

## Ming Fai International Holdings Limited

### New laundry service business expects to continue to record losses...

to summarize...

- The net profit of the Group for the six months ending 30 June 2012 is expected to decrease significantly as compared to the last corresponding period.
- The profit margin of the Group has been decreasing due to the increasing cost pressure in the PRC.
- The new business laundry service continues to record losses and the operating results of retail business "7 Magic" are expected to be lower.
- We estimate that revenue for full year FY12/12F to be HK\$1,490.7m, a 6% YoY increase, with HK\$1,301.4m contribution from the hotel and airlines amenities business and HK\$184.8m contribution from the retail business. We forecast net profit to be HK\$67.6m for FY12/12F.
- Our new DCF-derived target price is HK\$0.91 based on 2% terminal growth and 19% discount rate. We maintain our rating of Hold. The target price represents 9.8x FY12/12F P/E and 7.5x FY12/13F P/E.

**Company update:** The net profit of the Group for the six months ending 30 June 2012 is expected to decrease significantly as compared to the net profit for the last corresponding period. This is mainly attributable to (1) the profit margin of the Group has been decreasing due to the increasing cost pressure in the PRC (2) the new business laundry services continues to record losses and (3) the operating results of retail business "7 Magic" are expected to be lower.

Table 1. FY 12/11A result

12 months to Dec	Turnover (HK\$)	Gross Profit (HK\$)	Gross margin (%)	Pre-tax profit (HK\$)	Tax rate (%)	Net profit (HK\$)
FY 12/11A	1,475.4	323.5	21.9	90.2	25.2	71.7
FY 12/10A	1,085.9	303.4	27.9	135.9	19.3	116.1
YoY(%)	35.9%	6.6%		(33.6)		(38.3)

Source: Company data

**Earning forecast:** We estimate that revenue for full year FY12/12F to be HK\$1,490.7m, a 6% YoY increase, with HK\$1,301.4m contribution from the hotel and airlines amenities business and HK\$184.8m contribution from the retail business. We forecast net profit to be HK\$67.6m for FY12/12F. For FY12/13F we forecast revenue to be HK\$1,599.9m, a 6% YoY increase. With HK\$1,379.4m contribution from the hotel and airlines amenities business and HK\$215.9m contribution from the retail business. We forecast net profit to be HK\$72.7m for FY12/13F, representing a 8% YoY increase.

**Target price and our view:** Our new DCF-derived target price is HK\$0.91 based on 2% terminal growth and 19% discount rate. We maintain our rating of Hold. The target price represents 9.8x FY12/12F P/E and 7.5x FY12/13F P/E. We believe that the company is going through its rough patches due to the adverse market and operating condition in the current economics period. However, Ming Fai has a good reputation and a stable existing hotel & airlines amenities business. At the moment we're advising a hold rating on this stock counter.

### Last Reported Result

**FY12/11A Result:** The group reported annual result of FY12/11A. Revenue increased 35.9% YoY to HK\$1,475.4m. Gross profit of the period increased 6.6%

Please refer to important disclosures at the end of this report

Ticker	3828 HK
Rating	HOLD
Price (HK\$)	0.58
Target Price (HK\$)	0.91
12m Price Range (HK\$)	0.57-0.22
Market cap. (US\$m)	48.4
Daily t/o (US\$m)	0.1
Free float (%)	61.0

### Financial summary

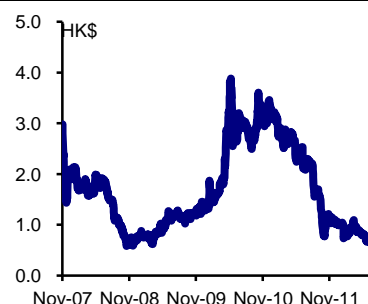
Year to Dec	09A	10A	11A	12F	13F
Turnover (HK\$)	811.3	1,085.9	1,475.4	1,490.7	1,599.9
Net Profit (HK\$)	96.3	109.7	67.5	67.6	72.7
EPS (HK\$)	0.163	0.184	0.107	0.093	0.122
P/E (x)	3.6	3.1	5.3	5.8	4.6
P/B (x)	0.44	0.36	0.37	0.34	0.31
EV/EBITDA (x)	(1.2)	0.9	1.4	1.0	0.6
Yield (%)	13.8	14.4	6.2	8.3	8.9
ROE (%)	12.4	12.4	6.7	6.3	6.3
ROCE (%)	14.1	14.4	8.5	8.0	8.0
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Source: SBI

	12F	13F
Consensus EPS (HK\$)	0.093	0.122

### Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	(7.8)	(21.7)	(68.9)
Actual price changes (%)	(7.9)	(28.4)	(73.6)



Source: Bloomberg

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YoY to HK\$323.5m. Operating profit of the period decreased 30.1% YoY to HK\$84.9m. Net profit decreased 38.3% YoY to HK\$71.7m. Earnings per share decrease by 42.6% to HK\$10.9 cents and propose a final dividend of HK\$3.5 cents per share.

