

Analyse This...

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Eratat Lifestyle Limited

Assuring auditing quality

 ERAT SP
 IPO Price: S\$0.30
 BUY: TP: S\$0.44

 Price @01/3/11: S\$0.225
 52-week range (SGD): 0.125 – 0.265
 Market cap – S\$93.4m

Have your concerns been addressed?

- **Face to face.** We invited Eratat down for our weekly corporate focus series. Management shared its latest 9M10 results as well as the company's growth plans going forward.
- **Allaying concerns.** During the Q&A session, questions over Eratat's financial position came in fast and furious, as jittery investors were concerned following the recent auditing fiasco at 2 S-chips. Management reassured investors over Eratat's cash balance, accounts receivables quality and collectability.
- **Growth plans.** Over the past few years, management has successfully maneuvered Eratat's transformation from a sports apparel manufacturer to a casual lifestyle apparel provider. Going forward, Eratat will focus on building up a premium series, offering a high-end product range for men in tier-1 cities. Eratat has also planned 50 shops for 1H11. In addition, Eratat plans to align distributor interests by offering better credit terms for performing distributors.
- **Recommendation.** In our view, management is attempting to ride on the growing middle class consumption power in the PRC going forward. Maintain Buy with unchanged target price of S\$0.44.

Hit me with your best shot

- **Q) Why would distributors or retailers want to take up your brand as opposed to others?**
 A) Due to Eratat's strong brand presence for the past 10-12 years. Most distributors of the company are long term, have been with the company for at least 5-7 years, and are staying because of their confidence in the brand and in the consumer.
- **Q) How much cash do you have, and do you still borrow money?**
 A) Eratat is currently in a net cash position of RMB 159m. The company does not have any borrowings.
- **Q) How do you see orders for the next few months?**
 A) Orders received from Jan-June 2011 have been confirmed. Eratat has received positive responses from distributors, especially with regards to Eratat's premium line.
- **Q) Will there be a placement?**
 A) Discussions are currently taking place. The previous placement (which fell through) price was S\$0.2135 for a placement of 63m shares. Cash proceeds will be used for working capital. Eratat plans to galvanise on its enlarged cash balance to strengthen its bargaining power over suppliers, which often prefer cash on delivery as compared to credit terms. Eratat also plans to extend its credit terms to performing distributors. The Company is still renegotiating the terms of the placement.
- **Q) Why is Eratat attempting to raise capital through placement instead of retail bonds like SIA?**
 A) SIA is a larger company and is more established. Though management has yet to consider such capital raising strategy, Eratat believes that it is not feasible at the moment due to the company's size and profile.
- **Q) Why hasn't Eratat explored bank financing to raise cash?**
 A) According to management, bank financing only offers a short term solution to Eratat's financing needs. Collateral for loans will also require a third party guarantee from an unrelated source, which makes the borrowing process complicated and cumbersome. Management also added that the cost of loans is high, at 10-12% per annum. Loans are also subjected to renewal, extension and government credit control policies.

- **Q) Can you please elaborate on Eratat's accounting control?**
 A) Eratat carries out monthly bank statement checks. Auditors also communicate with bank managers to authenticate cash balance accounts.
- **Q) Are audits conducted yearly or quarterly?**
 A) Audits are conducted on a yearly basis. Eratat appoints internal auditors to conduct checks on the company's accounts and processes.
- **Q) Does Eratat have an online accounting system as a form of accounting control?**
 A) Eratat does not have an online accounting system due to its scale of operations and cost involved. A phone call and data download is all it takes for the CFO to get the relevant data from his Chinese counterparts.
- **Q) Why doesn't Eratat conduct quarterly audits?**
 A) Eratat does not conduct quarterly audits mainly due to cost issues. However, management conducts regular meetings with the Board on a quarterly basis. During these meetings, any accounting discrepancies or queries have always been appropriately explained.
- **Q) Are receivable counterparties all independent and non-related third parties?**
 A) Yes.

Financial analysis

FYE Dec	2009	2010	2011F	2012F	2013F
Revenue (Rmb m)	885.0	968.3	1,124.0	1,293.6	1,493.0
yoy growth (%)	nm	9.4	16.1	15.1	15.4
EBITDA (Rmb m)	136.1	181.1	208.2	242.7	278.7
EBITDA margins (%)	15.4	18.7	18.5	18.8	18.7
Pretax profit (Rmb m)	137.6	176.4	203.0	237.3	273.2
Net profit (Rmb m)	102.1	131.0	150.2	175.6	202.1
yoy growth (%)	nm	28.3	14.7	16.9	15.1
EPS (Rmb cts)	24.6	31.6	36.2	42.3	48.7
EPS (S cts)	5.1	6.1	7.0	8.2	9.5
EPS growth (%)	nm	28.3	14.7	16.9	15.1
P/E (x)	4.8	3.8	3.3	2.8	2.4
FD EPS (S cts)	nm	nm	5.4	6.3	7.3
FD P/E (x)	nm	nm	4.2	3.6	3.1
Gross DPS (Rmb cts)	4.7	3.0	3.6	4.2	4.9
Gross DPS (S cts)	1.0	0.6	0.7	0.8	0.9
Dividend yield (%)	4.2	2.5	3.1	3.6	4.1
P/NTA (x)	1.0	0.8	0.6	0.5	0.4
NTA/sh (RMB cts)	123.6	150.5	183.7	222.4	266.8
NTA/sh (S cts)	25.4	29.2	35.7	43.2	51.8
BVPS (RMB cts)	124.0	150.9	184.1	222.8	267.3
BVPS (S cts)	25.5	29.3	35.7	43.3	51.9
ROE (%)	21.7	23.0	21.6	20.8	19.9
Net gearing (%)	cash	cash	cash	cash	cash
Net cash (RMB m)	180.3	159.3	130.9	160.2	199.9
Net cash/sh (Rmb cts)	43.5	38.4	31.5	38.6	48.2
Net cash per share (Sing cts)	8.9	7.5	6.1	7.5	9.4
P/CF (x)	4.6	3.6	3.1	2.7	2.4
EV/EBITDA (x)	2.4	1.8	1.6	1.4	1.2

Source: Company

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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.

SECTOR RECOMMENDATIONS

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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.

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