# China Post E-Commerce

## Growth model of fashion brand management

*to summarize…*

- Emergence as fashion brand management platform since 2011
- Manage brands Angevil, Lamborghini, Gay Giano, Cour Carre and Due G
- Expecting to turn around in 2012 on strong retail and swimwear arm
- Further organic growth and M&A growth in HK luxury retail market
- Currently trading at 0.9x pre-derivative P/B 1H FY12/11A

**Emergence as fashion brand management platform since 2011.** Intcera High Tech was listed in Hong Kong in Jul 2000. It had extensive background in Taiwan and produced ceramic components of fibre optic connectors for telecom industry. It recognized consecutive years of losses and the listco was put under suspension. Joseph Lau originally planned to acquire 75% enlarged shares while applying for a whitewash waiver in early 2008. Consequently, through a series of placements and rights issues, his shareholding was diluted to below 30% without triggering GO by the end of the year. In 2009, the listco acquired 20% an E-commerce platform from Guangdong Postal Group and 53% of a media subsidiary from China Outdoor Media Group (0254 HK) and third party with listco name changed to China Post E-Commerce (CPEC) in April. In 2011, with a new direction, the listco acquired medium-to-high end apparels brands as well as a swimwear brand. At the same time, it is currently in the progress of disposing ceramic products business. The listco proposed to change its name to Luxey International (荟萃国际) to reflect its emergence towards a mid-to-high end retailer. Table 1 shows latest shareholding structure of the company.

**Table 1. China Post E-Commerce shareholders**

| | Current shareholding | Upon derivatives dilution |
|---|---|---|
| Ma Hoi Cheuk | 18.2% | 37.1% |
| Joseph Lau Chi Yuen | 19.6% | 13.5% |
| Senrigan Capital | 9.4% | 6.5% |
| Others and public | 52.8% | 42.9% |
| Total | 100% | 100% |

*Source: SBI E2-Capital*

**Penetrating into retail industry with business plan targets China and HK.** In March 2011, CPEC acquired a swimwear business which specialized in ladies bikini and girl's style swimsuits at an adjustable consideration of HK$390m with a profit guarantee of HK$20m at a fixed P/E of 19.5x (12 months ended Sep 2011). In April 2011, CPEC acquired 51% of a Lamborghini licensee at HK$42.5m with a mixture of cash, CB and common shares. In July, the company was granted a sole and exclusive license to use 3 trademarks, Gay Giano, Cour Carre as well as Due G. Table 2 shows a summary of trademarks engaged in 2011 and the role of CPEC.

**Table 2. Trademarks engaged in 2011 in the progress of emergence**

| Date | Trademark engaged | Business model | Point of sales by 2011 end |
|---|---|---|---|
| Mar 2011 | Angevil | OEM and ODM | 0 |
| Apr 2011 | Lamborghini | Design, QC & distribution | 22 |
| Jul 2011 | Gay Giano, Cour Carre, Due G | Design, QC & distribution | 10 |

*Source: SBI E2-Capital*

| Ticker | 8041 HK |
|---|---|
| **Rating** | **Not Rated** |
| Price (HK$) | 0.12 |
| Target Price (HK$) | n.a |
| 12m Price Range (HK$) | 0.09-0.3 |
| Market cap. (US$m) | 48.8 |
| Daily t/o (US$m) | 0.2 |
| Free float (%) | 54.6 |

***Financial summary***

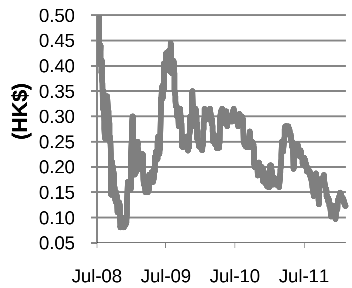
| Year to Dec | 08A | 09A | 10A |
|---|---|---|---|
| Turnover (HK$m) | 79 | 86 | 98 |
| Net Profit (HK$m) | (24) | (3) | (55) |
| EPS (HK$) | (0.00) | (0.00) | (0.03) |
| P/E (x) | - | - | - |
| P/B (x) | 3.80 | 1.82 | 2.22 |
| EV/EBITDA (x) | (20) | 254 | (8) |
| Yield (%) | - | - | - |
| ROE (%) | -25% | -2% | -25% |
| ROCE (%) | -20% | 1% | -28% |
| N. Gear. (%) | Net cash | Net Cash | Net Cash |

*Source: SBI E2-Capital*

| | 11F | 12F | 13F |
|---|---|---|---|
| Consensus EPS (HK$) | - | - | - |
| Previous earnings (HK$m) | - | - | - |
| Previous EPS (HK$) | - | - | - |

