

# Analyse this...

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17 Nov 2009

## China Eratat Sports Fashion Limited

 CERAT SP  
 BUY: TP: S\$0.39

 Price @13/11/09: S\$0.23  
 52-week range (SGD): 0.055 – 0.285  
 Market cap – S\$97.5m

### Maintain BUY

- Maintain **BUY**, target price reduced 20.4% to **S\$0.39** from S\$0.49 as we cut EPS by 19% on average over FY10-F12 in light of higher than expect selling and general expenses and tax rate. Sales forecast are unchanged.
- Price weakness could resurface in FY10 results as 2HFY10 could see a 30.5% yoy drop in net profit due to higher selling and general expenses and higher tax rate. Pre-tax profit decline could be lower at 19% yoy.
- The Company will be giving free bonus warrants to shareholders and the proceeds if the warrants are exercised will be used for working capital and to grow its distributor network.
- Orders received for Jan-Jun 2010 was RMB 400m versus RMB 500m for Jan-Jun 2009. The Company scaled down some orders from its distributors to be prudent.

### Below expectation

- 1HFY10 net profit/sales formed 45%/55% of our full year forecast respectively.
- Selling and distribution expenses were 12.5% of 2QFY10 sales and 11.2% of 1HFY10 sales, higher than our full year assumption of 10.5% of sales as the Company spent more on brand building.
- Effective tax rate also came in higher than expect at 27.5% versus our 25% assumption due to slight tax over-provision at subsidiary level which could be adjusted at the end of the financial year.

### Results summary

	2QFY10	2QFY09	yoy Chg (%)	1QFY10	qqq Chg (%)	1HFY10	1HFY09
Revenue (RMB mil)	228.8	212.9	7.5	259.7	(11.9)	488.5	382.7
Gross profit (RMB mil)	66.5	65.4	1.7	82.1	(19.0)	148.9	115.4
Net profit (RMB mil)	21.2	32.2	-34.2	35.4	(40.1)	56.6	60.6
EPS (RMB cts)	5.11	7.77	-34.2	8.53	(40.1)	13.64	15.43
NAV (RMB \$)	1.19	0.95	25.2	1.15	3.1	1.19	0.95

Source: Company, CIMB-GK Research

#### Profit ratios

	2QFY10	2QFY09	yoy Chg in ppt	1QFY10	qqq Chg in ppt
Gross profit margin (%)	29.1	30.7	(1.6)	31.6	(2.5)
Net profit margin (%)	9.3	15.1	(5.9)	13.6	(4.4)

Source: Company, CIMB-GK Research

#### Balance sheet ratios

	2QFY10	1QFY10	4QFY09	3QFY09	2QFY09	1QFY09
Net cash per share (Sing cts)	7.8	6.6	7.6	6.6	13.5	10.9
ROE (%)	22.9	29.6	28.4	31.6	30.7	31.4
AR days	92	83	79	77	42	44
Inv Days	10	6	7	29	24	34
AP Days	20	9	8	15	28	24
Cash cycle (days)	82	80	78	91	38	54
Current ratio (x)	5.4	6.7	8.3	5.8	4.1	4.3
Quick ratio (x)	5.2	6.5	8.0	5.1	3.8	3.7

Source: Company, CIMB-GK Research

\*annualised where relevant

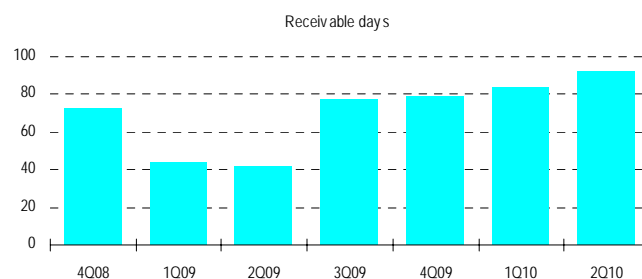
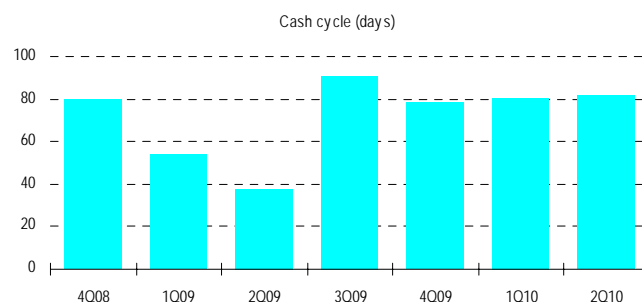
### Watch the cash

- We do not expect aggressive growth in additional distributors or number of retail points for 2HFY10. This means that existing stores sales will have to make up for the lack of growth in retail points.
- Cash cycle has been lengthening over the past quarters as receivable days have been growing longer. This is due to Eratat's policy of not financing its distributors via upfront cash payment but through longer credit policy. Receivable days have also been lengthening as Eratat is trying to cultivate distributor loyalty. In addition, if the Company deems

