

## Eratat Lifestyle Limited

### Fast and Furious

*Eratat Lifestyle Limited (Eratat) proposed a placement exercise just one day after our last update. The placement came earlier than anticipated as we had expected it to be executed at a higher price. Nonetheless, our conviction in this counter remains unchanged. The funds will firm the company's expected growth trajectory and support faster growth. **Maintain Increase Exposure view based on an adjusted intrinsic value of S\$0.420 (previously S\$0.480).***

#### Key Thoughts:

- "The company will continue to explore further fund raising opportunities..." Reading in between the lines, there may be another placement coming up. The company currently has the mandate to place out (up to) another 38m new shares, after this exercise.
- We read this first tranche as a move to lock in interested investors early. The share issue mandate will expire in Eratat's next AGM, which must be held by the end of this month.
- We understand that the company intends to raise its profile, via new activities in the near future such as roadshows in and out of Singapore. We envisage that the difference in valuation between Eratat and peers listed overseas may capture the attention of some investors, who may not have been aware of this counter.
- Our stance is clear. This company is undervalued fundamentally. The placees who subscribed for the new shares probably also believed in Eratat's growth story.
- We also noted that the company has not made any cash calls since its listing in April 2008 until this year. This suggests that the company has been deploying its available funds prudently.
- In our updated valuation, we had assumed that a total of 83m shares will be issued. Hence, foreseeable dilution risk has been accounted for in our valuation.

## Increase Exposure

- Intrinsic Value S\$0.420
- Prev Close S\$0.220

#### Main Activities

Eratat Lifestyle Limited is principally engaged in the design, manufacture and distribution of lifestyle fashion footwear, and the design and distribution of lifestyle fashion apparel under its well-established proprietary brand "ERATAT".

#### Financial Highlights

(Y/E Dec) RMB m	FY10	FYE10	FY11F
Revenue	898.7	787.6	1127.2
Gross Profit	258.5	237.4	349.4
Earnings	96.6	111.4	156.4
EPS (RMB cts)	23.3	26.8	34.0

<sup>^</sup>FYE10F data are based on the nine month period ended Dec 2010. Eratat changed its financial year end from Mar to Dec in May 2010.

Source: Company, SIAS Research

#### Key ratios (FY11F)

PER	3.4
P/BV	0.7
Return on Common Equity	21.2%
Gross Debt to Common Equity	0%
Current ratio	9.0

Source: SIAS Research

#### Indexed Price Chart

Green (FSSTI)  
White (ERATAT)



Source: Bloomberg

52wks High-Low S\$0.270 /S\$0.120  
Number of Shares 414.9m  
Market Capitalization S\$91.3m

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**Figure 1: Economic Profit Valuation Model**

RMB m	FY11F	FY12F	FY13F	FY14F
Revenue	1,127.2	1,296.3	1,490.8	1,788.9
EBIT	210.6	234.4	269.5	323.5
Tax on EBIT	-54.7	-58.7	-67.5	-81.0
NOPLAT	156.0	175.7	202.0	242.5
Invested Capital	626.0	850.9	1,007.7	1,380.4
% of Debt	0.0%	0.0%	0.0%	0.0%
% of Equity	100.0%	100.0%	100.0%	100.0%
WACC (%)	13.8%	13.8%	13.8%	13.8%
Capital Charge	86.6	117.8	139.5	191.0
Economic Profit	69.3	57.9	62.6	51.4
Terminal Value				443.0
Discount Rate	0.88	0.77	0.66	0.58
Present Value	60.9	44.7	41.1	29.6
Book Value	711.7 <sup>^</sup>	Risk Free Rate		2.5%
Explicit Value	176.3	Beta		1.4
Terminal Value	255.3	Market RP		8.4%
Value of Equity	1143.3	Cost of Equity		13.8%
Number of Shares (m)	497.9 <sup>^^</sup>	Cost of Debt		0.00%
Value per share (RMB)	2.296	LT Growth		2.0%
Value per share (S\$)	0.442	RMBSGD Rate		0.1926
Expanded Shares o/s (m)	621.5	(conversion of warrants)		
Add cash per share (S\$)	0.060	(from exercise of warrants)		
Value per share (S\$)	0.420			

<sup>^</sup>Book value of RMB626.0m as of end 2010 + Expected proceeds from the issue of 83m new shares at current placement price of S\$0.202 less 3% commission. <sup>^^</sup>414.9m shares as of end 2010 + 45m new shares + anticipated issue of another 38m new shares

Source: SIAS Research

In the scenario that there is no second placement exercise, our model would have yielded an intrinsic value of S\$0.440. Our valuation is conservative in the extent that we have not factored in potentially faster growth with the additional funds, nor the possibility of Eratat's order book exceeding our forecasts as highlighted in our earlier update.