**Business segments:** The hotel related business amounted to HK\$1,227.7m accounted for 83.2% of total sales compare to 81.1% in FY12/2010A. Net profit amounted to HK\$73.2m. The retail business accounted for 16% compare to 18.3% in sales, and amounted to HK\$33.3m in net profit. The 7 Magic businesses were acquired in FY2010, sales contribution started only for the last four months in 2010. The newly launched Laundry business widened loss to HK\$15m from a loss of HK\$2.8m in the previous year. The Parel business widened loss to HK\$8m from a loss of HK\$1.2m in the previous year. everyBody Labo business narrowed loss to HK\$3.7m from HK\$5.5m in the previous year.

**Margin:** The overall gross margin of the group dropped to 21.9% from 27.9%. The overall net margin of the group dropped to 4.6% from 10.1%. The dropped was mainly due to increase in cost of raw materials and labor. The hotel and airline business segment enjoyed a gross profit margin of 21% (FY12/10A: 27.4% 1H FY12/11A: 24.8%) and net profit margin of 4.6% (FY12/10A: 9.4% 1H FY12/11A: 9.2%). The 7 Magic business enjoyed a gross profit margin of 32.6% (FY12/10A: 33.9% 1H FY12/11A: 35.3%) and net profit margin of 14.5% (FY12/10A: 20.5% 1H FY12/11A: 22.1%). The everyBody Labo segment enjoyed a gross profit margin of 62.4% (FY12/10A: 71.8% 1H FY12/11A: 62.3%).

**Costs structure:** Among the cost, raw materials accounted for 72.7% compare to 73.6% in FY12/10A, staff costs accounted for 16.6% increased from 15.6%, utilities accounted for 2.2% decreased from 3.1%, and depreciation accounted for 1.8%.

**Table 2. Revenue breakdown by sales channels**

Sales Channels	31 Dec. 2009 (%)	31 Dec. 2010 (%)	31 Dec. 2011 (%)
Distribution Sales	61	57	55
Direct Sales	39	43	45
Total	100	100	100

Source: Company data

**Peers comparison:** The Hong Kong listed cosmetics and personal care peers are currently trading at average 16.6x FY12/12F fwd-P/E and 12.9x FY12/13F fwd-P/E based on market consensus. With the highest PE from L'Occitane trading at 22.0x FY12/12F fwd-P/E and 18.7x FY12/13F fwd-P/E based on market consensus. The China listed peers are currently trading at 38.4x fwd-FY12/12F and 30.2x FY12/13F fwd-P/E based on market consensus.

**Table 3. Valuation comparison**

Company name	Ticker	Mkt cap (US\$m)	Last Price (Local)	His P/E (x)	Curr-Yr P/E (x)	1-Yr P/E (x)	PB (x)	Est. ROE (%)
L'OCCITANE	973 HK	3,749.2	19.80	25.4	22.0	18.7	4.8	20.0
SA SA	178 HK	1,725.6	4.77	19.4	16.7	14.0	8.2	46.2
MAGIC	1633 HK	369.9	2.86	14.4	14.9	10.6	1.8	20.4
NATURAL BEAUTY	157 HK	295.2	1.15	20.0	12.8	8.2	2.9	14.7
WATER OASIS	1161 HK	99.9	1.02	7.7	-	-	2.7	30.7
MODERN BEAUTY	919 HK	95.2	0.85	7.6	-	-	1.9	15.6
VEEKO	1173 HK	54.1	0.19	6.9	-	-	0.7	13.7
<i>Average</i>				13.3	16.6	12.9		
Shanghai Jahwa-A	600315 CH	2,388.9	44.05	47.9	38.4	30.2	10.1	22.2

Source: Bloomberg

## Company Background

**Description:** Ming Fai International engages in the supply and manufacturing of amenity products to high-end hotel chains (4 and 5-star) and airlines. Its product lines include a wide range of personal care, toiletries, rooms and desk accessories. To move further downstream into the retail consumption market, they acquired a cosmetics retail business name "7 magic" or in Chinese "七色花" in the PRC in August of 2010.

