

# China Eratat – Reaping the benefits of shift in strategy from sportswear to mass appeal and casual lifestyle

Phillip Securities Research Pte Ltd

3 March 2010

Exchange Singapore Stock Exchange  
Sector Manufacturing–Fashion  
Reuters CESF.SI  
Bloomberg CERAT SP

Closing Price  
**S\$0.165**

## Trading Buy

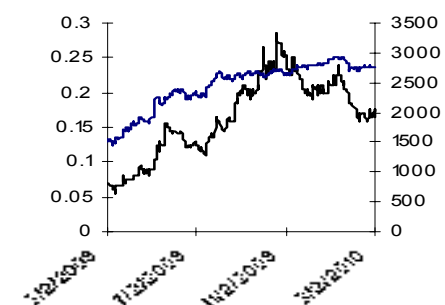
3-month Target Price  
**S\$0.205 (+24%)**

### Price

|                           |             |
|---------------------------|-------------|
| Last Price                | <b>0.17</b> |
| 52w k High (10/20/2009)   | 0.30        |
| 52w k Low (3/12/2009)     | 0.06        |
| Shares Outstanding (mil)  | 414.91      |
| Market Cap (S\$ mil)      | 68.46       |
| Avg. Daily Turnover (mil) | 0.23        |
| Free float (%)            | 62.96       |
| PE (X)                    | 2.60        |
| PB (X)                    | 0.75        |

### Price performance %

|          | 1M     | 3M     | 6M     |
|----------|--------|--------|--------|
| Absolut  | -8.3%  | -15.4% | -17.5% |
| Relative | -10.2% | -14.5% | -25.4% |



### Major Shareholders

|   |                          | %     |
|---|--------------------------|-------|
| 1 | Sunny Joy Limited        | 29.00 |
| 2 | Ye Sanzhi                | 7.75  |
| 3 | Legg Mason International | 3.62  |

This is not an initiation report. We may want to do a complete coverage only after we have visited *China Eratat* this month or next. For now, we are impressed by the change in its strategy in 2008 that is now reaping some benefit, as compared to its peers that stuck to the sportswear segment. *China Eratat* repositioned itself as a mass appeal and casual lifestyle company long before ‘rot’ set in.

*China Eratat's* latest quarterly revenue increased 0.8% y-o-y in a tough environment and in the same period that saw its SGX-listed peers like *China Hongxing* and *China Sports* reporting a 48.7% and a 21.4% y-o-y top line decline respectively.

In a consistent manner, it also topped its peers in bottom line performance with a 8.9% Patmi/Revenue. Earning per share is an annualized (simple 4 times quarterly) RMB 19.7¢ (or SG 4.1¢). At yesterday's closing price of SG 16.5¢, this translates to a cool P/E of 4.1x. (Below, the table headed LQ means latest quarter.)

