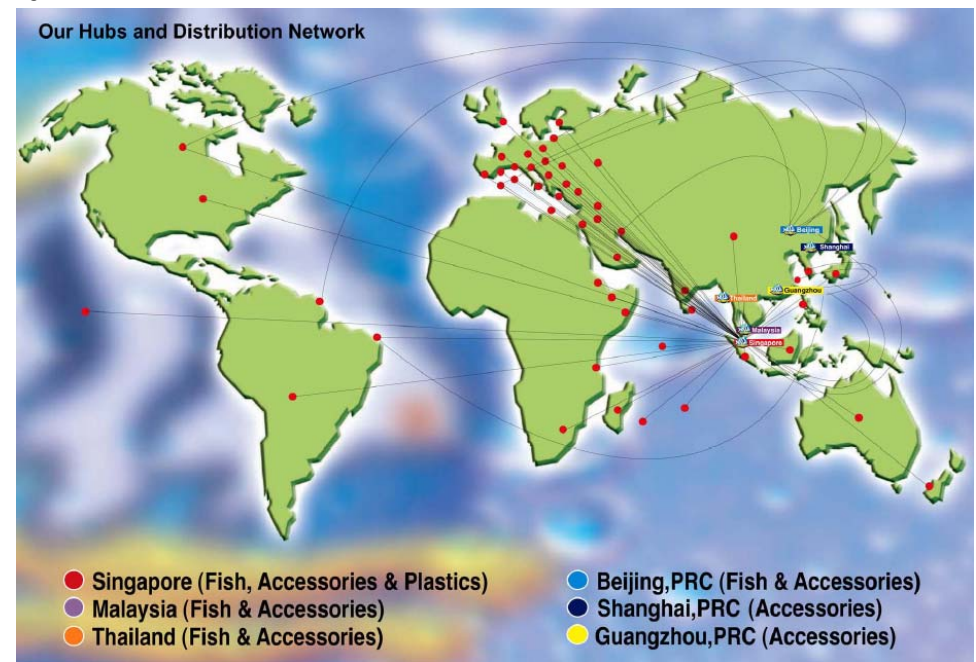
1) Ornamental fish. Qian Hu imports, exports, breeds, quarantines, conditions, farms and distributes ornamental fish. Its ornamental fish are imported from countries in South-East Asia, South America and Africa. It currently exports over 500 species and varieties of ornamental fish directly to more than 70 countries as well as distributes to local retailers and exporters. The "Qian Hu" dragon fish is increasingly regarded as a premium brand in north-east China.

2) Accessories. The distribution of accessories complements its ornamental fish business, meeting customers' aquarium needs. Qian Hu distributes more than 5,000 types of aquarium and pet accessories from more than 20 major manufacturers and principals to local retailers and wholesalers in Asia, including supermarkets operated by NTUC FairPrice, Cold Storage, Carrefour, Lotus and Tesco, etc.

In addition, it has developed its own brands of aquarium and pet accessories, namely "Ocean Free", "Delikate", "BARK", "Nature's Gift" and "ARISTO-CATS YI HU". It also has production facilities in Guangzhou, China to manufacture aquariums and pet accessories for itself and third parties.

3) Plastic bags. This is an ancillary business. Qian Hu manufactures plastic bags for its own use to package ornamental fish for sale in a separate factory located in Woodlands. The plastic bags are also supplied to third parties in the ornamental fish, food and electronics industries.