**Hotel & Airline business model:** The group owns the plant facilities in Shenzhen, China to produce comprehensive range of amenity products. Other products that are not produce in-house are sourced from suppliers. Through this model they are able to offer a one-stop shopping service to luxury hotels and airlines operators. The group also has its own design team they allows them to offer a customization of products to enhance the brand image awareness of the hotel and airline operators.

**Client profiles:** The group's clients comprise of world renowned hotel and airline groups. Its top five customers are Accor Hotel group, Shangri-La Hotel group, and distributors. Together they accounted for close to 30% of this segment's revenue and around 25% of total revenue.

**Retail Business "7 Magic - 七色花":** The "7 Magic" retail networks sell cosmetics and skin care accessories targeting young female consumer age between 15 to 25 in the PRC. As of the end of Dec 31st, 2011, the sales network had 1,258 POS in China compare to 1,381 at the end of FY12/10A. All of the outlets are operating under a franchise model but three are self-owned. Among the sales network, 96% of the shops are located in second and third tier cities. Each shop has an average size of 50 sq. meter selling on average of 2,500 number of SKU items. The average selling price is ranging approximately from RMB10 to RMB60. Ming Fai is a major supplier of products to all "7

Magic's franchise stores. Including the eight series of self-owned label exclusively designed by Ming Fai. The merchandise is sold at 45% of retail prices to the franchisees.

**Table 4. Sales network**

Number of outlets	31 Dec. 2010	30 June 2011	31 Dec. 2011	2012 Forecast	2013 Forecast
Shops under franchise contracts	1,013	1,150	1,255	1,555	1,855
Unofficial dealers	366	359	-	-	-
Self-owned shops	2	3	3	3	3
<b>Total</b>	<b>1,381</b>	<b>1,512</b>	<b>1,258</b>	<b>1,558</b>	<b>1,858</b>

Source: Company data

**Franchise model:** Majority of the retail chains are operating under a franchise model and will continue to do so. New franchisee can apply for a start-up at a new point of sale by first finding a suitable location and submit to Ming Fai for approval. Ming Fai makes sure that there won't be any overlapping of shops within the 1.2KM radius. Each franchisee pays a franchise fee of around RMB10,000 per year, with the first three years paid up-front. Under the agreement, each shop designs, layouts and promotional activities are coordinated nationwide. Each franchisee must purchase merchandises directly from "7 Magic" at a 45% discount to the retail price.

**New Off-site Laundry:** To further becoming a one-stop hospitality solution for their customers, Ming Fai has started a new off-site laundry services. The operation was commenced in March 2011. The newly launched laundry service is catering to a hotel clusters in major cities. The new site was open at Jiangsu at the end of 2010. Clients are charged RMB \$18 (HK\$20) per room per day for the service.

**The everyBody Labo:** The everyBody Labo brand carries a full line of high-end body care product. Penetration through strategic partners' extensive sales network. Products are now in sales at Manning's and Harvey Nichols in Hong Kong since the end of 2010. Total points of sales up to over 180 in Hong Kong. Products have also entered the China market through around 80 distributors to counters in cosmetics shops.

**Table 5. Sales and earnings forecast**

(HK\$m)	2009A	2010A	2011A	2012F	2013F
Hotel & Airlines	811.3	1,001.1	1,227.7	1,301.3	1,379.4
Retails	-	84.8	229.5	184.8	215.9
Other	-	-	18.2	4.5	4.5
<b>Sales Total</b>	<b>811.3</b>	<b>1,085.9</b>	<b>1,475.4</b>	<b>1,490.7</b>	<b>1,599.9</b>
Gross Profit	234.6	303.4	323.5	314.4	337.7
Operating Profit	106.7	121.5	84.9	89.9	96.7
Profit before Tax	119.7	135.9	90.2	90.3	97.2
Tax	23.4	26.2	22.8	22.8	24.5
<b>Net Profit</b>	<b>96.3</b>	<b>109.7</b>	<b>67.5</b>	<b>67.6</b>	<b>72.4</b>

Source: Company data, SBI E2-Capital

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**BUY:** absolute upside of >10% over the next six months

**HOLD:** absolute return of -10% YoY to +10% over the next six months

**SELL:** absolute downside of >10% over the next six months

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