| Profit and loss (RMB mil)                    | 9m2009A   | LQ2009A   | LQ2009A   | LQ2009A   |
|--|-----------|-----------|-----------|-----------|
|  | ERATAT    | ERATAT    | HONGXING  | SPORTS    |
| Revenue                                      | 717.9     | 229.4     | 439.5     | 397.3     |
| Cost of sales                                | (505.2)   | (165.2)   | (279.1)   | (346.5)   |
| Gross profit                                 | 212.8     | 64.2      | 160.5     | 50.8      |
| Gross profit margin                          | 29.6%     | 28.0%     | 36.5%     | 12.8%     |
| Gross profit margin, 12 months ago           |           | 30.7%     | 36.1%     | 16.4%     |
| Revenue yoy%                                 |           | 0.8%      | (48.7%)   | (21.4%)   |
| Selling and distribution expenses            | (83.4)    | (28.7)    | (115.7)   | (39.0)    |
| Administrative expenses                      | (23.2)    | (7.7)     | (40.2)    | (0.0)     |
| Other operating expenses                     | (0.3)     | 0.0       | (0.0)     | (0.0)     |
| Financial income/expenses                    | 0.4       | 0.1       | 0.0       | (0.3)     |
| Operating profit before tax                  | 106.3     | 28.0      | 4.5       | 11.5      |
| Other income                                 | 0.0       | 0.1       | 5.1       | 0.9       |
| Profit before tax                            | 106.3     | 28.0      | 9.6       | 12.4      |
| Tax  | (29.3)    | (7.6)     | (4.9)     | (2.0)     |
| Profit after tax                             | 77.0      | 20.4      | 4.7       | 10.4      |
| Attributable to equity holders of parent     | 77.0      | 20.4      | 4.7       | 10.4      |
| Earnings per share RMB¢ (annualised)         |           | 19.7      | 0.7       | 4.9       |
| Diluted earnings per share RMB¢ (annualised) |           | 15.2      | 0.7       | 4.9       |
| Valuation                                    | 31/03/09A | 31/12/09A | 31/12/09A | 31/12/09A |
|  | ERATAT    | ERATAT    | HONGXING  | SPORTS    |
| P/E basic (X), annualising by x4             | N/A       | 4.07      | 114.57    | 13.79     |
| P/B (X)                                      | N/A       | 0.65      | 0.51      | 0.60      |
| P/TCAI-TL (X)                                | N/A       | 0.81      | 0.65      | 0.68      |
| RMB/SGD                                      | 4.85      | 4.85      | 4.85      | 4.85      |

Source: Company, Phillip Securities Research

Analyst: Chan Wai Chee

☎ 65 65311231

FAX 65 65364435

✉ yebo@phillip.com

Web: www.poems.com.sg

MICA (P) 153/01/2010

Ref No: SG2010\_0074

In terms of book value, whether using the normal definition or comparing TCAi-TL (total current assets without inventories less total liabilities), *China Eratat* is more expensive than its peers.

### Some happy and unhappy ratios

*China Eratat's* trade payables/cost of sales is about 16 days. *China Hongxing* and *China Sports* pay trade creditors after 28 days and 38 days respectively. Hence *Eratat's* creditors are happiest of the lot.

*Eratat's* trade receivable/trade payable ratio stands at 8.09x at 31/12/09, slightly less than the 9.81x at 31/03/09. For better or worse, it depends if you are its debtor or creditor. On a peer comparison basis, as at 31/12/09, *Hongxing* and *Sports* have a corresponding ratio of 4.14x and 1.12x respectively. Again, debtors-wise, *Eratat* has got the happiest lot. These happy debtors help *Eratat's* branding too. On a management basis, one can say that *Eratat* is managing its Peter-Paul relationship.

### Target valuation

We choose a par TCAi-TL (total current assets without inventories less total liabilities) as a target price. This is RMB 98.3¢. At SG \$1=RMB4.85, this translates to a target price of SG 20.5¢, which is 24% away.