Figure 1: Distribution network



Source: Company

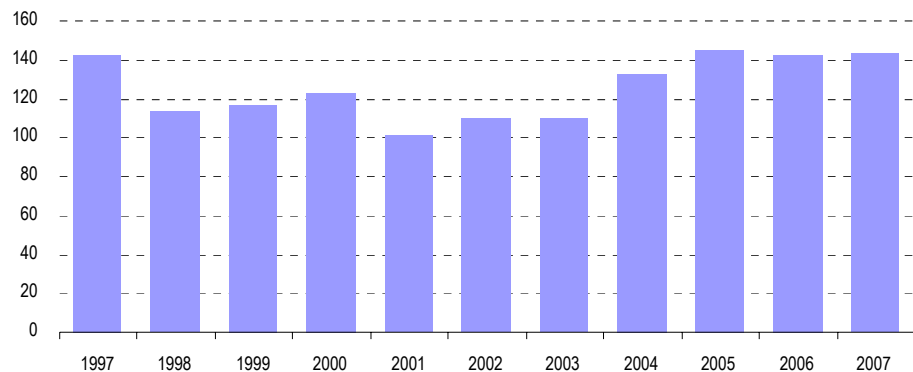
Industry outlook

Singapore is a growing global player. Singapore was the top exporter of ornamental fish in the world in 2005, with a 20% global market share. Singapore exports to 72 countries with its major markets being North America, Europe and Japan. According to the World Trade Organisation, the world trade in ornamental fish is worth more than US\$4.5bn. If accessories and fish feed are included, the total market balloons to more than US\$14bn. The value of the international ornamental fish trade has been growing at an average rate of 14% yearly since 1985. Of this, Asian countries account for a significant 68% share.

Ornamental fish capital of the world. Singapore is not only reputed to be the ornamental fish capital of the world, it is also lauded for its one-stop-shop capability. Exporters deal with about 500 varieties and species of ornamental fish, buying from local farms as well as overseas for re-export. Singapore is also the world's largest farm breeder of ornamental fish.

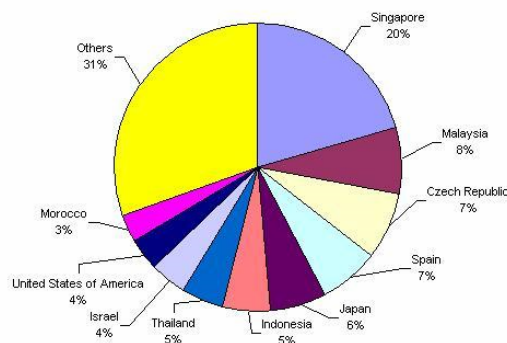
Strong product knowledge. Ornamental fish handling is a knowledge-based business, requiring years of experience in handling different types of fish imported from South-East Asia, South America and Africa. Knowledge of environmental conditioning, proper nutrition, quarantine and medication is required. Even the seemingly simple process of preparing fish for export requires precision. The fish have to undergo stringent pre-flight conditioning to prepare them for the long journey overseas. This preparation spans the regulation of water quality and diet, to waste reduction, space acclimatisation and temperature control. The process helps to ensure that the fish arrive at their destinations in good shape. With ISO 9001 and ISO 14001 in place, customers can be assured that their orders will arrive in good condition. Qian Hu is able to guarantee customers a loss rate of not more than 3% when the fish are delivered to them.

Figure 2: Farm production of aquarium fish (m)



Source: Singapore aquarium fish exporters' association (SAFEA)

Figure 3: Main exporting countries for ornamental fish in 2005



Source: FAO. Fishstat Plus, commodities production and trade 1976-2005

Company outlook

Market leader in Singapore. We believe that Qian Hu is one of Singapore's leading exporters of ornamental fish, accounting for more than 10% of Singapore's ornamental fish exports. It is also the only fish company in the world able to export fish from four countries in Asia, namely Singapore, Malaysia, Thailand and China. It intends to export ornamental fish to more than 80 countries from 70 countries currently in the coming years.

Four pillars of growth. Qian Hu is uniquely positioned as an integrated ornamental fish service provider, providing one-stop services to domestic and international wholesalers, retailers and consumers. It has four growth engines: 1) the export of ornamental fish and accessories; 2) distribution of ornamental fish and accessories; 3) manufacturing of aquariums and pet accessories; and 4) the breeding of dragon fish.

Aiming to be top-3 manufacturer of accessories in China. The accessories business is an important growth driver for Qian Hu as consumers invariably spend an average of five dollars on accessories for every dollar spent on ornamental fish. Currently, Qian Hu distributes more than 5,000 types of aquarium and pet accessories for about 27 major manufacturers and principals. It aims to emerge as one of the top three manufacturers in China for aquarium accessories in the not-too-distant future.