***Price performance***

| Year to Dec | 1m | 3m | 12m |
|---|---|---|---|
| Relative to HSI (%) | 29.9 | (28.1) | (4) |
| Actual price changes (%) | 39.8 | (21.7) | (21.7) |




*Source: Bloomberg*

**Research Team**
(852) 2533 3700
sbie2research@sbie2capital.com

**Summary on transactions in connection to the emergence.** Since the first acquisition of textile business completed on March 2011, CPEC have diversified its business model into an original equipment manufacturing (OEM) and original design manufacturing (ODM) of medium to high-ended apparel business. CPEC is now engaged in advertising and media services, manufacture and trading of high ended swimwear and related garment products and trading and retail of apparel business, and looks for further M&A opportunity to expand the clothing arm.

- **Granted the right to use the trademark of 'Angevil' and '安格薇', acquisition of Ratio Knitting.** CPEC acquired 100% equity interest in Ratio Knitting on 11 March 2011, which is engaged in manufacturing for and trading of high-end underwired styles swimwear and related garment products with an exclusive right to use the trademark 'Angevil' for 50 years for a total consideration of HK$390m. The consideration was satisfied as follow:
    - HK$260m by issuance of convertible preference share at issue price HK$0.15
    - HK$80m by issuance of consideration shares at issue price HK$0.15
    - HK$50m by 0% 5 years promissory notes

  Under the sales and purchase agreement, vendor (Mr Ma) made a profit Guarantee on the net profit before tax on 30 Sep 2011 not less than HK$20m and adjudicated tax liability not more than HK$4m. In the case of violation, no promissory notes shall be released and subjected to deduction no more than HK$130m via promissory notes and consideration shares. The deduction is calculated as follow: (Full-Year Guaranteed Profit – Full-Year Actual Profit) x 19.5 + difference between actual and estimated tax liability. Assuming there is no difference in actual and estimated tax payments, the profit guarantee effectively capped the acquisition valuation at 19.5x P/E unless actual net profit for the period was below HK$13.3m.

- **Granted the right to use the trademark of 'Tonino Lamborghini', acquisition of Charmston.** On 12 June 2011, CPEC acquired 51% ownership in Charmaston for total consideration of HK$42.5m. Charmaston, was found in 1991 to operate trading and retail of apparel, was wholly-owned by Mr Lee, and started as the licensee of 'Tonino Lamborghini in 1999. The trademark right allow company to manufacture, import, distribute, wholesales of advertise Tonino Lamborghini and related accessories for a term of 10 years up to 2015 in Hong Kong, Macau and China. The consideration was satisfied as follow:
    - HK$12.5m by issuance of 0% redeemable 1 year convertible bonds at convertible price HK$0.278
    - HK$15m by cash
    - HK$15m by issuance consideration share at issue price HK$0.278

  Under the sales and purchase agreement, vendor (Mr Lee) made a profit Guarantee on the net profit before tax on 30 Jun 2011 not less than HK$10m. In the case of violation, deduction will be made in the forms of cash or other agreed methods via the formula: (10,000,000 – 2011 Profit) x 8.33 x 51%. It locked acquisition valuation at 8.3x P/E.

- **Granted the right to use the trademark of 'Gay Giano, Cour Carre, & Due G', license agreement.** On 13 July 2011, CPEC's 51% subsidiary – Charmaston was granted a 20 years right to manufacture and sales the trademarks of Gay Giano, Cour Carre and Due G and take over 9 of the existing fashion apparel retail shops in Hong Kong. Charmaston shall pay the licensor an upfront fee and royalties on net profits of related products sold.

**Key management in place to carefully develop and execute business plan.** Joseph Lau and Eric Chung, chairman and CEO respectively, are experienced in finance and management with near 15 years experience in the field. For each of the major business segment, key personnel are in place. For instance, Billy Chan, who is in charge of E-Commerce segment, held senior positions in communications and IT enterprises. He was the Chief Consultant of internet products as well as business sales of New World Communications. He was a former sales department head of PCCW. Fanny Ng and Philip Lee were former Director and former head of sales of garment trading companies. The management team has sound expertise and business network in this new business direction. In fact, Philip is the founder of Charmston Group in 1991.