| Balance sheet (RMB mil)                    | 31/03/09A | 31/12/09A | 31/12/09A | 31/12/09A |
|--|-----------|-----------|-----------|-----------|
|  | ERATAT    | ERATAT    | HONGXING  | SPORTS    |
| Cash and bank balances                     | 154.3     | 180.3     | 3,049.4   | 901.9     |
| Trade receivables                          | 167.7     | 237.9     | 363.4     | 163.7     |
| Other receivables                          | 59.2      | 60.7      | 115.5     | 27.0      |
| Inventories                                | 11.0      | 9.9       | 165.5     | 25.5      |
| TOTAL Current assets                       | 392.1     | 488.8     | 3,693.8   | 1,118.1   |
| Property, plant, equipment                 | 73.6      | 71.9      | 672.4     | 79.3      |
| Land rights                                | 23.0      | 22.6      | 30.0      | 2.8       |
| Goodwill                                   | 1.8       | 1.8       | 0.0       | 0.0       |
| Other                                      | 0.6       | 0.5       | 21.9      | 0.0       |
| TOTAL Non-current assets                   | 99.0      | 96.7      | 724.3     | 82.1      |
| TOTAL Assets                               | 491.1     | 585.5     | 4,418.1   | 1,200.2   |
| Trade payables                             | 17.1      | 29.4      | 87.8      | 146.4     |
| Other payables                             | 24.2      | 33.7      | 55.5      | 106.0     |
| Provision for tax                          | 6.2       | 7.8       | 29.9      | 1.3       |
| TOTAL Current liabilities                  | 47.4      | 70.9      | 173.2     | 253.7     |
| TOTAL Liabilities                          | 47.4      | 70.9      | 173.2     | 253.7     |
| Share capital                              | 239.2     | 239.2     | 3,035.3   | 495.5     |
| Reserves                                   | 204.5     | 275.5     | 1,209.7   | 451.0     |
| TOTAL Equity=Equity to shareholders        | 443.7     | 514.6     | 4,245.0   | 946.5     |
| TOTAL Current assets w/o inventories       |           |           |           |           |
| Less TOTAL liabilities (TCAi-TL)           | 333.7     | 408.0     | 3,355.1   | 838.9     |
| Total Shares                               | 414.9     | 414.9     | 2,800.0   | 842.1     |
| Total warrants@S\$0.30@12/1/13             | 123.6     | 123.6     | 0.0       | 0.0       |
| TCAi-TL value/share RMB¢                   | 80.4      | 98.3      | 119.8     | 99.6      |
| Book value/share RMB¢                      | 106.9     | 124.0     | 151.6     | 112.4     |
| Diluted book value/sh RMB¢ (+all warrants) | 115.8     | 129.0     | 151.6     | 112.4     |

Source: Company, Phillip Securities Research

### How *Eratat* is managing its Brand

It is pretty expansive in its brand building. After the high profile it achieved during the *Beijing* Olympics, it did TV reality shows in 2008 and 2009. It says that it is preparing the 2010 shows for launch in 1H10 as well as TV-advertising the *Eratat* several times daily.

It has also launched its 2010 'Spring & Summer Series' marketing campaign for apparel and

shoes with a colourful catalogue, which I am perusing at the moment. The 'Series' comes in 4 different categories: 'Travel Lifestyle', 'Stylish Lifestyle', 'Life Fashion' and the interestingly named 'Celebrity Character'.

To build the **Eratat**'s visibility and its market positioning as a casual fashion brand, it requires its key distributors to directly own more specialty shops progressively. To support these distributors' working capital needs, it has extended longer credit terms to them. This explains its Receivable turnover days increase from 47 days a year ago to 90 days now. **Eratat** is avoiding rebates as its gross profit margin, at 28%, is already below *Hongxing's* 36.5%. **Eratat** attributes the decrease in gross profit margin to more expensive but better quality materials used in its footwear.

### Seeing some other positives

- Its auditors, Moore Stephens, signed off a 'clean' statement on 26/06/09, 8 months ago.
- It uses Grant Thompson Transactions Services Pte Ltd to do its subsidiary's (Quanzhou City Quangang Hongli Shoes Co., Ltd) business cycles internal audit. Its audit committee had reviewed the internal audit findings, which noted no significant internal control weakness.
- This is its 3Q and no dividend was declared. However RMB 6.06m dividend was paid (after IPO) for year ending 30.06.09.
- Legg Mason is one of the top 3 shareholders.

### Technically ...



Source: Bloomberg

This appears that the head-and-shoulders' support neckline, as depicted by the horizontal dotted white line, is broken. However, on closer inspection, the volume at the breaking point is noted to be relatively low. This increases the chance of failure of this bearish formation.

If one looks at the MACD, when the white crosses and stays above the red, it is bullish. The white again has just crossed above the red and is trying to stay above it.

The MACD histogram (green), besides showing a divergence as depicted by the green arrows (different directions), has become positive. This is bullish.