Improving in-house brands. Qian Hu is working on improving its various retail brand identities. Through the years, it has developed in-house brands such as "Ocean Free", "Delikate", "Bark" and "Aristo-Cats Yi Hu" for its aquariums and pet accessories.

Figure 4: Qian Hu's integrated value chain

	Fish	Accessories	Retail chain stores	Plastic
Singapore	•	•		•
Kuala Lumpur, Malaysia	•	•	•	
Batu Pahat, Malaysia	•	•	•	
Bangkok, Thailand	•	•	•	
Beijing, China	•	•		
Guangzhou, China		•		•
Nanjing, China			•	
Shanghai, China			•	
Taiwan		•		
Jakarta, Indonesia	•	•		
Bandung, Indonesia			•	

Source: Company

Focusing on R&D of dragon fish, which offers fatter margin. Qian Hu is one of the earliest farms in Singapore to secure a licence to breed and distribute dragon fish. Currently, there are only six farms in Singapore registered with the AVA for breeding dragon fish. Entry barriers are high in view of the knowledge and experience required and the high capital investment involved in the breeding of dragon fish. Qian Hu capitalised 350 brooder stocks amounting to S\$1.5m as fixed assets in 1999. As at end Jun 08 quarter, its brooder stocks were worth S\$24m.

Qian Hu's collaboration with Temasek Life Sciences Laboratory has yielded excellent results. The research team has completed the genotyping of all the brooders owned by Qian Hu and has set up an efficient method to identify breeding pairs. For the first time in the history of Arowana breeding, offspring collected from the mouth of brooders can be assigned to both their parents, opening the way to pedigrees based on pair-wise breeding. The team is now searching for sex-linked DNA markers that can be used on juveniles and even larvae. We believe the R&D efforts will enable the group to increase the production of dragon fish in its farms, and improve its ability to meet future growth in demand for dragon fish as well as profitability. We also understand that the group has invested about S\$3m on a new farm in Singapore, next to its current fish farm. This new farm will be 2-3x bigger than the existing one and is under construction. Earnings contributions are expected from 2009.

Figure 5: SWOT analysis

<p style="text-align: center;">Strengths</p> <ul style="list-style-type: none">• Vertically integrated service provider.• Wide distribution network.• Established track record and reputation in the industry• Committed and experienced management team• High quality standards, with ISO 9001 and ISO 14001 certification.	<p style="text-align: center;">Opportunities</p> <ul style="list-style-type: none">• Huge market. The world trade in ornamental fish including accessories and fish feed is estimated to exceed US\$14bn.• Increasing dragon fish popularity in China.
<p style="text-align: center;">Weaknesses</p> <ul style="list-style-type: none">• Heavily reliant on Asian markets for the popularity of dragon fish.• Dependent on family management.• Dependent on suppliers in Malaysia and Indonesia for the supply of ornamental fish.	<p style="text-align: center;">Threats</p> <ul style="list-style-type: none">• Disease outbreaks.• High exposure to foreign currencies (Rmb, Thai baht, US\$, yen and ringgit).• Restricted from trading in certain species of fish considered endangered.• Changes in government legislation or regulations.

Source: Company, CIMB-GK Research

Risks

Disease outbreaks. Like all other livestock, ornamental fish are easily affected by disease and infections. However, fatal infections across breeds are uncommon. Nonetheless, it is possible that a rare or virulent strain of bacteria or virus may infect many of the fish at the farm. To minimise risks, the group has diversified its fish breed. Currently, its own breed of Arowana (dragon fish) and arapaima contribute about 10% of its sales while the breeding of another 500 species of ornamental fish has been outsourced.

