

**CORPORATE INSIGHTS**

*The story behind the numbers*

# The *Making* of *Toy Story*

How will Creative Master Bermuda, a specialist manufacturer of die-cast collectible toys, sustain and enhance its future income streams?

By Timmy Tan

**M**ention toys and many of us will probably think of cheap plastic and an unkempt room filled with playthings. But while Creative Master Bermuda has its manufacturing base in China, the toys it produces are certainly not cheap and neither are these playthings to be recklessly thrown about. You see, Creative Master is a specialist contract manufacturer of collectible, die-cast replicas such as cars, trucks, buses, airplanes and boats.

What is more, Creative Master is a profitable entity. Its Chief Executive, Carl Tong, has maintained a business philosophy on which a solid platform has been built. "We do not make inferior toys even though it is easy to build volume with such products and secure jobs purely on cheaper prices. We do not make low quality premiums – it eats up capacity. Moreover, you may have large dollar sales but low profit margins. We do not make products for clients in direct competition with our existing valued clients. We do not serve any client unless they can provide us with revenues of at least US\$1 million per annum because we have to invest in the infrastructure and people," says Mr Tong.

Collectible replicas are traditionally made by craftsmen and are extremely pricey but there is a unit within Creative Master specialising in collectible die-cast replicas which utilises softer tools like fiberglass and not steel moulds. For example, spin-cast soft moulds are used for the car's chassis. Such soft moulds can be one-tenth the price of traditional steel moulds but are not as lasting. Other materials used include resin. The manufactured parts are then hand-assembled to produce the final end-product. "There is a trade-off between high-priced finished goods

Photography by Vincent Nghia



**Carl Tong**  
Chief Executive Officer  
Creative Master Bermuda

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and mass-produced ones but I can take orders for between 300 and 500 units of a model and still make money,” notes Mr Tong.

While there may not be high growth rates for toy collectibles, Mr Tong is nonetheless, highly optimistic of the segment he is playing in because of the strategies adopted that not only differentiates Creative Master from the competition but enhances its earnings streams. “Firstly, we are helping mass market clients to upgrade their range of products by developing collectible quality products at ‘toy’ prices. We are not

creating different segments. Toy makers have been dictated by a handful of mass market retailers like Wal-Mart, K-Mart and Toys R Us. Such toy makers have been competing for shelf-space because stores like Wal-Mart will only display the products that make a difference and can sell," says Mr Tong.

For example, Creative Master helped customers like Funline Merchandise, Inc (a maker of customised Japanese cars and motorcycles) and Beanstalk, Inc, the licensor and distributor of brands owned by Ford Motor Company (whose portfolio include car marques like ThunderBird, Volvo, Aston Martin, Jaguar and Land Rover) to change the paradigm of the mass market. In the case of Beanstalk, Creative Master made the Jaguar and Aston Martin car replicas which were featured in the James Bond movie 'Die Another Day'. Such replicas become more like collectible items rather than mass market toys. "With such 1/18-scale cars with better detailing and paintwork, we are providing clients with products that 'incentivise' retailers to give them more shelf space. We have even made replicas of tuned-up Japanese cars and we shipped millions. There are plenty of baby boomers who love cars of the 50s as well and they are fond of our die-cast collectible car replicas," says Mr Tong. "We have made 1/18-scale cars for Norev Jouets & Miniatures which are sold in Carrefour. We even have high detail Formula One cars priced at 2,000 euros. There may not be many made but they can sell," he adds. One success story is the battleship 'Missouri' where more than 2,000 of such models were sold.

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Even Tamiya, which is a shareholder of Creative Master, benefited. "Their do-it-yourself plastic model kits were not growing as it was a tedious task and only serious hobbyists would enjoy assembling their plastic toys. Many people would prefer finished products. Creative Master assembles the models and that is why they can sell; from motorbikes, Formula One cars and Ferraris. We created that market which is enjoying good growth," says Mr Tong.

Understanding the market as well as the clients and developing product and marketing ideas are the keys to success, according to Mr Tong. For instance, Creative Master made replica tanks for MiniChamps and an introduction was made to Degremont. "After that, MiniChamps sold as many tanks in the United States as they have in Germany. Degremont is strong in the States but not in Europe. We even introduced Degremont to Tamiya. Tamiya is now selling more models in the US. They are doing very well," says Mr Tong.