**Recommendation**

The fundamentals of *China Eratat*, as represented by the latest result announcement, outperform those of its SGX-listed peers, *China Hongxing* and *China Sports*.

We are looking at the market giving it a *Benjamin Graham's* "bargain" valuation of using net-current-assets alone and not counting inventories, and all non-current-assets. This is SG20.5¢. You may refer to his book, "The Intelligent Investor" Nov/Dec 1976 reprint, page 205 for more details.

The technical reading is bullish.

Being a S-chip, it is still wise to work with a stop-loss if the MACD reverses its current directions.

Or, if one uses a very small percentage of one's portfolio, then *China Eratat* can be considered as one stock in a basket of *Benjamin Graham* "bargain" buys. In this case, you should not be using the 3-month target price of SG20.5¢ because you should then be buying at not more than SG20.5¢.

## Ratings History

### China Eratat Sports fashion Limited

| Rating | Date         | Closing price (S\$) | Fair value (S\$) | Remarks            |
|--------|--------------|---------------------|------------------|--------------------|
| Buy    | 3 March 2010 | 0.165               | 0.205            | Trading Buy (+24%) |
|        |              |                     |                  |                    |
|        |              |                     |                  |                    |

|   |              |  |
|---|--------------|--|
| Phillip Research<br>Stock Selection<br>Systems  | TRADING BUY  | Share price may exceed 10% on the upside over the next 3 months, however longer-term outlook remains uncertain   |
|   | BUY          | >15% upside from the current price   |
|   | HOLD         | -10% to 15% from the current price   |
|   | SELL         | >10% downside from the current price   |
|   | TRADING SELL | Share price may exceed 10% on the downside over the next 3 months, however longer-term outlook remains uncertain |
| <p>We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation</p> |              |  |

## Important Information

This publication is prepared by Phillip Securities Research Pte Ltd., 250 North Bridge Road, #06-00, Raffles City Tower, Singapore 179101 (Registration Number: 198803136N), which is regulated by the Monetary Authority of Singapore ( “**Phillip Securities Research**”). By receiving or reading this publication, you agree to be bound by the terms and limitations set out below.

This publication has been provided to you for personal use only and shall not be reproduced distributed or published by you in whole or in part, for any purpose. If you have received this document by mistake, please delete or destroy it, and notify the sender immediately. Phillip Securities Research shall not be liable for any direct or consequential loss arising from any use of material contained in this publication.

The information contained in this publication has been obtained from public sources which Phillip Securities Research has no reason to believe are unreliable and any analysis, forecasts, projections, expectations and opinions (collectively, the “**Research**”) contained in this publication are based on such information and are expressions of belief of the individual author or the indicated source (as applicable) only. Phillip Securities Research has not verified this information and no representation or warranty, express or implied, is made that such information or Research is accurate, complete, appropriate or verified or should be relied upon as such. Any such information or Research contained in this publication is subject to change, and Phillip Securities Research shall not have any responsibility to maintain or update the information or Research made available or to supply any corrections, updates or releases in connection therewith. In no event will Phillip Securities Research or persons associated with or connected to Phillip Securities Research, including but not limited its officers, directors, employees or persons involved in the preparation or issuance of this report, (i) be liable in any manner whatsoever for any consequences (including but not limited to any special, direct, indirect, incidental or consequential losses, loss of profits and damages) of any reliance or usage of this publication or (ii) accept any legal responsibility from any person who receives this publication, even if it has been advised of the possibility of such damages. You must make the final investment decision and accept all responsibility for your investment decision including but not limited to your reliance on the information, data and/or other materials presented in this publication.

Any opinions, forecasts, assumptions, estimates, valuations and prices contained in this material are as of the date indicated and are subject to change at any time without prior notice.

Past performance of any product referred to in this publication is not indicative of future results.