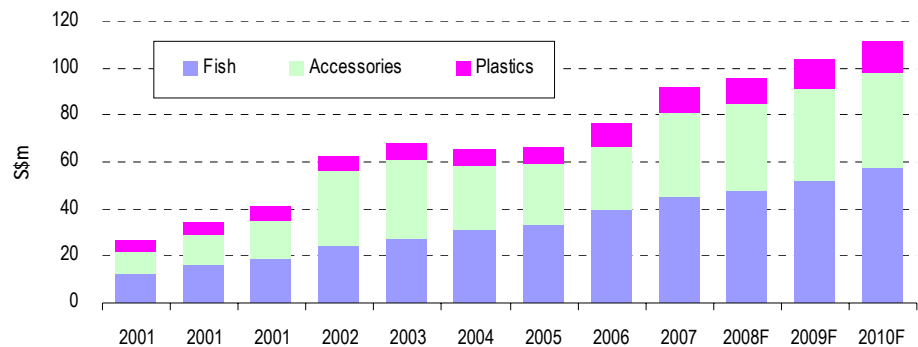
Heavily reliant on Asian markets for the popularity of dragon fish. Qian Hu has invested heavily in the breeding of dragon fish. It depends heavily on the Japanese and Singapore markets for the sale of dragon fish. Therefore, any changes in consumer perceptions and preferences will affect its earnings. However, the demand for dragon fish in Asia has been stable in the past 30 years.

Currency risk. The group primarily trades in S\$ for its ornamental fish, but most of its purchases are made in foreign currencies like the ringgit, rupiah and US\$. For accessories, raw material and staff costs are primarily in Rmb. As such, any material fluctuations in the relevant currency rates against the S\$ will have an effect on its consolidated financial statements.

Financials

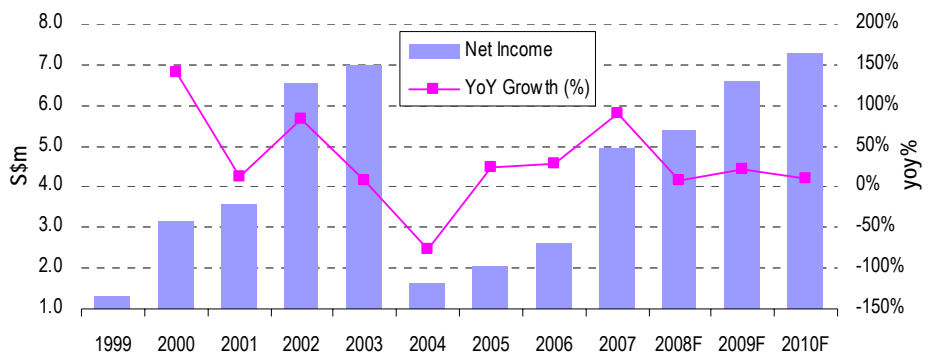
Steady revenue growth. Accessories revenue declined in 2004 after strong growth in 2002-03 due to a “Luo Han” craze. Group sales have been growing steadily since 2001 (14% CAGR from 2001 to 2007), underpinned by steady growth in the ornamental fish segment. We expect the growth to be sustainable in the next couple of years. FY04-07 revenue CAGR was 12% and net profit CAGR was 45%. Yoy revenue growth in FY07 was 14% for the ornamental fish business, 33% for accessories, and 11% for plastic bags. Such growth was accompanied by an increase in new markets. Going forward, we project 5-10% yoy revenue growth for FY08-10 for ornamental fish and accessories, and 5% for plastic bags, which is lower than the overall industry growth rates of 14%. We understand that management is focusing on bottom-line growth.

