

Eratat Lifestyle Limited

Yet Another Exciting Set of Results

Eratat Lifestyle Limited's (Eratat) 1Q FY11 results surprised us again with net attributable profit growing by 90.7% YoY on the back of revenue growth of 28.3%. Eratat will be announcing its Autumn/Winter 2011 order book very soon. As Eratat continues to show impressive results, we believe that it is a matter of time before its share price reflects its growth prospects. **Maintain Increase Exposure view based on an intrinsic value of S\$0.430.**

Key Developments:

Apparel Sales Drove Growth: Revenue from apparel sales grew by 67.7%, which accounted for more than 90% of group top-line growth. Gross profit from this line of products also grew by 98.4% YoY, accounting for 85% of overall gross profit growth. Higher average selling prices also led gross margin to increase by 6%.

While ERATAT footwear sales continued to decline as the company emphasizes more on apparel products, this was offset by increased footwear OEM business to occupy Eratat's manufacturing capacity in footwear.

To See Higher ERATAT CLASSIC Sales in 2Q: Eratat ended 1Q FY11 with 42% of its Spring/Summer order book of RMB477m delivered. With the remaining orders expected to be delivered in 2Q, we expect 2Q to be more than 30% better than 1Q, in terms of both sales and profits. It looks like 2Q FY11 will be another record quarter.

ERATAT PREMIUM Contribution to Come in 2Q FY11: Eratat's order book of RMB40m will also be delivered in 2Q FY11, which will propel Eratat's 2Q performance further upwards.

Dilution Risk Reduced: The completion of Eratat's recent placement of 60m new shares at S\$0.202 has, in our opinion, provided the company with the working capital to grow in 3Q and 4Q 2011. As such, we believe that any risk of further dilution in the near term is significantly reduced. We are maintaining our forecasts, pending review when Eratat announces its Autumn/Winter order book.

Increase Exposure

- Intrinsic Value S\$0.430
- Prev Close S\$0.210

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	35.1

[^]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	3.1
P/BV	0.6
Return on Common Equity	21.7%
Gross Debt to Common Equity	0%
Current ratio	8.7

Source: SIAS Research

Indexed Price Chart

Green (FSSTI)
White (ERATAT)



Source: Bloomberg

52wks High-Low S\$0.270 /S\$0.120
Number of Shares 474.9m
Market Capitalization S\$99.7m

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Roll-Out of ERATAT PREMIUM Outlets on Track: Just a recap, Eratat plans to get its distributors to open 50 PREMIUM shops in Anhui, Guangdong, Henan, Shandong, Shanxi and Zhejiang in 1H 2011. According to the management, the implementation of this plan is “on target”, with “no surprises” expected at the moment.

Accordingly, some of these outlets have already been renovated, but are currently carrying CLASSIC products. The ERATAT PREMIUM Summer series are delivered to distributors starting Apr onwards and will begin to hit the retail stores by end June onwards.

ERATAT PREMIUM will also extend its presence to Shanghai within this month. By collaborating with a shopping mall chain operator, Eratat will have several ERATAT PREMIUM outlets in Shanghai within this year.

Distribution Network was streamlined: Currently, Eratat has 12 active distributors, down from 17 in 2010. We were told that the affected distributors were either performing relatively slowly, or did not share the same strategic direction as Eratat. The crux of the issue is that Eratat has been evolving very rapidly from sports to casual wear and now has added a new high end product series. As such, distributors that are unable to adapt were axed. Consequentially, the number of Eratat specialty stores and shop-in-malls fell to 730 from 930 at the end of 2010.

Nonetheless, we were assured that Eratat has stopped selling to these five distributors since the beginning of this year and that its RMB477m order book did not include any orders from them. The fact that Eratat managed to deliver growth with fewer distributors showed that it is actually consolidating its distribution network to focus on working with stronger partners.

With the addition of ERATAT PREMIUM outlets in 2011, we believe that Eratat’s distribution network will revert to growth over the rest of the year.

Cash Position Enhanced: In 1Q FY11, Eratat generated net cash of RMB54.6m from operating activities, after movements in working capital. Consequentially, Eratat’s cash balances increased to RMB213.9m. Account receivable turnover days remained almost flat QoQ from 100 days at the end of last year to 106 days in 1Q FY11. This provides evidence that Eratat’s account receivables are collectible.

