

Ming Fai International Holdings Limited

Expanding into a retail consumption play

to summarize...

- Ming Fai International engages in the supply & manufacture of amenity products to high-end hotel chains and airlines. And now it is expanding into the retail consumption market by acquiring the “7Magic - 七色花” retail networks that sells cosmetics, skin care, fashion and hair accessories.
- Last reported earnings was for FY12/10A. Revenue increased +33.8% to HK\$1,085.9m from HK\$811.3m in FY12/09A. Hotel business accounted for 92.2% and retail business accounted for 7.8%. Profit for the year increased +18.5% to HK\$116.1 from HK\$97.9m.
- To further become a one-stop hospitality solution for their customers, they begin to offer off-site laundry services. The newly launched laundry service is catering to a hotel clusters in major cities, with total capacity to accommodate up to 15,000 room per day upon completion.
- The “7Magic” retail networks targets young female age between 15 to 25 in the PRC. As at the end of 2010, the sales network had 1,381 POS targeting to add another 700 for 2011.
- With Ming Fai’s existing expertise and being able to self-design and self-produce will have a significant advantage over competitors. Currently the counter is trading at 11.5x current year fwd P/E and 7.8x 1-yr fwd P/E on consensus.

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 have acquired a cosmetics retail business name “7magic” or in Chinese “七色花” in the PRC in August of 2010.

Table 1. FY10A Result

12 months to Dec	Turnover (HK\$)	Gross Profit (HK\$)	Gross margin (%)	Pre-tax profit (HK\$)	Tax rate (%)	Net profit (HK\$)
FY10A	1,085.9	303.4	65.9	135.9	19.3	109.7
FY09A	811.3	234.6	63.2	119.7	19.6	96.3
YoY(%)	33.8	29.3		13.5		115.8

Source: Company data

Last Reported Financials: Ming Fai’s last reported earnings was for FY12/10A. Revenue increased +33.8% to HK\$1,085.9m from HK\$811.3m in FY12/09A. Gross profit increased +29.9% to HK\$303.4m from HK\$234.5m. Profit for the year increased +18.5% to HK\$116.1 from HK\$97.9m. Earnings per share attributable to equity holder increased +16.6% to HK\$19 cents from HK\$16.3 cents. Gross profit margin decreased -1.0pcp YoY to 27.9% from 28.9%. Operating profit margin decreased -1.9pcp YoY to 11.2% from 13.1%. Net profit margin decreased -1.8pcp YoY to 10.1% from 11.9%. The hotel related business accounts for 92.2% of total sales. The retail business accounts for 7.8% of the sales. Since the retail business is newly acquired, sales contribution is only for the last four months of 2010.

Hotel Related Business

Revenue Breakdown: The hotel related business has benefited from the global tourism recovery. Sales to the PRC accounted for 35.5%, North America accounted

Please refer to important disclosures at the end of this report

Ticker	3828 HK
Rating	NR
Price (HK\$)	2.16
Target Price (HK\$)	n.a.
12m Price Range (HK\$)	1.98-3.73
Market cap. (US\$m)	185.0
Daily t/o (US\$m)	0.7
Free float (%)	62.0

Financial summary

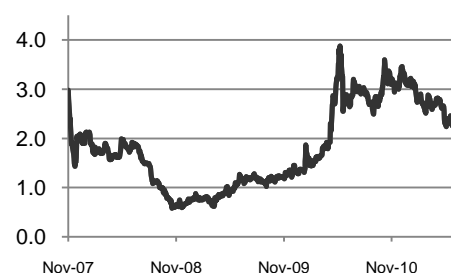
Year to Dec	08A	09A	10A
Turnover (HK\$)	876.0	811.3	1,085.9
Net Profit (HK\$)	100.8	96.3	109.7
EPS (HK\$)	0.170	0.184	0.163
P/E (x)	12.9	13.5	12.4
P/B (x)	1.82	1.70	1.46
EV/EBITDA (x)	5.1	5.0	6.5
Yield (%)	3.9	2.3	2.1
ROE (%)	14.2	13.1	12.9
ROCE (%)	19.5	18.6	18.8
N. Gear. (%)	Cash	Cash	Cash