Figure 6: Sales growth



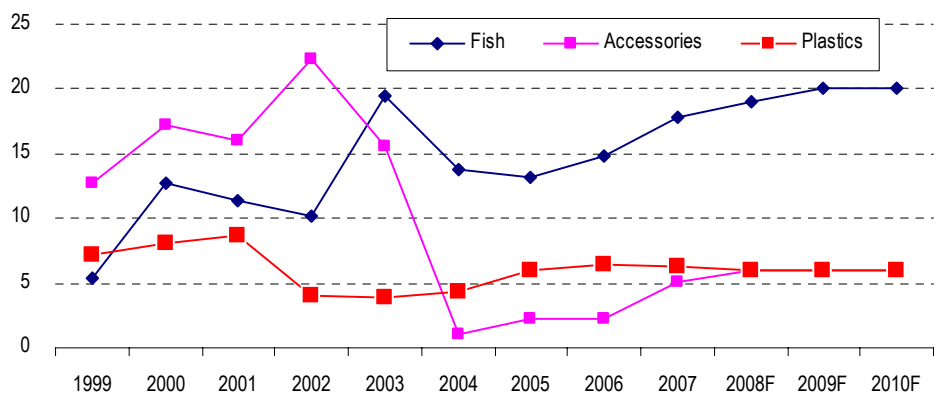
Source: CIMB-GK Research, Company

Figure 7: Profit growth



Source: CIMB-GK Research, Company

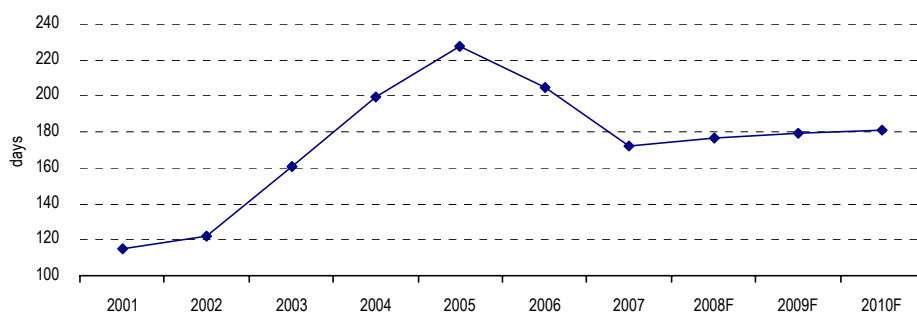
Figure 8: Operating profit margins (%)



Source: CIMB-GK Research, Company

Low gearing and stable cash cycle days. Net gearing inched up from 3% as at end FY07 to 9% as at end-Jun 08, due to additional bank borrowings to finance its new farm in Singapore. Stock turnover days were down 23 days to 132 days in FY07. We expect the figure to remain at around 136 days in FY08.

Figure 9: Cash conversion cycle days



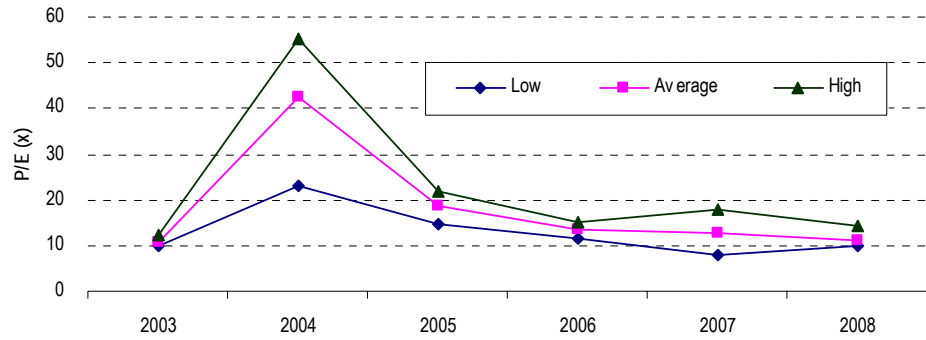
Source: CIMB-GK Research, Company

Healthy cash flows. Operating cash flow increased from S\$2m from FY00 to S\$8.7m in FY07. We expect operating cash flow to remain stable over the next three years. Free cash flow, on the other hand, was negative for Qian Hu in 2007 due to the purchase of brooder stocks in Malaysia. We expect free cash flow to remain negative in FY08 due to expansion needs. However, we expect free cash flow to turn positive in FY09-10 on higher profits generated and a decline in capex. We expect Qian Hu to pay out 20% of its profits as dividends, translating into DPS of 0.3 Sct or a dividend yield of 2-3%.