**Table 3. Experienced team in place to develop a fashion brand management platform**

| | Responsibility | Expertise field | Experience |
|---|---|---|---|
| Joseph Lau | Chairman | Finance, Merger and acquisition | 14 years+ |
| Eric Chung | CEO | Finance, account and management | 15 years+ |
| | | | |
| Billy Chan | E-Commerce | Communications and IT | 10 years+ |
| Fanny Ng | Swimwear | Garment | 20 years+ |
| Philip Lee | Retail | Fashion apparel retailing | 30 years+ |

*Source: SBI E2-Capital*

**Luxury retail market business**

**Ia) Tonino Lamborghini**

**Asset light retail platform on reputable Italian name.** Tonino Lamborghini began with Mr. Ferrucco Lamborghini, a highly respectful industrialist in the Italian history. He introduced of the very first sports Lamborghini car in 1963. Beginning from 1981, Tonino had diversified the Lamborghini business to a spectacular spectrum including men's wear, leather goods, watches, jewels, perfumes and other accessories with an image of high quality. Building on this platform, CPEC maintains an asset light business model. While there are retail points in HK, CPEC does not own any land or property for its production or retail outlets. As such, the company expects to stay defensive during tough operating environment and responses quickly during up-market. Some Lamborghini products are shown in illustration 1 in the following, including men's apparel as well as accessories:

**Illustration 1. Lamborghini products**


*Source: CPEC*

**Main product categories and historical financial performance.** Lamborghini continues to focus on men's apparel with 50%+ turnover from the sub-segment. The second largest contributor is fashion accessories, which contributed 20%-25% turnover in the track records disclosed in circular. While Lamborghini also provides other categories including women's apparel, leather goods and others, each of them also made up 5%-10% turnover. Table 4 shows turnover mix of Lamborghini products within CPEC universal. Table 5 shows key financial items of Charmston Group, which CPEC acquired 51% in 2011.

**Table 4. Lamborghini product category for CPEC in terms of turnover mix**

| | As percentage of turnover |
|---|---|
| Men's apparel | 50%-55% |
| Women's apparel | 5%-10% |
| Leather goods | 5%-10% |
| Fashion accessories | 20%-25% |
| Others – trading of fabrics | 10% |
| Total | 100% |

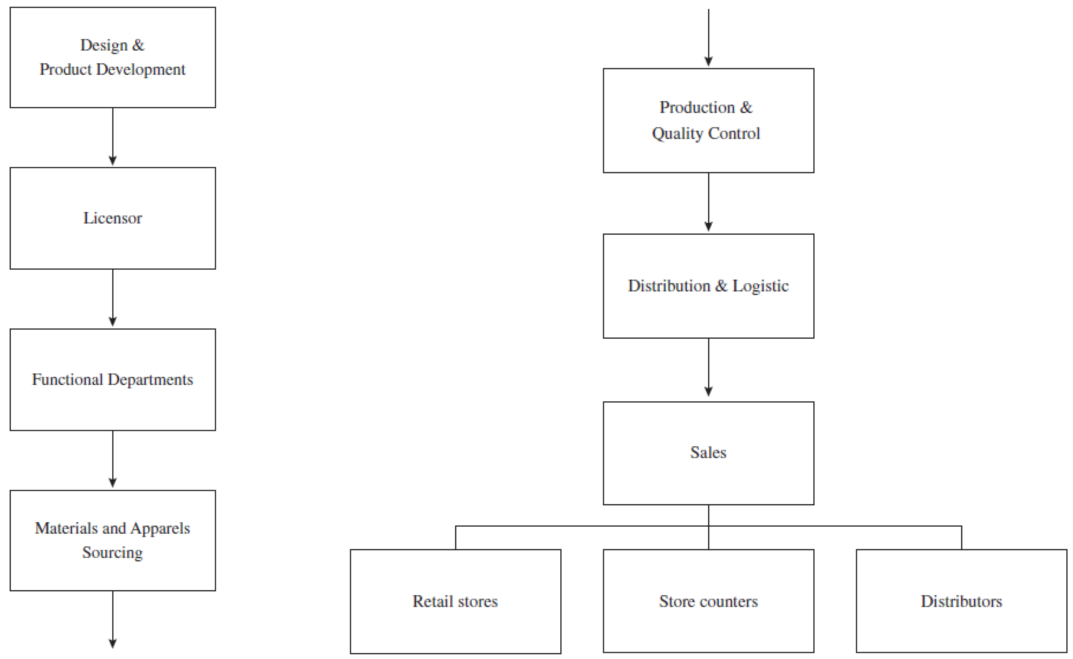
**Table 5. Historical financial items of Charmston Group (of which CPEC acquired 51%)**

| HK$m | FY06/08A | FY06/09 | FY06/10 |
|---|---|---|---|
| Turnover | 106.7 | 84.8 | 104.5 |
| Gross profit | 51.3 | 51.9 | 64.7 |
| Net profit | (2.5) | (5.4) | 5.4 |
| | | | |
| | End of Jun 2008 | End of Jun 2009 | End of Jun 2010 |
| Total asset | 62.7 | 69.6 | 73.8 |
| Total liabilities | 48.5 | 60.6 | 57.4 |
| Total equity | 14.2 | 9.0 | 16.4 |
| Cash and cash equivalents | 3.6 | 3.6 | 6.9 |

