

Stella International

Wed, 07 Jan 2009

Under pressure

HOLD (from BUY)

Financial summary

Year to Dec	06A	07A	08F	09F	10F
Turnover (US\$m)	779.3	937.2	1,096.2	903.1	947.3
Net Profit (US\$m)	91.4	114.7	122.1	28.7	29.8
EPS (US\$)	0.156	0.165	0.151	0.036	0.037
EPS Δ%	6.8	5.8	(8.6)	(76.5)	3.6
P/E (x)	5.7	5.4	5.9	25.1	24.2
P/B (x)	1.18	0.98	0.95	1.05	1.18
EV/EBITDA (x)	6.9	5.4	4.7	15.0	13.7
Yield (%)	-	1.7	1.8	1.8	1.8
ROE (%)	22.4	19.6	16.3	4.0	4.6
ROCE (%)	21.9	18.7	16.4	3.4	4.0
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Ticker:	1836.HK	12 mth range:	HK\$5.80-17.98
Price:	HK\$6.94	Market cap:	US\$713.4m
Target:	HK\$7.36 (+6%)	Daily t/o, 3 mth:	US\$0.7m
		Free float %:	29.5%

Key points:

- * The company expects FY12/09F sales to decline 10%.
- * Our conservative forecast reflects the contracting market and rising competition.
- * Share price approaching our target, BUY to HOLD.

FY12/09F sales to decline 10%. The company's customers have reduced their orders for 2009 after a silent Christmas. According to MasterCard Inc.'s SpendingPulse unit, retail sales in the US dropped 5.5% in Nov and 8% in Dec through Christmas Eve, making it one of the worst holiday shopping periods in decades. Stella expects its top line to decline 10% YoY in FY12/09F, with single-digit declines in the sales volume and price. Meanwhile, the EBITDA margin should remain stable.

Better than expected. We have assumed an 8.6% decline in the shipment volume, though the company should be better off than peers given its reputation for quality work and R&D. Due to its cost-plus nature, we expect the selling price to drop 11.1% backed by softening raw material costs and intensifying competition in a shrinking market. Another threat may come from potential sales mix changes as consumption migrates to cheaper products. This, however, could be offset by the company's efforts to expand its capacity for higher-end designer labels (2m pairs at present).

Forecast maintained. Despite the better-than-expected guidance, we keep our forecast unchanged due to concerns about declining consumption spending and severe survival competition among footwear manufacturers. The selling price drop will push down EBITDA margins from 13.0% in FY12/08F to 5.1% in FY12/09F. We expect some recovery in FY12/10F.

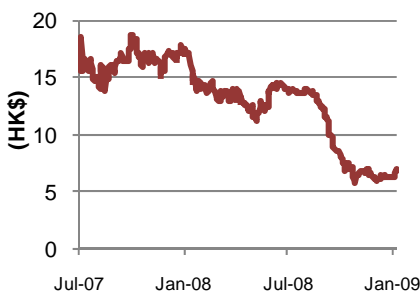
Target price intact. We maintain our target price at HK\$7.36, which represents a 20.0% discount to the estimated fair value of HK\$9.20 (HK\$5.78 from operations and HK\$3.42 from US\$377.5m net cash at end-Sep). The current share price has approached our target so we change our recommendation from BUY to HOLD.

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	+0.4	+0.3	-29.3
Actual price changes (%)	+12.5	-7.5	-60.2

	08F	09F	10F
Consensus EPS (US\$)	0.150	0.138	0.150
Previous forecasts (US\$m)	122.1	28.7	29.8
Previous EPS (US\$)	0.151	0.036	0.037