Valuation and recommendation

Initiate with Buy and target price of S\$0.22. Qian Hu trades at 8x CY09 P/E and 4.5x EV/EBITDA, which are not lofty in view of our 15% EPS CAGR projection for the next three years. Given its rather unique business and strong brand name, we have a target price of S\$0.22, based on 10x CY09 P/E. This is at the low end of its 6-year historical P/E band. Given the 69% upside potential, we initiate coverage with a Buy recommendation. We see potential catalysts from its successful expansion into the accessories businesses and positive contributions from the new farm in 2009.

Figure 10: Historical P/E band



Source: CIMB-GK Research

Management

Figure 11: Management biographies

Kenny Yap Kim Lee
*Executive Chairman &
Managing Director*

Mr Kenny Yap is the Executive Chairman and Managing Director. Mr Yap is largely responsible for establishing Singapore as the ornamental fish capital of the world. He has a string of awards to his name, including the Public Service Award in 2004. Mr Yap graduated from Ohio State University (US) with a 1st Class Honours degree in Business Administration. He currently serves as the Chairman of the Ornamental Fish Business Cluster initiated by the AVA and is a member of the Action Community for Entrepreneurship (ACE). In 2007, he was appointed by the National Youth Council as the Chairman of the Youth Award (Entrepreneurship) Committee.

Alvin Yap Ah Seng
Deputy Managing Director

Mr Alvin Yap, a founding member of the group, oversees Qian Hu's aquarium and pet accessories operations as Deputy Managing Director. Mr Yap holds a diploma in Mechanical Engineering from Singapore Polytechnic and was the Managing Partner of Yi Hu Fish Farm Trading from 1988 to 1998. In 2000, he, together with Mr Kenny Yap and Mr Andy Yap, was one of the Top 12 Entrepreneurs of the 12th Rotary-ASME Entrepreneur of the Year as well as a finalist at the 10th Rotary-ASME Entrepreneur of the Year in 1998.

Andy Yap Ah Siong
Deputy Managing Director

Mr Andy Yap, a founding member of the group, heads Qian Hu's ornamental fish operations as Deputy Managing Director. Mr Yap holds a diploma in Business Studies from Ngee Ann Polytechnic and was the Managing Partner of Qian Hu Fish Farm Trading from 1989 to 1998. In 2000, he, together with Mr Kenny Yap and Mr Alvin Yap, was one of the Top 12 Entrepreneurs of the 12th Rotary-ASME Entrepreneur of the Year as well as a finalist at the 10th Rotary-ASME Entrepreneur of the Year in 1998.

Lai Chin Yee
Finance Director

Ms Lai Chin Yee was the Group Financial Controller before assuming her appointment as Finance Director in Nov 04. She is responsible for accounting, finance, treasury and tax functions. Prior to joining the group in 2000, Ms Lai was an auditor with international accounting firms. She holds a Bachelor's degree in Accountancy from the National University of Singapore and is a fellow of the Institute of Certified Public Accountants of Singapore.