*Source: SBI E2-Capital*

**Business model for Lamborghini products.** For every season, CPEC develops new themes and fashion concepts for the upcoming collections, subject to approval by licensor on ideas, designs and materials. In order to keep abreast with the latest fashion trend, the in-house designers attend various fashion shows in Europe such as, Pitti Uomo fashion shows in Florence for menswear, Premiere Vision shows in Paris for fabric, Linea Pelle show in Bologna for leather accessories and Micam Shoevent in Milan for shoes. With optimal selection of suppliers and factories, CPEC places mass production orders and focus on quality control. Qualified finished products will be centralized in warehouse for distribution. CPEC sells Lamborghini products through self operated point of sales in Hong Kong and authorized distributors in Macau and China. The following flow chart on the next page illustrates design, production and sales process of Lamborghini products in Hong Kong, China and Macau.

**Flow chart 1. Design, production and sales process of Lamborghini products**




*Source: CPEC*

**Certain history of the licensee acquired.** The licensee acquired was appointed by Lamborghini in 1999 with 1 retail store and 2 department store counters in Hong Kong. With years of development, the licensee currently operates 12 retail stores as well as 10 department store counters by end of 2011. Table 6 shows the number of stories in different regions in HK. Noted that retail points are in HK as sales to Macau and China is achieved through distributors. Table 7 shows operation status of Lamborghini point of sales.

**Table 6. Retail stores and department store coutners owned by CPEC**

| | Number of stores |
|---|---|
| Retail stores | |
| HK Island | 3 |
| Kowloon | 4 |
| New Territories | 5 |
| | |
| Department store counters | |
| HK Island | 4 |
| Kowloon | 3 |
| New Territories | 3 |

**Table 7. Operation status of Lamborghini point of sales**

| | 2011A |
|---|---|
| HK | |
| Self-operated retail stores | 12 |
| Self-operated department store counters | 10 |
| Total self-operated point of sales | 22 |

*Source: SBI E2-Capital*

**Discussion on return portfolio – case study on Shun Tak retail store.** We understand Shun Tak retail store serves as flagship of Lamborghini which has superior operational performance. According to our checks, while monthly income is subject to seasonal factors, on average it lies between HK$500k and HK$700k a month. While gross profit range is relatively stable at 70% to 80%, operating margin range is potentially between 15% and 40% on heavy fixed cost such as rental and staff costs. Assuming monthly sales of HK$600k with 30% operating margin for a successful new retail store, investment may be recovered during the first or second year of operation on this asset light model, according to the management. While average performance of other point of sales may stay near the bottom of the ranges, 22 point of sales (including department store counters) may deliver up to HK$130m-180m sales and HK$20m+ operating profit contribution. Table 8 is an illustration on self-operated Shun Tak flagship store.

**Table 8. Illustration case of self-operated Shun Tak Flagship store in HK**

| | Shun Tak store |
|---|---|
| General background | |
| Location | Shop 251-254, 2/F, Shun Tak Centre |
| Property ownership | Rental |
| | |
| Income | |
| Expected average monthly gross sales | HK$500k to HK$700k |
| Indicated gross margin range | 70% - 80% |
| Indicated operating margin range | 15% - 40% |
| | |
| Capital employed | |
| Fixture and fittings | HK500k |
| Working capital – inventories and receivables | HK$1,000k |

*Source: SBI E2-Capital*

**Ib) Gay Giano and Cour Carre**

**Well established brand since 1980.** Gay Giano was first introduced in 1980 to market the premium customers in Europe, and later in 1991 established a brand Cour Carre to be medium end brands of ladieswear and menswear for modern professional and business executives. Cour Carre is becoming a well-known smart fashionable clothes mixed with accepted office wear in Hong Kong. The core concept of Cour Carre is to create a unique fashion experience for smart and youthful executives that address the desire of modern urbanites to stand out and impress. The main stream fashion style is from French, which the designers seek inspiration from the energy and craftsmanship. CPEC acquired via license agreement to use the trademark of **'Gay Giano, Cour Carré and Due G'** for 20 years from Goldpoly New Energy (686 HK) in 2011. These brands will be managed under a 51% owned subsidiary namely Charmston, by a new holding company namely Top Achiever while CPEC has granted a option to third party to acquire 20% of existing of Top Achiever's share capital. Pursuant the license agreement, CPEC had taken over 9 of the existing apparel retail stores in Hong Kong.