Price Chart



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Table 1: P & L

Year to Dec (RMBm)	06A	07A	08F	09F	10F
Revenue	779.3	937.2	1,096.2	903.1	947.3
Cost of sales	(613.7)	(716.1)	(839.0)	(737.3)	(768.6)
Gross profit	165.7	221.0	257.2	165.8	178.8
Other income	15.0	15.9	10.5	9.5	9.2
Selling and distribution costs	(31.7)	(38.5)	(49.5)	(49.7)	(52.1)
Administrative expenses	(28.9)	(45.8)	(56.5)	(59.6)	(67.0)
Research and development costs	(26.4)	(33.0)	(32.9)	(36.1)	(37.9)
Share of results of an associate		(0.1)	(0.1)	0.1	0.4
Finance costs	(0.1)	(0.3)	(0.4)	(0.3)	(0.3)
Profit before tax	93.6	119.2	128.4	29.7	31.0
Income tax expense	(2.3)	(4.6)	(6.3)	(1.0)	(1.2)
Profit for the period	91.4	114.6	122.1	28.7	29.8
Attributable to:					
Equity holders of the Company	91.4	114.7	122.1	28.7	29.8
Minority interests		(0.1)	0.0	(0.0)	(0.0)
EPS - Basic (US\$)	0.156	0.165	0.151	0.036	0.037
Proposed DPS (HK\$)		0.900	1.000	1.000	1.000