Source: SBI

	11F	12F
Consensus EPS (HK\$)	0.278	0.378
Previous EPS (HK\$)	-	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	-4.0	-14.7	-34.4
Actual price changes (%)	-8.5	-18.8	-30.1



Source: Bloomberg

Baron Sun

(852) 2533 3715

baronsun@sbie2capital.com

for 35.7%, Europe accounted for 14.4%, Asia Pacific accounted for 9.7% and Australia accounted for 3.6%. Direct client sales increased to 43% from 39%. Sales to distributor accounts for 57% down from 61%. Among the cost, raw materials accounts for 73.6%, staff costs accounts for 15.6%, utilities accounts for 3.1%, and depreciation accounts for 2.1%.

Table 2. Revenue Breakdown (Geographic & Sales Channels)

Geographic	31 Dec. 2009 (%)	31 Dec. 2010 (%)	Sales Channels	31 Dec. 2009 (%)	31 Dec. 2010 (%)
China	39	35.7	Distribution Sales	61	57
North America	31	35.5	Direct Sales	39	43
Europe	16	14.4			
Asia Pacific	11	9.7			
Australia	3	3.6			
Others	0	1.1			
Total	100	100		100	100

Source: Company data

Production Capacity: Current annual production capacity is for 853 million pieces. The toiletries has annual capacity of 420 million pieces, soap production has capacity of 187 million pieces, gift set production (i.e. toothbrush, vanity, comb, shower cap. etc) has capacity of 246 million pieces. The existing utilization rate is currently running at 80% with target utilization increasing up to 85% - 90% for 2011. All of Ming Fai's customers are from top hotels and airlines.

Illustration 1. Clientele & Brands



Source: Company data

New Off-site Laundry Services: To further become a one-stop hospitality solution for their customers, Ming Fai has started a new off-site laundry services. The newly launched laundry service is catering to a hotel clusters in major cities. The new site is opened at Jiangsu in the late 2010. Clients are charged HK\$20 per room per day for the service. Currently they have two clients with combine of 780 rooms serviced per day. During the first phase of the operation, the current capacity can accommodate 5,000 hotel rooms per day. The second phase of the operation expansion will go into operation by July which can accommodate another 5,000 hotel rooms per day. For the third phase of the operation expansion, capacity can accommodate another 5,000 room, thus upon the completion of the entire expansion project, total capacity can accommodate up to 15,000 room per day for the off-site laundry services.

Growth Driver: The China hotel industry is experiencing robust growth with overall occupancy rate remain at 49%. Industrial research shows new hotels rooms in the pipeline are more than 120,000 rooms with half of these in the four to five stars hotels. There are also upgrade trend where three-star hotels are converting into four- or five-star hotels. Ming Fai should stand to benefit greatly since most of their clients are mainly four- or five-star hotels.

Retail Business

About “7Magic - 七色花”: The “7Magic” 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 2010, the sales network has 1,381 POS in China. All of the outlets are operating under a

franchise model but two 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 "7Magic"'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.

Products Breakdown: For the last four months in 2010, the retail business contributed HK\$84.7m (or 7.8%) of total turnover and contributed HK\$14.8m to the group's net profit. Currently the cosmetics and skincare products accounts for 39% of store sales, fashion and hair accessories accounted for 38%, toys and stationary accounts for 16% and other gift items accounts for 7%. The gross margin on the cosmetics & skincare productions is in a high range from 35% to 50%, fashion & hair accessories gross margin ranges approximately from 15 to 25%, toys & stationary gross margin ranges approximately from 15% to 25% and other gift items has gross profit margin ranges from 10% to 15%. Due to the higher margin from the cosmetics and skincare items, future strategies is to increase the sales of cosmetics and skincare items, targeting up to 50% of the retails sales.

Table 2. Product Breakdown & Gross Margin

	31 Dec. 2010 (%)	31 Dec. 2011 Target (%)	GP Margin (%)
Cosmetics & Skincare	39	50	35 – 50
Fashion & Hair Accessories	38	25	15 – 25
Toys & Stationary	16	10	15 – 25
Other Gifts	7	15	10 – 20
Total	100	100	

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 star-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 "7Magic" at a 45% discount to the retail price.