**Table 9. Cour Carre**


*Source: CPEC*

**Strategic store locations throughout the heart in Hong Kong.** Retail segment is one of the best prospective businesses in Hong Kong, for the first 11 months total retail sales increased 18% YoY, little affected by the European debt crisis and China slowdown in GDP growth. CPEC had expanded its retail selling points to 10 since the agreement was made on Jul 2011. The retail stores are located in the hot shopping malls for tourists and local, such as Festival Walk in Kowloon Tong, Langham Place in Mong Kok and Harbour City in Tsim Sha Tsui. Key selling channel is not limited to retail store, company is planning to establish numerous department store counters in famous shopping malls such as SOHO in Causeway Bay and utilizes its internet sales platform in www.babybamboo.net (which mainly operates in Hong Kong). According to the management, CPEC targeted to expand the number of retail stores for Cour Carre in Hong Kong to 15~18 in 2012 and 20~25 in 2013, and consider the possibility of modified brand in order to diversify into Chinese market.Ttable 10 layout the address for the Cour Carre retail stores in Hong Kong.

**Table 10. Stores Location**

| Location |
|---|
| Shop LG1-28, Festival Walk, Kowloon Tong, Kowloon |
| Shop UG 15, Citywalk, No 1 Yeung Uk Road, Tsuen Wan, NT |
| Shop B209 Basement 2, K11, 18 Hanoi Road, Tsim Sha Tsui Kowloon |
| Shop 052, G/F, Cityplaza 2, Taikoo Shing |
| Shop G35-37, Fashion World, Site 2 Whampoa Garden. Hunghom |
| Shop 38-39 Upper Ground Floor, China Hong Kong City, Tsim Sha Tsui |
| Shop UC2, Upper Concourse, APM, Millennium City , Kwun Tong |
| Shop 3, Level 3, Langham Place, 8 Argyle Street, Mongkok |
| Shop 103, 1/F, Style House, The Park Lane, Causeway Bay |
| Shop 2106, level 2, Harbour City, Tsim Sha Tsui, Kowloon |

*Source: CPEC*

**Discussion on return portfolio – case study on Langham Place.** Langham Place shopping mall, located in the heart of Mong Kok, is one of the landmarks in the Kowloon district. Cour Carre retail store located at level 3 of Langham Place, next to the elevator. We estimate the sales will be in the range between HK$400K and HK$700K per month. Assuming the retail price is the mark up at 5x of cost of goods sold implied the gross profit margin between 75% and 80%. The indicated net profit margin is around 25% to 40% depending on the season. We estimated the total sales of 10 retail stores, using the lowest range of profit. We took the lowest estimated profit because sales fluctuates domestically depending on season, coupled with Langham Place is the one of the most profitable. In general, medium brand apparel retail integrated with manufacturing can achieve in average around 20% net margins. The calculated total sales of 10 stores could be between HK$50m and HK$85m, with 20% operating margin implied operating profit is expected to be HK$10m+.

**Table 11. Illustration case of self-operated Langham Place**

| | Langham Place store |
|---|---|
| General background | |
| Location | Level 3, Langham Place |
| Gross floor area | n.a. |
| Property ownership | Rental |
| | |
| Income | |
| Expected average monthly gross sales | HK$400k ~ HK$700k |
| Indicated gross margin range | 75% ~ 80% |
| Indicated operating margin range | 20% ~ 40% |
| | |
| Capital employed | |
| Fixture and fittings | HK400k |
| Working capital – inventories | HK$600k |

*Source: SBI E2-Capital*

**Ic) Swimwear Segment.**

**Turning point to engage in appeal business – Swimwear and the trademark of Angevil.** Acquisition of **Ratio Knitting** was made on 11 March 2011, whose engaged in swimwear design and trading business with a trademark Angevil. Ratio Knitting incorporated in 1982 as a trading company of swimwear, in 2004 granted with quality approval licence from EU testing institute to distribute products in the EU. The business was sold 99% interest to Mr Ma in Sep 2010, and acquired 50 years trademark right of Angevil a month after the acquisition. Subsequently, CPEC acquired 99% interest in Ratio Knitting from Mr Ma for total consideration of HK$390m with 2011 profit guarantee of HK$20.0m, which implied the project 2011 P/E ratio under the profit guarantee was 19.5x and the actual 2010 implied P/E ratio was 25.4x. CPEC adopted original equipment manufacturing (OEM) and original design manufacturing (ODM) model to operate the appeal segment. OEM refers to a company is responsible for designing and building a product according to its own specifications then selling the goods to another company, which responsible for its distribution. The prior company produces the products on behalf of the later firm, after which the purchasing company markets the product under its own brand name.OCM refers to a company is responsible for designing and building a product as another company's requirements.