**FULL STEAM AHEAD**

Though it would be difficult to estimate the market size for such collectible toys, it does appear that Creative Master is redefining the market. "With our strategy, we are accomplishing growth with existing clients and not just new ones," says Mr Tong.

**TOP 5 CUSTOMERS**

Company	Contribution to 1H FY04 sales
1. Funline Merchandise, Inc	27.8%
2. Paul's Model Art GmbH & Co KG	16.4%
3. MBI, Inc	12.9%
4. Athearn, Inc	9.8%
5. Mattel, Inc	7.0%

Another sector which will drive further Creative Master's growth is the hobby train sector. Athearn, Inc, a maker of train sets, is among the top five customers of Creative Master and it accounted for around 10% of the group's first half sales. Athearn is a market leader in its segment and it used to produce train sets in California, USA but rising costs led it to outsource production to Creative Master in China. In January 2004, Horizon Hobby, the second largest hobby distributor to hobby stores in the US with a network of more than 2,000 outlets, acquired Athearn Trains of Compton from Athearn Inc.

"In the US, the hobby train market size is



Carl Tong with a real Bentley and a die-cast replica Bentley made by Creative Master.



almost the same size as the remote control market for cars and planes. Sales of trains by Horizon Hobby used to be less than that for remote control cars and planes because not as much resources were devoted to push the sales of toy trains. With the acquisition, the situation will change. Athearn's trains are highly detailed, precise and unique. It is a win-win deal as Horizon Hobby will be the exclusive distributor of trains made by Athearn. Hopefully, we will be able to manufacture more trains as well. There is a new line of Athearn trains which are competitively priced and are very detailed," says Mr Tong. For the mass market train sets, a starter kit could be priced between US\$100 and US\$150 and it would include a power supply system, rail tracks and simple carriages.

Another recent development was the acquisition of MDC Roadhouse by Horizon Hobby. Like Athearn, MDC Roadhouse, is a toy train maker and it has a 60-year history. "With this acquisition, Horizon Hobby will have more SKUs [stock keeping units] and it may be good news for Creative Master because we can possibly manufacture more for them," surmises Mr Tong.

To cater for higher demand, a new factory has been built and Creative Master's joint venture with a third party for tooling purposes is now bearing fruit, according to Mr Tong. The joint venture company is involved in injection moulding and it helps support the business, Tamiya in particular. "We have good clients and even friends like Tamiya have become a shareholder. Together with our strategic alliances, we can derive more growth," concludes Mr Tong. **si**

**HALF-YEAR FINANCIAL SUMMARY: FOR THE SIX MONTHS ENDED JUNE**

HK\$000s	Jun-04	Jun-03
Turnover	216,539	151,285
Pre-tax profit	11,476	7,960
Net profit	8,149	5,544
Pre-tax profit margin	5.3%	5.3%

**FINANCIAL SUMMARY & FORECAST**

HK\$000s	Dec-04F	Dec-03	Change
Turnover	432,000	384,241	12.4%
Pre-tax profit	25,000	31,356	-20.3%
Net profit	19,000	23,615	-19.5%
Earnings per share (HK cents)	11.88		
Pre-tax profit margin	5.8%	8.2%	
Net profit margin	4.4%	6.1%	

F: Forecast based on *Smart Investor* estimates  
Market capitalisation based on 23 cents a share and 160 million shares: S\$36.8 million

Revenues for Creative Master Bermuda are typically higher in the second half of its financial year whereby sales could be 60% higher than in the first half. However, for fiscal year 2004, sales in the fourth quarter fell short because of lower orders from one major customer. In an announcement dated 31 December 2004, Creative Master declared that sales in the second half would be comparable to the first half but earnings would be lower than that reported on a pro-forma basis for the fiscal year ended December 2003.

As such, sales for the year ending December 2004 could well be HK\$432,000. Assuming some margin improvements in the second half, net profit could be S\$19 million, translating into an earnings per share of 11.88 Hong Kong cents. At the exchange rate of HK\$1 = S\$0.209, earnings per share would be 2.48 Singapore cents. At the share price of 23 cents, Creative Master is trading at the prospective price-earnings multiple of 9.3 times.