

CHINA ERATAT: PE less than 3, dividend yield 6.6%, net cash S\$36 m

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Wednesday, 09 June 2010



**At CIMB yesterday: Ho Ker Chern, 44, wearing casual wear designed by his company. He has been its CFO since Oct '07. Photo by Leong Chan Teik**

**CERTAINLY, the business of sports footwear or apparel manufacturing is very competitive and working capital needs are significant. Having said that, China Eratat is a stock and a S-chip that seems to be trading at way below its fair value.**

CIMB-GK analyst William Ting has pegged its fair value at 30 cents, which is more than 100% upside from its recent price of 14.5 cents.

At 14.5 cents, the stock traded at a historical PE of 3 and CIMB's forecast of 2.88.

There is something else to like about China Eratat: Unlike many of its China peers, it has just proposed a final dividend for the FY ended March. The dividend is RMB0.0466, or about S\$0.0096, a share, translating into a yield of **6.6%**.

Said William Ting in his May 31 report when the stock was at 13.5 cents: "Valuation is once again attractive, at 0.5x CY10 P/NTA, prospective P/Es of less than 3x and prospective dividend yields of 7.5% to 9.7%.

"That the Company mentioned an effort to pay out 20% of profit as dividends was a surprise given that being small still, growth opportunities are plentiful."

As at end-March, China Eratat, which went IPO in April 2008, had zero borrowing and RMB176 m cash (equivalent to S\$0.866 a share).

Its FY10 revenue rose 15.6% to RMB898.7m while net profit fell 23% to RMB 96.6 m owing to the absence

of a foreign exchange translation gain (RMB14.1 m in the previous year) and a rise in income tax rate of its subsidiary.

ERATAT brand (RMB 'm)	FY08		FY09		FY10	
Sports	269.9	64%	389.3	54%	252.1	29%
Casual	150.3	36%	332.1	46%	626.8	71%
Total	420.2	100%	721.5	100%	879.0	100%

Speaking to investors at CIMB-GK Investment Centre yesterday, China Eratat CFO Ho Ker Chern said: “The biggest significant event for us over the last 3 years is we have successfully repositioned ourselves as a casual lifestyle wear company, instead of sportswear company.” (See table above)

The products are targeted at consumers aged 18 to 48 living in tier 2 and 3 cities.

China Eratat has 1,680 retail points via its 30 distributors. Its orderbook stands at RMB500 million for the July-Dec (autumn/winter) season, or 12% higher than the actual sales for the previous corresponding period.

Here are some of the questions raised yesterday after presentations by Mr Ho and Kellyn Tan, the vice-president for investor relations:

**Q: How big is the casual wear market and what is your market share?**

**Ho Ker Chern:** The market is very big and the market segment in each province is very fragmented.

**Q: How are sales in April and May?**

**Ho:** Our revenue is driven by the orders we receive at 2 trade fairs - in March/April and Aug/Sept. The April and May sales this year came from orders received at the trade fair last August, and almost half have been delivered in Jan-March.



China Eratat manufactures its shoes but outsources production of its apparel. Photo: annual report

**Q: You said you are targeting tier 2 and 3 cities and you can raise the average selling prices....**

**Ho:** I'm sure you are aware that that the salaries of Chinese workers have been increasing. Their taste has started to change and their demand for certain goods will also change. Our target consumers earn between RMB1,500-5,000. We are looking at middle-income and looking for value product.

**Q: What is the price range for your shoes?**

**Ho:** For our mid-range shoes, it's RMB200-300 per pair. We have high range at 400 and 150 also have.

**Q: You sound Singaporean. What's the make-up of the management team?**

**Ho:** The management team is from China, except me and Kellyn. We are Singaporeans. The board has 3 independent directors who are Singaporean and two who are from China.

**Q: There is an increase in dividend for FY10 compared to FY09. Is the payout going to be consistent going forward?**

**Ho:** In our IPO prospectus, we said we would start giving out dividends from FY10 at 20% of net profit, which we have proposed. Last FY we didn't have to but we gave out some (RMB0.0152). We wanted to assure shareholders we are ok and reward shareholders. Definitely we will continue to pay. We will try to pay 20% but we will look at how much we need to keep for expansion.

**Q: How much of your operating expenses is due to labour cost?**

**Ho:** Currently we have close to 2,000 employees, including production people. We only produce shoes, and the apparel production is outsourced. For shoes, 80% of the cost of production is materials and overheads. Labour takes up about 10%. Even if there is a 20% increase in salaries, the impact on the cost of shoes is not great.

**Q: Investors are concerned about corporate governance of S-chips. What do you have to say about corporate governance of your company? And is your cash of RMB176 million really in the bank?**

**Ho:** The money is in the bank. The auditor has gone to the bank to obtain confirmation. They have done due diligence on the accounts and the cash. How to signal the existence of the cash? Look at the dividends we pay. We do have cash.

We have 3 independent directors, who are Singaporean – and they form the majority of the board. And they do meet regularly.