**High margin business, experienced management team.** Apparel manufacturing business's net margin normally around 7 to 10%, might even lower under current unfavourable market conditions. Pursuant company announcement, the swimwear business managed to maintain a relatively high profit margin at 18% in 2010, despite the various pressure on profitability such as increase in raw material costs coupled with appreciation in RMB and various other operation costs in China. According to company management, CPEC is confident to achieve its 2011 net margin around 20%. As an OEM or ODM business model, CPEC required to purchase raw materials for processing and manufacturing purpose, therefore changes in raw materials prices will directly affect the company profitability, which represent around 60 to 70% of total costs. Swimwear management team has years of experience in garment industry, and successfully procured fabric raw materials in off-season. Management of the Ratio Knitting:

- **Ms. Ng Suk fun, Fanny,** is the director and general manager of Ratio Knitting, who has over 20 years of working experience in the garment industry. She joined the company since 2005, and prior that she took a position as a director of AE continent company.
- **Ms. Wong Yan Chu,** is the technical consultant of Ratio Knitting with 40 years experience in swimwear industry, who joined the company since 2010. She was an ex-owner of Fung Lee Garment Factory between the period 1992 and 2009.
- **Ms. Yu Wai Yin, Vicky,** is the director of Ratio Knitting and Yofiel since 2010 with over 10 years of experience in the textile and garment industry. Vicky previously worked as a merchandiser in Leedro Limited from 1997 to 2000.

At the current stage, CPEC's processing partners are mainly located in Dongguan in China, while we see an opportunity to expand or diversify its processing facilities to Southeast Asia. For example, Cambodia, according to the EU-Cambodian textile agreement in 1999, Cambodian Garment manufacturers become both quota-free and duty-free to European counties, coupled with cheap labour force. Therefore, favourable operation condition coupled with increasing pressure in Chinese manufacturing sector, we are reasonably forecast CPEC will seek opportunities to diversify its manufacturing facilities to the Southeast Asia via M&A or self-develop. The expansion or diversification will induce organic growth along with improvement in profit margin. We expect the construction of new facility by CPEC can quickly ramp up to production in a year, due to swimwear business nature and its highly experience management team.

**Competitive in-house design endorsed by clients.** The swimwear industry is highly fashion driven business and therefore highly sensitive to changes in consumer preferences. CPEC has its own in-house design team which leads its success in the garment industry. The in-house designers of CPEC initiates original design ideas or develop previous ideas for its customers to develop new collections or series for coming seasons or years. CPEC also creates a one-stop service platform for its customers, that the in-design teams will assist customer to develop prototypes for the in-house designed, while manufacture some samples for reviews prior mass productions. In addition to design ideas, CPEC also co-develop various new materials for its costumers to differentiate from competitors and customers' need. For example, the design team co-operates with fabric vendors to co-develop new materials that with additional functions such as UV protection, fitness controlling, quick dry, long life and comfort materials for making new swimwear.

**Comprehensive product range.** As mentioned above, CPEC provides differentiate designs and materials for its clients. Its products include premium bikinis, tankinis, classic underwired styles swimwear, one-piece swimwear and pareo to kid's swimwear. The Table 12 illustrates the percentage distribution of product category.

**Table 12. Product Category**

| Product Category | % |
|---|---|
| Ladies' Bikini | 52% |
| Girl's Styles Swimsuit | 30% |
| Ladies Swimsuit | 13% |
| Others (e.g. Men's/Boy's Swimtrunks, Pareo, etc) | 5% |