New Products: With the acquisition of "7Magic", there will be ample of rooms for Ming Fai to leverage on its expertise in developing new and exclusively products for retail sales. So far, the newly launched skincare line named "QQ Tomato" series targeting at teenagers has becomes a top-seller. And they have revived an older skincare series named "Little Cucumber" with new packaging, designed and new formula ingredients which also has becomes among the top-sellers.

Marketing Strategy: The advertising and promotional expenses are targeting to be around eight percent of the retail sales. The hiring of young and popular celebrities is use to generate brand awareness among the targeted consumer group. Currently the spokespersons are 罗志祥 and 萧亚轩, both are popular pop star among young Chinese market.

Acquisition Consideration: In August 2010, Ming Fai completed the acquisition of "7Magic" brand license and manufacturing facilities in Guangzhou. The total consideration of the acquisition was at RMB250m with RMB50m profit guarantee for 2011. The consideration was paid with RMB150m in cash and RMB100m in shares at issued price of HK3.07 per shares.

Future Plan

Increasing POS: The group plans to increase the number of new shops to 700, bringing the current 1,381 to around 2,000 POS in China by the end of 2011. In addition they have signed agreements with Wal-Mart to open shop-in-shop setup in each Wal-Mart outlets. Wal-Mart currently has 280 stores across the PRC. There are also plans to setup flagship stores in top tier cities such as Beijing, Shanghai, Chengdu, Dalian and Wuhan with purpose of brand building and introducing expansive product series.

Improving Efficiency: Ming Fai will implement a new comprehensive ERP system for all "7magic" retail networks in attempt to allow better monitoring of the inventory level of each product. They will upgrade the supply chain system by implementing in-store ERP and POS systems to better manage their franchise operators.

Valuation & Our View: Ming Fai has a good stable existing hotel-related business and an attractive retail business that's beginning to take shape. We feel that the retail business has a potential of becomes a significant contributor to the group's earning. With Ming Fai's existing expertise, we feel that being able to self-design and self-produce will give them a significant advantage over competitors by offering better quality, and at the same time has flexibility to cater to market demand changes. We also foresee that the gross margin of the retail business will improve with more sales of self-produced cosmetics and skincare items. Although Ming Fai is currently not a pure cosmetic consumption play, we can use the Hong Kong cosmetics peers as a reference point, since there might be a re-rating eventually when retails sales becomes a significant contributor. Currently the counter is trading at 11.5x current year fwd P/E and 7.8x 1-yr fwd P/E on consensus. The Hong Kong listed peers are currently trading on average at 17.0x current year fwd P/E and 15.4x 1-yr 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)	1-Yr P/E (x)	2-Yr P/E (x)	PB (x)	Est ROE (%)
SA SA	178 HK	1,761.8	4.90	22.0	21.6	17.4	12.2	32.9
Bonjour	653 HK	479.4	1.27	19.3	15.7	12.7	17.6	105.7
Magic	1633 HK	422.8	3.95	20.1	21.9	17.7	-	47.8

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Water Oasis	1161 HK	90.1	0.92	12.4	9.9	8.4	3.0	28.1
Ming Fai	3828 HK	185.0	2.16	11.5	7.8	5.7	1.4	13.1
Average				17.0	15.4	12.4		

Source: Bloomberg

Table 5. Historical P & L

Year to Dec (HK\$m)	2008A	2009A	2010A
Revenue	876.0	811.3	1,085.9
Cost of sales	(643.5)	(576.8)	(782.6)
Gross profit	232.5	234.6	303.4
Distribution Costs	(67.8)	(73.1)	(113)
Administrative expenses	(51.4)	(56.3)	(73.7)
Other Incomes	1.1	1.5	4.9
Profit from operations	114.3	106.7	121.5
Finance income	12.1	1.8	1
Finance costs	(5)	(0.5)	(0.8)
Share of Profit of associates company	0.1	0.1	0.2
Fair value gain on investment properties	-	11.6	14
Profit before tax	121.5	119.7	136
Income tax	(20.7)	(23.4)	(26.2)
Net profit	100.8	96.3	109.7

Source: Company data, SBI E2-Capital

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