

Letter to Investors
2003 Full Year Review

January 2004

Dear Investors,

2003 has been an eventful year. The first half of the year was impacted by the Iraq War and the SARS outbreak. The second half, however, was marked by a recovery in market sentiment from the abatement of the SARS outbreak. In terms of the Straits Times Index, we have seen an appreciation from the 1300+ level in April to a convincing breach of the 1800 level at the end of 2003. Such a recovery is hardly surprising considering the fact that much of the world has been mired in a recession since the bursting of the Internet bubble in late 2000. A simple explanation for the turn of events that has transpired could be highlighted as follows: (Downturn) Massive building of capacity/investment in late 1990s leading to supply/demand imbalance – bursting of bubble – cost cutting/mothballing of capacity – bankruptcy/takeovers of inefficient companies further restricting supply – rising unemployment decreases retail spending – (Upturn) increased corporate spending due to need to replace old machinery, factories – increased employment from new production requirements – increased retail spending.

The economic boom/bust cycle has occurred throughout the history of civilization – only masquerading in different forms at different periods of time. While economic landscapes and investment themes may differ with every market cycle, history has shown the market participants to remain largely the same each time – sometimes being driven by greed, and other times gripped by fear. Hence sometimes it seemed that no price is too high to pay for a tulip bulb in 1600 Holland; for the South Sea Company stock in 1700 England; for Florida real estate in 1920 America; for Japanese stocks in 1989; for Hong Kong real estate in 1996; or for Internet stocks in 1999. And at other times superb investment opportunities available at bargain prices were left unnoticed – post-depression America in the 1930s, post-war Japan in the 1940s, post-crash Wall Street in 1987, during-financial-crisis Asia in 1998, during-SARS Singapore in 2003. As we can see, greed and fear has repeatedly propelled markets to oscillate from times of unbridled optimism to times of extreme depression and back. It is our confidence in the continued perpetuation of the economic cycle and the human character which dictates an important tenet in the strategy for investing your money – to buy at times of overwhelming pessimism and to sell at times of irrational exuberance.

The first half of the year was an exciting time – promising companies growing earnings at 15-25% could be bought at low price-earnings ratios of anything from 4 to 7 (price-earnings ratio is obtained by dividing the share price by its underlying earnings-per-share) . As a rule of thumb, companies should trade at a price-earnings multiple of at least their growth rate; hence you can see the steep discount many stocks are trading at then. There were too many investment opportunities and not enough money to capitalize on all of them. It was the Great Singapore Sale on the Exchange. The market has since taken off in a big way, and you would have seen the effects of the rally from the considerable gains in your portfolio.

That being said, the current market offers fewer opportunities to buy into undervalued stocks as was the case during the first half. Market sentiment is almost euphoric, with IPOs appreciating considerably in their first day of trading. The recent popularity of

leveraged instruments such as 1-year call warrants issued by banks such as DBS on the shares of various listed companies further corroborates the speculative sentiment in the market. It seems that we are approaching a market where bold speculators – momentum traders betting on the hottest sectors/stocks – hold reign. Hence, it is probable that your value-centred portfolio will somewhat lag the market in the near future as we seek to abstain from participation in speculative issues. We are constantly mindful of the trading adage – that there are no bold and old traders.

Investing is like running a marathon – and nobody wins a marathon by running it as a series of 100-metre sprints. And as you may know, your portfolio is managed with the tenet of purchasing growing businesses at a reasonable price. As the legendary investor Benjamin Graham aptly put it, the market is a voting machine in the short run, but a weighing machine in the long run. Hence while we are assured that our strategy would yield favourable long term results, the path to success would inevitably be paved with short term disappointments along the way.

Hence, against such a backdrop, your investments would be managed with caution. Expect to see more sales of shares from your portfolio as the market continues its speculative climb – and expect cash levels to rise as a percentage of your portfolio value. Also expect your portfolio to lag for the near future with this prudent approach – We have strongly believed in investing only when the risk/reward ratio is favourable. Nevertheless, undervalued securities will always exist in every market situation – only that their successful discovery now requires more stones to be overturned.

Now we would like to share the investment merits of some of the stocks held in your portfolios.

People's Food Holdings – People's Food is the second largest producer of pork in China (largest in terms of capacity). Yet its market share of pork products sold in China is only slightly more than 1%. Hence, the potential for growth is enormous. In terms of margins and return on equity, which have averaged 12% and 40% for the past few years, People's Food has outdistanced its closest competitors who are mainly large state-owned enterprises. The pork industry in China is fragmented with many small, inefficient players. People's Food, with its substantial economies of scale and more advanced technological capabilities, is set to consolidate the Chinese pork market by taking market share from these inefficient, small players. Its Jinluo brand of pork products has been ranked as one of China's top ten meat brands. The company's record of turnover and profit growth is almost impeccable – sales grew from S\$250 million in 1997 to S\$1,071 million in 2002, and profit before tax grew from S\$30 million to S\$174 million over the same period. People's Food's results in 2003 was earlier affected by the SARS epidemic which has forced plant closures, but has since resumed normal operations. We see great

potential in this company in becoming the dominant pork processor in China. Management is aggressively expanding capacity in 2004, increasing production capacity from 900,000 tons of pork in 2003 to 1,440,000 tons by end of 2004, a >50% increase! This would be the near term driver of growth. We're expecting to see People's Food grow at more than 10% yearly for the next few years. With its stock trading at a price-earnings ratio of 7, this company is substantially undervalued.