*Source: CPEC*

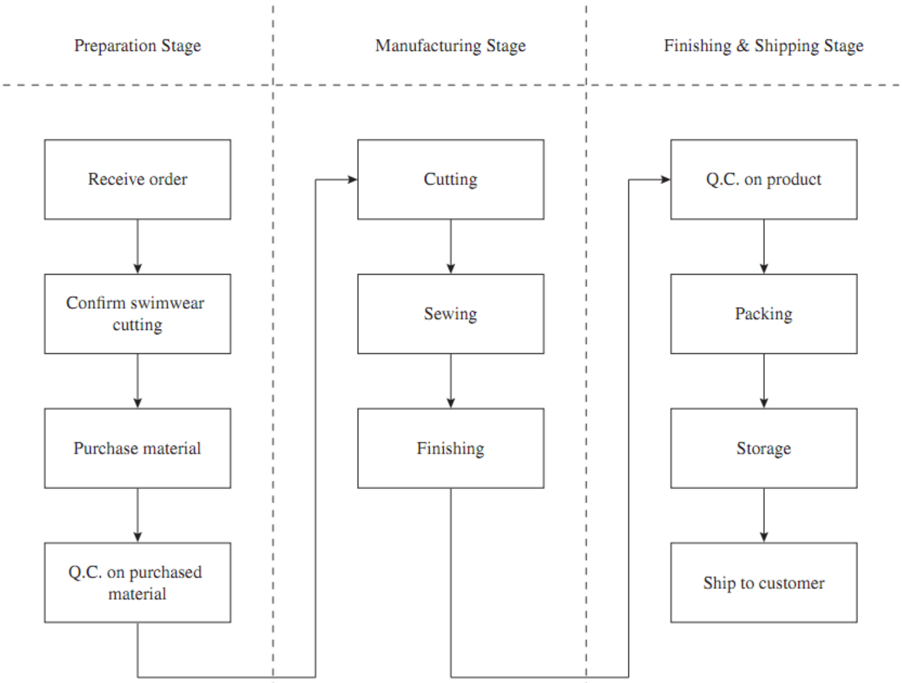
**The trademark – Angevil**, currently represents only small portion in term of total sales but bigger plan coming ahead. Angevil is an underwear designer label originated in South Korea for South Korean celebrities and subsequently introduced to China since 2007. Angevil has retail stores located throughout major cities in China. Angevil is a well-known brand in underwear industry, and therefore Angevil could serve as CPEC's stepping stone to enter into the female underwear market in China. CPEC started to assist the design and manufacturing of Angevil underwear products in 3Q 2011, in a small scales of 28,000 pieces, and further utilized its e-commerce arm to promote its high-end female underwear products both online and offline via internet and magazine media.

**Table 13. Angevil**

*Source: CPEC*

**Long term partnership with key 'processing partners'.** CPEC outsources the manufacturing operation via the processing arrangement with two state-owned partners namely 'Humen External Economic Development Company' and 'Dongguan External Manufacturing and Assembling Service Company' in Guangdong Province. Pursuant the agreement, CPEC will provide raw materials, supplemental materials and package materials necessary for production, and also bear all the transportation cost and insurance cost for both raw materials and finish products back and forth the factory. The processing partners have been co-operation with Ratio Knitting since April 1992, over 18 years of partnership. The products quality is the major concern under this type of agreements, while the long term relationship with the partners and strict quality control policy had lower the mismatch of finished product expectation, or worse-than expected outputs. The processing partners firstly perform on-production-line quality control and quality control of finished products on random sample base and prepare daily quality control report to monitor products quality and production efficiency. On the other hand, CPEC sends quality control (QC) personnel to perform on-site quality control before the shipment is made. The operation flow outlays as table 14 below:

**Table 14. Operation flow**




*Source: CPEC*

### Id) Future growth on retail business

**Organic growth of retail business.** To capture potential on further same-store-sales growth in HK market, CPEC targets to further improve its retail sales network in HK. The management believes that it would be optimal for CPEC to run 50 point of sales in HK. As such, the management expects to gradually increase point of sales from 37 by the end of 2011 to around 50 by the end of 2013. That said, CPEC may realize growth in both number of stores as well as SSS growth in the coming 1-2 years before attaining a more complete network covering area. Table 15 shows target stores opening plan for 2012F and 2013F. Table 15 and 16 show some of the places CPEC currently covered by its self-operated retail stores.