Every additional earnings of RMB17.8m (13.4% of 12M 2010 RMB131m of net profit) beyond our 2011 forecast only and leaving subsequent years' forecasts constant will raise our valuation by S\$0.005 based on our assumed number of shares stated above.

**Figure 2: Financial Forecasts and Estimates**

RMB m	FY09	FY10	FYE10	FY11F	FY12F	FY13F	FY14F
Revenue	777.3	898.7	787.6	1127.2	1296.3	1490.8	1788.9
Gross Profit	234.0	258.5	237.4	349.4	388.9	447.2	536.7
Operating Profit	145.9	131.5	150.2	210.6	234.4	269.5	323.5
Net Profit	125.9	96.6	111.4	156.4	176.2	202.5	243.0
Attributable to Shareholders							
Total Current Assets	392.2	511.3	629.8	846.7	1010.8	1368.4	1589.0
Total Non-Current Assets	99.0	95.8	92.1	98.0	104.3	124.6	143.8
Total Current Liabilities	47.4	73.1	95.9	93.9	107.5	112.5	136.1
Total Non-Current Liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Equity	443.7	534.0	626.0	850.9	1007.7	1380.4	1596.6
Cash from Operating Activities	7.0	30.0	2.9	5.2	176.3	39.9	154.0
Cash from Investing Activities	-21.5	-1.9	-0.3	-10.0	-10.0	-25.0	-25.0
Cash from Financing Activities	164.8	-6.3	-19.3	67.2	-19.4	170.2	-26.7
Net Change in Cash	150.3	21.8	-16.7	62.4	146.9	185.1	102.2
Inventory Days	10	9	12	15	15	15	15
Receivable Days	52	76	94	115	115	115	115
Payable Days	11	17	24	25	25	25	25
Return on Common Equity	41.5%	19.8%	25.6%	21.2%	19.0%	17.0%	16.3%
Return on Assets	36.0%	17.6%	22.3%	18.8%	17.1%	15.5%	15.1%
Gross Debt / Common Equity	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Current Ratio	8.3	7.0	6.6	9.0	9.4	12.2	11.7
EPS (RMB cents)	30.8	23.3	26.8	34.0	38.3	32.6	39.1
BV / Share (RMB cents)	89.1	107.3	125.7	170.6	202.1	221.9	256.7
PER	3.7	4.9	4.3	3.4	3.0	3.5	2.9
P/BV	1.3	1.1	0.9	0.7	0.6	0.5	0.4

^ROE and ROA are annualized figures in FYE10. FYE10F EPS is for the period Apr to Dec 2010. FYE10F PER is based on 9M EPS. We assume the conversion of outstanding warrants in FY13F. Receivable days are based on the net AR balances – adjusted to exclude 17% VAT on sales which is recorded as part of accounts receivable. EPS and BV from FY11F are based on assumption that 83m new shares will be issued at S\$0.202.

Source: Company, SIAS Research

**Rating Definition:**

**Increase Exposure** – The current price of the stock is significantly lower than the underlying fundamental value. Readers can consider increasing their exposure in their portfolio to a higher level.

**Invest** – The current price of the stock is sufficiently lower than the underlying fundamental value of the firm. Readers can consider adding this stock to their portfolio.

**Fairly Valued** – The current price of the stock is reflective of the underlying fundamental value of the firm. Readers may not need to take actions at current price.

**Take Profit** – The current price of the stock is sufficiently higher than the underlying fundamental value of the firm. Readers can consider rebalancing their portfolio to take advantage of the profits.

**Reduce Exposure** - The current price of the stock is significantly higher than the underlying fundamental value of the firm. Readers can consider reducing their holdings in their portfolio.

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