Source: Company

Financial tables

PROFIT & LOSS (<i>S\$ m, FYE Dec</i>)	2006	2007	2008F	2009F	2010F
Revenue	76.1	91.7	96.2	103.4	111.2
Operating expenses	(68.7)	(81.8)	(84.5)	(90.1)	(96.7)
EBITDA	7.4	9.9	11.7	13.2	14.4
Depreciation & amortisation	(2.3)	(2.2)	(2.8)	(3.0)	(3.2)
EBIT	5.1	7.7	8.8	10.2	11.3
Net interest & invt income	0.2	0.2	0.2	0.2	0.2
Associates' contribution	-	0.0	0.0	0.1	0.1
Exceptional items	-	-	-	-	-
Pretax profit	5.3	7.9	9.0	10.5	11.6
Tax	(1.4)	(1.6)	(2.2)	(2.4)	(2.7)
Minority interests	(1.3)	(1.4)	(1.4)	(1.5)	(1.7)
Net profit	2.6	4.9	5.4	6.6	7.3
Wt. shares (m)	355.3	368.1	415.2	415.2	415.2
Shares at year-end (m)	355.3	368.1	415.2	415.2	415.2
BALANCE SHEET (<i>S\$ m, as at Dec</i>)	2006	2007	2008F	2009F	2010F
Fixed assets	26.8	33.8	39.9	42.7	45.5
Intangible assets	2.1	2.1	2.1	2.1	2.1
Other long-term assets	0.0	0.8	0.8	0.8	0.8
Total non-current assets	28.9	36.8	42.8	45.7	48.4
Cash and equivalents	5.6	7.5	7.6	10.2	10.9
Stocks	21.6	22.0	24.0	25.8	27.8
Trade debtors	15.9	17.6	18.2	19.5	22.2
Other current assets	3.5	4.9	3.6	4.1	4.6
Total current assets	46.7	52.0	53.4	59.7	65.4
Trade creditors	6.0	7.4	6.8	7.3	7.9
Short-term borrowings	6.7	7.5	11.5	12.4	12.2
Other current liabilities	10.9	13.5	14.4	15.2	16.1
Total current liabilities	23.6	28.4	32.8	35.0	36.2
Long-term borrowings	0.8	1.9	1.7	1.8	1.8
Other long-term liabilities	2.5	2.9	1.1	1.2	1.3
Total long-term liabilities	3.2	4.8	2.8	3.0	3.2
Shareholders' funds	42.5	48.0	51.6	56.8	62.2
Minority interests	6.3	7.6	9.1	10.6	12.3
NTA/share (S\$)	0.11	0.12	0.12	0.13	0.14
CASH FLOW (<i>S\$ m, FYE Dec</i>)	2006	2007	2008F	2009F	2010F
Pretax profit	5.3	7.9	9.0	10.5	11.6
Depreciation & non-cash adjStments	5.4	5.8	6.6	5.2	5.6
Working capital changes	(0.1)	(4.0)	(7.5)	(5.4)	(7.0)
Cash tax paid	(1.3)	(1.1)	(3.7)	(2.2)	(2.4)
Others	-	-	-	-	-
Cash flow from operations	9.4	8.7	4.3	8.1	7.7
Capex	(6.7)	(8.9)	(8.9)	(5.9)	(5.9)
Net investments & sale of FA	0.1	(0.7)	1.0	0.1	(0.3)
Others	-	-	-	-	-
Cash flow from investing	(6.6)	(9.6)	(8.0)	(5.9)	(6.3)
Debt raised/(repaid)	0.0	(0.0)	3.9	0.9	(0.1)
Equity raised/(repaid)	-	1.2	-	-	-
Dividends paid	(0.5)	(0.6)	(1.1)	(1.3)	(1.5)
Cash interest & others	(1.2)	0.4	0.9	0.8	0.8
Cash flow from financing	(1.7)	0.9	3.7	0.4	(0.8)
Change in cash	1.1	(0.0)	0.0	2.7	0.7
Change in net cash/(debt)	1.1	(0.0)	(3.8)	1.8	0.8
Ending net cash/(debt)	(1.4)	(1.5)	(5.3)	(3.5)	(2.8)
KEY RATIOS (<i>FYE Dec</i>)	2006	2007	2008F	2009F	2010F
Revenue growth (%)	14.9	20.5	4.9	7.5	7.5
EBITDA growth (%)	17.5	33.6	17.4	13.6	9.1
Pretax margins (%)	7.0	8.6	9.3	10.2	10.4
Net profit margins (%)	3.4	5.4	5.6	6.3	6.5
Interest cover (x)	high	high	high	high	high
Effective tax rates (%)	26.8	20.2	24.0	23.0	23.0
Net dividend payout (%)	24.2	15.3	20.0	20.0	20.0
Debtors turnover (days)	74.4	66.7	67.9	66.6	68.5
Stock turnover (days)	155.5	132.4	135.5	137.6	137.6
Creditors turnover (days)	25.1	26.6	26.9	25.0	25.0

Source: Company, CIMB-GK estimates