This report does not constitute, and should not be used as a substitute for, tax, legal or investment advice. This publication should not be relied upon exclusively or as authoritative without further being subject to the recipient’s own independent verification and exercise of judgment. The fact that this publication has been made available constitutes neither a recommendation to enter into a particular transaction nor a representation that any product described in this material is suitable or appropriate for the recipient. Recipients should be aware that many of the products which may be described in this publication involve significant risks and may not be suitable for all investors, and that any decision to enter into transactions involving such products should not be made unless all such risks are understood and an independent determination has been made that such transactions would be appropriate. Any discussion of the risks contained herein with respect to any product should not be considered to be a disclosure of all risks or a complete discussion of such risks.

Nothing in this report shall be construed to be an offer or solicitation for the purchase or sale of any product. Any decision to purchase any product mentioned in this research should take into account existing public information, including any registered prospectus in respect of such product.

Phillip Securities Research, or persons associated with or connected to Phillip Securities Research, including but not limited to its officers, directors, employees or persons involved in the preparation or issuance of this report, may provide an array of financial services to a large number of corporations in Singapore and worldwide, including but not limited to commercial / investment banking activities (including sponsorship, financial advisory or underwriting activities), brokerage or securities trading activities. Phillip Securities Research, or persons associated with or connected to Phillip Securities Research, including but not limited to its officers, directors, employees or persons involved in the preparation or issuance of this report, may have participated in or invested in transactions with the issuer(s) of the securities mentioned in this publication, and may have performed services for or solicited business from such issuers. Additionally, Phillip Securities Research, or persons associated with or connected to Phillip Securities Research, including but not limited to its officers, directors, employees or persons involved in the preparation or issuance of this report, may have provided advice or investment services to such companies and investments or related investments as may be mentioned in this publication.

Phillip Securities Research or persons associated with or connected to Phillip Securities Research, including but not limited to

its officers, directors, employees or persons involved in the preparation or issuance of this report may, from time to time maintain a long or short position in securities referred to herein, or in related futures or options, purchase or sell, make a market in, or engage in any other transaction involving such securities, and earn brokerage or other compensation in respect of the foregoing. Investments will be denominated in various currencies including US dollars and Euro and thus will be subject to any fluctuation in exchange rates between US dollars and Euro or foreign currencies and the currency of your own jurisdiction. Such fluctuations may have an adverse effect on the value, price or income return of the investment.

To the extent permitted by law, Phillip Securities Research, or persons associated with or connected to Phillip Securities Research, including but not limited to its officers, directors, employees or persons involved in the preparation or issuance of this report, may at any time engage in any of the above activities as set out above or otherwise hold an interest, whether material or not, in respect of companies and investments or related investments which may be mentioned in this publication. Accordingly, information may be available to Phillip Securities Research, or persons associated with or connected to Phillip Securities Research, including but not limited to its officers, directors, employees or persons involved in the preparation or issuance of this report, which is not reflected in this material, and Phillip Securities Research, or persons associated with or connected to Phillip Securities Research, including but not limited to its officers, directors, employees or persons involved in the preparation or issuance of this report, may, to the extent permitted by law, have acted upon or used the information prior to or immediately following its publication. Phillip Securities Research, or persons associated with or connected to Phillip Securities Research, including but not limited to its officers, directors, employees or persons involved in the preparation or issuance of this report, may have issued other material that is inconsistent with, or reach different conclusions from, the contents of this material.

The information, tools and material presented herein are not directed, intended for distribution to or use by, any person or entity in any jurisdiction or country where such distribution, publication, availability or use would be contrary to the applicable law or regulation or which would subject Phillip Securities Research to any registration or licensing or other requirement, or penalty for contravention of such requirements within such jurisdiction.

Section 27 of the Financial Advisers Act (Cap. 110) of Singapore and the MAS Notice on Recommendations on Investment Products (FAA-N01) do not apply in respect of this publication.