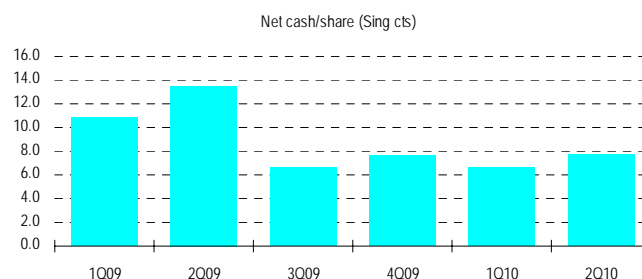
the mega store concept a success, additional such stores may be opened and longer credit period can be expected but the Company does not expect receivable days to exceed 90 days. In 1HFY10, Eratat has already starting granting longer credit period for selected distributors.

- The Company has however managed to control its inventory well and has also been able to lengthen repayment to its suppliers in the recent quarter. This has helped to mitigate the increase in receivable days.
- The Company is still in a net cash position as at end September 2009 with no borrowings.

### Deteriorating cash cycle



### ... But still net cash



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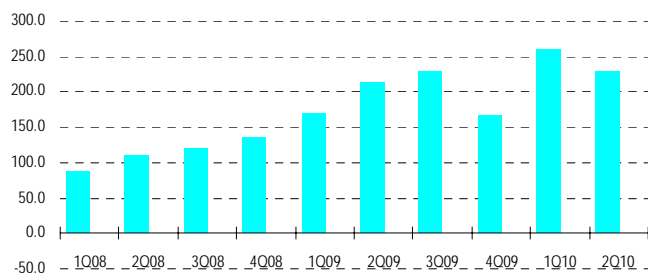
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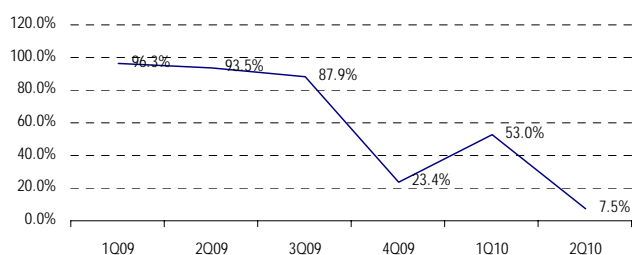
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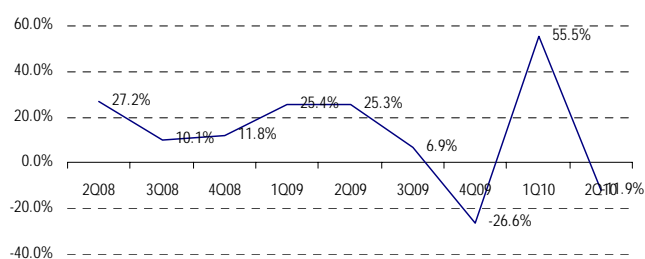
### Quarterly sales



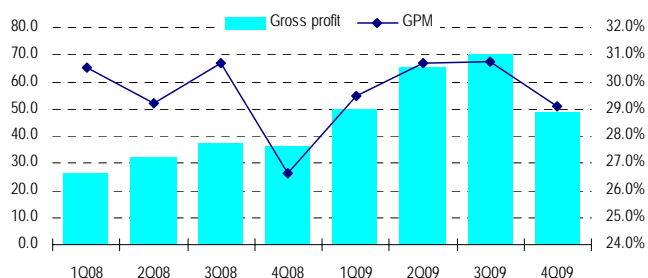
### Sales growth yoy



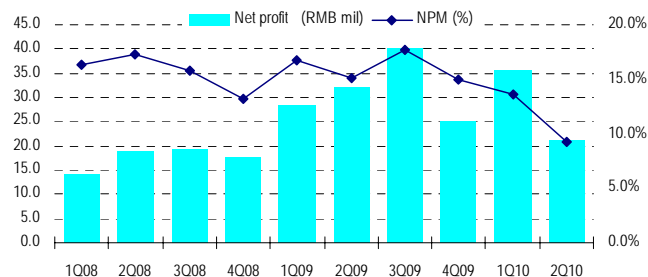
### Sales growth qoq



### Gross profit and margin trend



### Net profit and margin trend



### Bonus warrants

- Eratat has proposed a bonus warrant issue of 3 warrants for every 10 existing shares. Warrant holders will be able to convert each warrant into 1 share of Eratat at S\$0.30.
- If approved by the SGX, a total of 124.5m shares would be issued if all the warrants are converted into shares. The warrants will have a 3 year life span.
- Total proceeds from the warrant conversion could come to S\$37.3m which will likely be used for working capital as well as to expand the Group's distribution network.