Nonetheless, some of Eratat’s cash will be used in 2Q to fund its inventory purchases for the Autumn/Winter Season 2011. The company has to put up a 50% deposit upfront when it places orders for apparel items and make another 30% to 40% payment upon receipt of the goods.

Figure 1: Results Analysis

	Jan -Mar 2011	Jan - Mar 2010	Change
ERATAT APP			
Revenue (RMB m)	119.9	71.5	67.7%
m pieces	1.39	1.05	32.4%
ASP (RMB)	86.2	68	26.7%
Gross Margin	38.8%	32.8%	6% pts
Gross Profit	46.5	23.5	98.4%
ERATAT FW			
Revenue (RMB m)	90.6	107.8	-16.0%
m pieces	1.12	1.52	-26.3%
ASP (RMB)	80.9	70.9	14.0%
Gross Margin	23.8%	25.4%	-1.6% pts
Gross Profit	21.6	27.4	-21.2%
ERATAT FW+APP			
Revenue (RMB m)	210.5	179.3	17.4%
Gross Margin	32.3%	28.4%	4% pts
Gross Profit	68.1	50.8	33.9%
3rd Party FW			
Revenue	21.4	1.6	NM
Gross Margin	22.7%	-316.5%	NM
Gross Profit	4.9	-5.1	NM
Group			
Revenue	231.9	180.8	28.3%
Gross Profit	72.9	45.8	59.4%
Operating Expenses	-22.5	-20.0	12.3%
Profit Before Tax	50.5	25.7	96.0%
Net Attributable Profit	37.4	19.6	90.7%
Gross Margin	31.4%	25.3%	6.1% pts
Net Margin	16.1%	10.9%	5.3% pts

Source: SIAS Research

Figure 2: 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	817.8	964.0	1,327.4
% of Debt	0.0%	0.0%	0.0%	0.0%
% of Equity	100.0%	100.0%	100.0%	100.0%
WACC (%)	14.0%	14.0%	14.0%	14.0%
Capital Charge	87.9	114.8	135.4	186.4
Economic Profit	68.0	60.8	66.7	56.0
Terminal Value				474.6
Discount Rate	0.91	0.79	0.67	0.59
Present Value	61.7	48.3	44.9	33.1
Book Value [^]	688.0	Risk Free Rate		2.5%
Explicit Value	188.0	Beta		1.2
Terminal Value	280.6	Market RP		9.6%
Value of Equity	1156.6	Cost of Equity		14.0%
Number of Shares (m)	474.9	Cost of Debt		0.00%
Value per share (RMB)	2.435	LT Growth		2.0%
Value per share (S\$)	0.462	RMBSGD Rate		0.1898
Expanded Shares o/s (m)	598.5	(conversion of warrants)		
Add cash per share (S\$)	0.062	(from exercise of warrants)		
Value per share (S\$)	0.430			

[^]Book value of RMB626.0m as of end 2010 + Expected proceeds from the issue of 60m new shares at current placement price of S\$0.202 less 3% commission.

Source: SIAS Research

Figure 3: 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	813.6	967.2	1315.4	1521.4
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	817.8	964.0	1327.4	1529.1
Cash from Operating Activities	7.0	30.0	2.9	102.1	96.0	137.2	82.8
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	35.4	-29.9	160.9	-41.3
Net Change in Cash	150.3	21.8	-16.7	127.5	56.0	273.1	16.4
Inventory Days	10	9	12	15	15	15	15
Receivable Days	52	76	94	120	120	120	120
Payable Days	11	17	24	25	25	25	25
Return on Common Equity	41.5%	19.8%	25.6%	21.7%	19.8%	17.7%	17.0%
Return on Assets	36.0%	17.6%	22.3%	19.1%	17.8%	16.1%	15.6%
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	8.7	9.0	11.7	11.2
EPS (RMB cents)	30.8	23.3	26.8	35.1	37.1	42.6	51.2
BV / Share (RMB cents)	93.4	112.4	131.8	172.2	203.0	221.8	255.5
PER	3.6	4.7	4.1	3.1	3.0	2.6	2.2
P/BV	1.2	1.0	0.8	0.6	0.5	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.

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.

IMPORTANT DISCLOSURE

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