HTL International - HTL is a maker of leather sofas, and a processor of raw leather hide (which serves as the raw material input for its sofa business). The company processes its leather and manufactures its sofas from 7 factories across Asia, and is one of the lowest-cost sofa makers in the world. HTL has grown rapidly in recent years – sales increased from S\$153 million in 2000 to S\$329 million in 2003. Profit before tax has similarly risen from S\$8.2 million to S\$22.8 million over the same period. The company has signed a product licensing agreement with well-known German brand Musterring to use design and manufacture sofas for sale under the Musterring brand. These branded sets have been a great hit in Europe. Sales to Europe have grown at an exponential rate for the past few years. Future growth will be driven by a recent expansion into the U.S., where a partnership has been established with Berkline (a major U.S. sofa manufacturer). The company has since reported favourable market penetration into the U.S. Currently trading at a price-earnings ratio of 11, we are expecting HTL to grow at 15% for the next few years.

Sincere Watch – As you may know, Sincere is a purveyor of fine watches. Most of its retail operations are based in Singapore, with wholesale distribution carried out in Hong Kong, Taiwan, Korea, Thailand and other South East Asian countries. The value of Sincere lies in its brand management capabilities – it has exclusive distribution rights (in Asia) to more than 10 high-end brands such as Franck Muller and A. Lange & Sohne. These exclusive deals allow Sincere to command much higher margins than your normal watch retailer. Sincere has been very successful in selling these expensive time-pieces to the well-heeled – sales have grown from S\$117 million in 1999 to S\$222 million in 2003. Net profit has exploded from S\$1.4 million to S\$13.2 million over the same period. Return on equity was an impressive 20% in 2003, and net profit margin was 6% - compare this with Hour Glass's (another listed watch retailer in Singapore) net profit margin of 1% in 2003 (or, 2.4% in 2002) and you can see the superior business model Sincere is operating on. With continued development of brands under exclusive distributorships, coupled with expansion into new markets (Indonesia and in the near future, China), we are confident of the future prospects of the company. The company is trading at an undemanding price-earnings ratio of 7, which we believe to be undervalued.

Sinwa – Sinwa is a ship chandler – the company supplies consumables such as food and tools, as well as equipment such as anchors to ships when they dock at the port. They also provide services such as insulation of hulls of sea-going vessels. Sounds like a boring company in a sunset industry? On the contrary, the past growth record of the company

has been anything but that – Sales have grown from S\$27 million in 1999 to S\$42 million in 2002. Net profit has similarly grown from S\$0.9 million to S\$4 million over the same period. The company achieved a return on equity of an impressive 60% in 2002 and generates a huge amount of free cashflow. Sinwa is one of the leading ship chandlers in the world – and as an attest to its strong competitive position, the company recently secured a 2-year contract from Shell to supply its sea-going vessels. Future prospects look promising as the company has already entered into joint ventures to supply ships calling at the Dalian, Shanghai, and Guangzhou ports in China. The 3 ports together account for 406.5 million tons or 32.4% of the PRC's total cargo volume. What is exciting is that they have an option to purchase a controlling stake in all their China joint venture companies, at a low price after 2005 when the WTO restrictions on foreign ownership are relaxed. Further growth could come from Sinwa's recent foray into the currently booming offshore oil and gas sector – a subsidiary has been started to supply to offshore oil rigs. We have on several occasions spoken to Mike Sim, Sinwa's majority owner and CEO, and have found this man to be a dynamic business leader with a clear vision for his company. Mike's confidence in his company has been more than just talk – he recently invested close to a million dollars of his own money to buy shares in Sinwa. We are expecting Sinwa to grow at more than 10% for the next few years – and with Sinwa trading at a price-earnings ratio of about 10, the potential returns from this investment is attractive.

Food Empire Holdings – Food Empire is the market leader in the instant 3-in-1 coffee market in Russia and Ukraine, having beaten Nestle to the top spot. The company sells beverage and snack products to over 40 different countries, and has positioned itself strongly in the emerging markets in Eastern and Central Europe, with Russia being its main market. The company's flagship brand, MacCoffee, has recently been valued by Interbrand, a leading international brand consultancy, to be worth S\$114 million. With the company's current market capitalization of just S\$128 million, this means the market is valuing all its other brands (other coffee and snack brands, bearing in mind that the company sells more than 170 types of products) at a mere S\$14 million (\$128m - \$114m)! Seems like a situation of substantial undervaluation here. Food Empire's track record has been remarkable – sales have grown from S\$48 million in 1998 to S\$112 million in 2002. Net profit has similarly increased from S\$4 million to S\$15 million over the same period. Return on equity stands at an impressive 29% in 2002. The company's recent heavy investments in advertising and in expanding overseas operations have impacted near-term profits in 2003. However, we believe that these investments will pay off in the long run as the company continues to strengthen the value of its brands. The stock is trading at a historic price-earnings ratio of 9 - which seem to be undervalued considering the company's significant growth potential once they reap the returns from their brand building efforts.

With that, we come to the end of this year's investment round-up. If you have any questions or clarifications relating to your investments, be sure to let us know.

Yours truly,



Wong Yu Liang



Victor Khoo

Disclaimer

The analysis and research in this publication is intended for the private use of clients and investors of Lumiere Capital Ltd. This publication and the contents hereof are intended for information purposes only, and may be subject to change without further notice. Lumiere Capital Ltd neither represent nor warrant the accuracy or completeness of the information contained herein or as to the existence of other facts which might be significant, and will not accept any responsibility or liability whatsoever for any use of or reliance upon this publication or any of the contents hereof. Neither this publication, nor any content hereof, constitute, or are to be construed as, an offer or solicitation of an offer to buy or sell any of the securities or investments mentioned herein.