### Financial analysis

FYE Mar	2008	2009	2010F	2011F	2012F
Revenue (RMB m)	453.0	777.3	892.2	1,024.0	1,182.4
EBITDA (RMB m)	83.6	150.3	142.3	177.5	213.2
EBITDA margins (%)	18.4	19.3	16.0	17.3	18.0
Pretax profit (RMB m)	80.2	146.8	138.4	173.8	209.7
Net profit (RMB m)	70.2	125.9	101.0	126.8	153.1
EPS (RMB fen)	24.2	30.8	24.4	30.6	36.9
EPS growth (%)	+73%	+27%	-21%	+26%	+21%
P/E (x)	4.7	3.7	4.7	3.7	3.1
Gross DPS (RMB fen)	-	1.5	4.9	-	-
Dividend yield (%)	-	1.3	4.3	-	-
P/NTA (x)	2.4	1.1	0.9	0.8	0.6
ROE (%)	72.4	41.5	20.9	21.6	21.0
Net gearing (%)	(2.8)	(34.8)	(31.0)	(35.1)	(37.9)
Net cash per share (RMB fen)	1.6	37.2	39.2	55.1	73.5
P/CF (x)	4.5	3.6	4.5	3.6	3.0
EV/EBITDA (x)	3.8	2.1	2.2	1.8	1.5

### Forecast changes

	FY10F	FY11F	FY12F
<b>Net profit</b>			
Old	126.1	154.3	190.9
New	101	126.8	153.1
Chg (%)	(19.9)	(17.8)	(19.8)
<b>EPS</b>			
Old	30.4	37.2	46.0
New	24.4	30.6	36.9
Chg (%)	(19.7)	(17.7)	(19.8)

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### Peer valuation

	Bloomberg ticker	Mkt cap (US\$ m)	Core P/E (x)		P/BV (x)	ROE (%)
			CY2010	CY2011	CY2010	CY2010
361 Degrees	1361 HK	1,199	10.5	7.7	-	28.8
Anta	2020 HK	3,529	17.1	13.9	4.0	25.5
Dongxiang	3818 HK	3,707	14.9	13.0	2.9	21.1
Hongxing	CHHS SP	343	8.3	6.1	0.5	6.8
Li Ning	2331 HK	3,177	18.7	-	6.2	38.0
Peak Sport	1968 HK	1,012	9.2	7.4	2.5	26.1
Xingquan	XISH MK	129	3.4	2.7	1.0	38.3
Xtep International	1368 HK	1,102	10.1	8.7	2.2	23.7
China Eratat Sports	CERAT SP	69	3.9	3.2	0.8	21.4
China Sports	CSPORT SP	100	3.7	3.4	0.6	19.9
	<b>Simple average</b>		<b>10.0</b>	<b>6.6</b>	<b>2.1</b>	<b>25.0</b>
	<b>Simple average excluding China Eratat</b>		<b>10.6</b>	<b>7.0</b>	<b>2.2</b>	<b>25.4</b>
Adidas	ADS GR	10,361	15.0	12.1	1.8	12.6
Nike	NKE US	31,373	17.5	16.0	3.2	19.0
Mizuno Corp	8022 JP	608	18.7	16.2	0.6	3.6
Asics Corp	7936 JP	1,652	16.0	12.3	1.5	9.1
Columbia Sportswear Co	COLM US	1,331	19.4	15.2	1.3	6.3
Wolverine World Wide Inc	WWW US	1,320	12.9	12.1	2.3	18.5
Deckers Outdoor Corp	DECK US	1,275	11.8	10.8	2.3	23.3
K-Swiss Inc	KSWIS US	303	na	na	1.1	(10.6)
	<b>Simple average</b>		<b>15.9</b>	<b>13.5</b>	<b>1.8</b>	<b>10.2</b>

Source: CIMB-GK Research, Bloomberg

### Technical BUY



- In our report earlier (see 9th Nov issue), we expected the stock to ease further towards S\$0.19 if the S\$0.21 support gave way. However, the stock appears to have found some support around the S\$0.22 level and formed a double bottom formation.
- With improving indicators, the stock could soon test the double bottom neckline at S\$0.25 next.
- S\$0.25-0.255 is the 2nd Nov gap that has yet to be filled.
- Aggressive traders may want to buy now to jump on the buying bandwagon for a short term trade. If the gap is closed, we could see prices head towards S\$0.27-0.28 next.
- Get out quickly if prices fall below the double bottom low of S\$0.22 as it could fall back towards the stock's strong support at S\$0.175.

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**BUY:** The stock's total return is expected to be +15% or better over the next three months.

**HOLD:** The stock's total return is expected to range between +15% and -15% over the next three months.

**SELL:** The stock's total return is expected to be -15% or worse over the next three months.

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**NEUTRAL:** The industry, as defined by the analyst's coverage universe, has either (i) an equal number of stocks that are expected to have total returns of +15% (or better) or -15% (or worse), or (ii) stocks that are predominantly expected to have total returns that will range from +15% to -15%; both over the next three months.

**UNDERWEIGHT:** The industry, as defined by the analyst's coverage universe, has a high number of stocks that are expected to have total returns of -15% or worse over the next three months.