Source: Company data, SBI E2-Capital

P & L (US\$m)	06A	07A	08F	09F	10F	Cash Flow (US\$m)	06A	07A	08F	09F	10F
Year to Dec						Year to Dec					
Turnover	779.3	937.2	1,096.2	903.1	947.3	EBIT	89.3	109.5	122.3	24.3	25.7
% chg	16.5	20.3	17.0	(17.6)	4.9	Depre./amort.	13.0	15.3	20.5	21.8	24.5
Gross profit	165.7	221.0	257.2	165.8	178.8	Net int. paid	4.4	9.8	6.1	5.2	4.9
EBITDA	102.3	124.8	142.8	46.2	50.3	Tax paid	0.0	0.0	(7.7)	(6.3)	(1.0)
Depre./amort.	(13.0)	(15.3)	(20.5)	(21.8)	(24.5)	Dividends received	0.2	0.1	0.0	0.0	0.0
EBIT	89.3	109.5	122.3	24.3	25.7	Gross cashflow	106.8	134.7	141.3	45.1	54.2
Net int. income/(exp.)	4.4	9.8	6.1	5.2	4.9	Chgs. in working cap.	(55.2)	(78.7)	(41.3)	(58.5)	92.6
Exceptionals						Operating cashflow	51.6	56.0	100.0	(13.5)	146.8
Associates	0.0	(0.1)	(0.1)	0.1	0.4	Capex	(22.1)	(24.2)	(60.2)	(25.8)	(22.9)
Jointly-controlled entit.						Free cashflow	29.5	31.9	39.8	(39.3)	123.9
Pre-tax profit	93.6	119.2	128.4	29.7	31.0	Dividends paid	(21.8)	(122.7)	(93.4)	(107.2)	(103.8)
Tax	(2.3)	(4.6)	(6.3)	(1.0)	(1.2)	Net distribution to MI					
Minority interests	0.0	0.1	(0.0)	0.0	0.0	Investments					
Net profit	91.4	114.7	122.1	28.7	29.8	Disposals					
% chg	7.0	25.5	6.5	(76.5)	3.6	New shares	0.0	444.6	0.0	0.0	0.0
Dividends	(21.8)	(251.2)	(93.4)	(107.2)	(103.8)	Others	2.8	(20.4)	1.4	0.2	0.2
Retained earnings	69.6	(136.5)	28.7	(78.5)	(74.0)	Net cashflow	10.5	333.3	(52.1)	(146.2)	20.4
EPS (US\$) - Basic	0.156	0.165	0.151	0.036	0.037	Net (debt)/cash - Beg.	63.2	73.7	407.0	354.9	208.6
EPS (US\$) - F.D.	0.156	0.165	0.151	0.036	0.037	Net (debt)/cash - End.	73.7	407.0	354.9	208.6	229.1
DPS (US\$)	-	0.115	0.128	0.128	0.128	Interim Results (US\$m)	06A	07A	07A		
No. sh.s o/s (m) - W.A.	585.0	693.9	809.3	809.3	809.3	Six months to Jun					
No. sh.s o/s (m) - Y.E.	585.0	809.3	809.3	809.3	809.3	Turnover	352.2	417.3			
No. sh.s o/s (m) - F.D.	585.0	693.9	809.3	809.3	809.3	% chg		18.5			
Margins (%)						Profit from operations	42.7	52.3			
Gross	21.3	23.6	23.5	18.4	18.9	Interest expenses	(0.0)	(0.1)			
EBITDA	13.1	13.3	13.0	5.1	5.3	Associates	0.0	0.0			
EBIT	7.0	11.7	11.2	2.7	2.7	Jointly-controlled entit.					
Pre-tax	12.0	12.7	11.7	3.3	3.3	Pre-tax profit	42.7	52.2			
Net	11.7	12.2	11.1	3.2	3.1	Tax	0.0	0.0			
						Minority interests		0.0			
Balance Sheet (US\$m)	06A	07A	08F	09F	10F	Net profit	42.7	52.3			
Year to Dec						% chg		22.3			
Fixed assets	144.6	158.2	180.9	184.8	183.2	EPS (US\$) - Basic	0.071	0.086			
Intangible assets	9.5	10.4	27.1	27.0	27.1	DPS (US\$)		0.038			
Other LT assets	0.6	1.2	0.0	0.0	0.0	Shareholding Structure					
Cash	73.7	407.0	354.9	208.6	229.1				Shares o/s (m)	%	
Accounts receivable	128.0	174.1	203.7	301.0	189.5	Cordwalner Bonaventure Inc.			564.3	70.5	
Other receivables						Others			235.6	29.5	
Inventories	77.9	97.9	114.5	112.9	99.7	Total			799.9	100.0	
Due from related co.s	78.7	7.1	21.8	0.0	0.0	Background					
Other current assets	50.1	0.8	0.8	0.8	0.8	Established in 1982, Stella International is a Taiwan-based footwear manufacturing company. Products include men's casual, men's fashion, women's casual, women's fashion, etc. Production facilities are located in China and Vietnam with effective capacity totaling 45.0m pairs in 2007. The company commenced its own retailing operation in 2006 and owns two brands (Stella Luna and What For) now. It listed in Hong Kong exchange in Jul 2007.					
Total assets	563.0	856.7	903.6	835.2	729.3	Key Ratios	05A	06A	07A	08F	09F
Accounts payable	(105.6)	(115.6)	(135.2)	(150.5)	(118.4)	Net gearing (%)	Cash	Cash	Cash	Cash	Cash
Other payable						Net ROE (%)	22.7	22.4	19.6	16.3	4.0
Tax payable	(3.0)	(7.7)	(6.3)	(1.0)	(1.2)	EBIT ROCE (%)	22.3	21.9	18.7	16.4	3.4
Due to related co.s	(15.1)	0.0	0.0	0.0	0.0	Dividend payout (%)	-	23.8	219.1	76.5	373.0
ST debts						Effective tax rate (%)	0.5	2.4	3.9	4.9	3.3
Other current liab.	0.0	(0.3)	(0.3)	(0.3)	(0.3)	Net interest coverage (x)	na	na	na	na	na
LT debts						A/R turnover (days)	62.8	56.9	58.8	62.9	102.0
Other LT liabilities						A/P turnover (days)	49.2	45.8	43.1	41.7	57.7
Total liabilities	(123.7)	(123.6)	(141.8)	(151.8)	(120.0)	Stock turnover (days)	45.6	42.6	44.8	46.2	56.3
Share capital	0.0	10.4	10.4	10.4	10.4						
Reserves	439.3	722.6	751.4	672.9	598.9						
Shareholders' funds	439.3	733.0	761.7	683.3	609.3						
Minority interest	-	0.1	0.1	0.1	0.1						
Total	439.3	733.1	761.9	683.4	609.4						
Capital employed	439.3	733.1	761.9	683.4	609.4						
Net (debt)/cash	73.7	407.0	354.9	208.6	229.1						

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