This material is intended for general circulation only and does not take into account the specific investment objectives, financial situation or particular needs of any particular person. The products mentioned in this material may not be suitable for all investors and a person receiving or reading this material should seek advice from a professional and financial adviser regarding the legal, business, financial, tax and other aspects including the suitability of such products, taking into account the specific investment objectives, financial situation or particular needs of that person, before making a commitment to invest in any of such products.

Please contact Phillip Securities Research at [65 65311240] in respect of any matters arising from, or in connection with, this document.

This report is only for the purpose of distribution in Singapore.

## Contact Information

### Singapore Research

**Chan Wai Chee**  
CEO, Research  
+65 6531-1232  
[vebo@phillip.com.sg](mailto:vebo@phillip.com.sg)

**Lee Kok Joo, CFA**  
Head of Research  
REITS, Strategy  
+65 6531-1685  
[leekj@phillip.com.sg](mailto:leekj@phillip.com.sg)

**Magdalene Choong** Investment  
Analyst  
US Equities  
+65 6531-1791  
[magdalenechoongss@phillip.com.sg](mailto:magdalenechoongss@phillip.com.sg)

**Joshua Tan**  
Economist  
US, Singapore, China  
+65 6531-1249  
[joshuatan@phillip.com.sg](mailto:joshuatan@phillip.com.sg)

**Phua Ming-weii**  
Technical Analyst  
+65 6531-1735  
[phuamw@phillip.com.sg](mailto:phuamw@phillip.com.sg)

**Alfred Low**  
Investment Analyst  
Telecom, shipping, property  
+65 6531-1793  
[alfredlowih@phillip.com.sg](mailto:alfredlowih@phillip.com.sg)

## Regional Member Companies

### SINGAPORE

**Phillip Securities Pte Ltd**  
Raffles City Tower  
250, North Bridge Road #06-00  
Singapore 179101  
Tel : (65) 6533 6001  
Fax : (65) 6535 6631  
Website : [www.poems.com.sg](http://www.poems.com.sg)

### HONG KONG

**Phillip Securities (HK) Ltd**  
11/F United Centre  
95 Queensway, Hong Kong  
Tel : (852) 2277 6600  
Fax : (852) 2868 5307  
Website : [www.poems.com.hk](http://www.poems.com.hk)

### THAILAND

**Phillip Securities (Thailand) Public Co Ltd**  
15/F, Vorawat Building  
849 Silom Road  
Bangkok Thailand 10500  
Tel : (622) 635 7100  
Fax : (622) 635 1616  
Website : [www.poems.in.th](http://www.poems.in.th)

### MALAYSIA

**Phillip Capital Management Sdn Bhd**  
B-2-6 Megan Avenue II  
12 Jalan Yap Kwan Seng  
50450 Kuala Lumpur  
Tel : (603) 2166 8099  
Fax : (603) 2166 5099  
Website : [www.poems.com.my](http://www.poems.com.my)

### CHINA

**Phillip Financial Advisory (Shanghai) Co. Ltd**  
No 550 Yan An East Road,  
Ocean Tower Unit 2318,  
Postal code 200001  
Tel: (86-21) 51699200  
Fax: (86-21) 63512940  
Website: [www.phillip.com.cn](http://www.phillip.com.cn)

### JAPAN

**PhillipCapital Japan K.K.**  
Nagata-cho Bldg.,  
8F, 2-4-3 Nagata-cho,  
Chiyoda-ku, Tokyo  
Tel : (81) 03 3666 2101  
Fax : (81) 03 3664 0141  
Website : [www.phillip.co.jp](http://www.phillip.co.jp)

### UNITED KINGDOM

**King & Shaxson Capital Ltd**  
6<sup>th</sup> Floor, Candlewick House  
120 Cannon Street  
London EC4N 6AS  
Tel : (44) 207 426 5950  
Fax : (44) 207 626 1757  
Website : [www.kingandshaxson.com](http://www.kingandshaxson.com)

### FRANCE

**King & Shaxson Capital Ltd**  
35 rue de la Bienfaisance  
75008 Paris  
T: (33) 1 456 33100