**Table15. Increase in number of stores**

| | 2011A | 2012F | 2013F |
|---|---|---|---|
| Retail stores | 24 | 27 | 30 |
| Department store counters | 13 | 16 | 20 |
| Total | 37 | 43 | 50 |

**Table 16. Places covered by CPEC self-operated retail stores**

| | | | | |
|---|---|---|---|---|
| Shun Tak Centre | Convention Plaza | Causeway Bay Centre | | |
| Festival Walk | Eaton Hotel | K11 | Cityplaza | Langham Place |
| China HK City | The Park Lane | Harbour City | Regal Kowloon Hotel | Grand Century Place |
| Whampoa Garden | | | | |
| Mega Box | APM | HK Airport | Hollywood Plaza | Tsuen Wan Plaza |
| Citywalk | | | | |

*Source: SBI E2-Capital*

**M&A opportunities ahead.** While Angevil serves as a cash cow to generate sufficient resources, we believe CPEC may utilize Charmston platform to further develop its retail business arm. Upon consolidation of Lamborghini into CPEC in 1H 2011, the company was granted the use of trademarks of Gay Giano, Cour Carre, & Due G shortly afterwards. We interpret this as the management's intention to build a strong portfolio of fashion brand and thus short-to-medium term growth is highly dependent on the retail arm with support from swimwear division.

### E-Commerce opportunities

**Groupbuy on the rise - Babybamboo.com.** In 2009, the listco acquired 20% an E-commerce platform from Guangdong Postal Group and 53% of a media subsidiary from China Outdoor Media Group (0254 HK), and third-party with listco name changed to China Post E-Commerce (CPEC) in April. In 2011, Babybamboo.com, a collective buying website under the company, has received 60,000+ subscribers. According to the management, with encouraging conversion factor of 90%+, the website itself is subject to slight loss in 2011 and expects to recognize a maiden profit in 2012. The management sees opportunities in online collective buying and react fast to changing market environment.

**Screen shot 1. Design, production and sales process of Lamborghini products**


*Source: CPEC*

### Risk factors and financial information

**Risk factors.** 1) CPEC may be subject to execution risk in connection to downstream expansion in both China and Hong Kong for its retail businesses; 2) Continual success of its acquired business is essential especially with its HK$496m goodwill, which may have direct impact on P&L; 3) CPEC emergence towards a brand management model posses challenges with respect to brand portfolio management and asset M&A execution ; 4) Upon full conversion, largest shareholder Ma Hoi Cheuk only control the company through a combination of ~12.8% common shares and ~24.3% convertible preference shares; 5) CPEC may issue new equity to finance expansion and acquisitions that leads to potential dilution. Table 16 and 17 are balance sheet and P&L summary respectively.

**Table 16. Balance sheet summary at period end**

| HK$m | FY12/08A | FY12/09A | FY12/10A | 1H FY12/11A |
|---|---|---|---|---|
| Non-current assets | | | | |
| Property, plant and equipment | 85 | 79 | 39 | 36 |
| Goodwill | 0 | 75 | 75 | 496 |
| Other non-current assets | 3 | 43 | 0 | 0 |
| | | | | |
| Current assets | | | | |
| Trade and other receivables | 29 | 61 | 87 | 137 |
| Bank balances and cash | 26 | 37 | 41 | 62 |
| Other current assets | 37 | 19 | 20 | 50 |
| | | | | |
| Non-current liabilities | | | | |
| Deferred tax liabilities | 15 | 15 | 7 | 5 |
| Promissory Notes | 12 | 0 | 0 | 39 |
| Deposit received | 0 | 0 | 0 | 4 |
| | | | | |
| Current liabilities | | | | |
| Trade and bills payables | 18 | 25 | 20 | 215 |
| Other current liabilities | 19 | 32 | 37 | 83 |
| | | | | |
| Equity | | | | |
| Total equity | 116 | 242 | 198 | 435 |

*Source: CPEC*

**Table 17. Profit and loss summary**

| HK$m | FY12/08A | FY12/09A | FY12/10A | 1H FY12/11A |
|---|---|---|---|---|
| Revenue | 79 | 86 | 98 | 73 |
| Cost of goods sold | (60) | (65) | (75) | (63) |
| Gross profit | 19 | 21 | 23 | 10 |
| | | | | |
| Operating expenses | (41) | (19) | (76) | (282) |
| Other expenses | (1) | (1) | (0) | (1) |
| Profit before tax | (23) | 1 | (53) | (273) |
| | | | | |
| Income tax expenses | (4) | (5) | (4) | (0) |
| Total net profit | (27) | (4) | (57) | (273) |

*Source: CPEC*

**Valuation.** While CPEC was loss-making, acquisition of profitable swimwear brand and retail business should contribute positively in 2012. With potentially organic growth as well as M&A growth, the management is confident to deliver high growth in next 2-3 years. For HK$435m total equity by the end Jun 2011, the counter is trading at 0.9x *pre-derivative* P/B.

SBI E2-Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. Find our research on: sbie2capital.com, thomsononeanalytics.com, factset.com and multex.com

**SBI E2-Capital stock ratings:**

**STRONG BUY :** absolute upside of >50% over the next three months

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

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

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

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