

Fragmented China lingerie market

China Consumer

Embry Holdings

Not Rated

Company profile. Founded in 1970's, Embry is a multi-branded H.K. lingerie manufacturer and retailers with production base in Shenzhen and Changzhou. It has a total of 1,080 outlets in both China and H.K., which consist of 64 self-operated stores and 1,016 concession counters. It carries its own brands, namely Embry Form, Fandecie, Comfit and LC with ASP ranging from RMB100 to RMB1,800. Apart from its own brands, its OEM segment accounted for 5.7% of total sales in 2005. China is Embry's major market, accounting for 84% of 1H06 sales followed by H.K. with 13%. According to the China Industry Research Center, Embry Form captured 12.4% of China's market share based on lingerie sales value in 2005, the largest on a national level, followed by Triumph and Maniform. The top ten best selling brands in China accounted for 67% of total market share in China. It plans to raise HK\$300m from an IPO in Hong Kong.

Table 1: No. of outlets

	China	HK	China + HK
self-operated stores	49	15	64
concessions	987	29	1016
Total	1,036	44	1,080

Source: Company data

Table 2: Current production capacity

Locations	units (a basic feature brassiere)	Usage
Shenzhen	6.6m	R&D + Production
Changzhou	5.2m	Production
Current capacity	11.8m	

Source: Company data

Table 3: Expected production capacity by 2008

Location	units (a basic feature brassiere)	Usage
Shandong	11.5m	Production
Current + expected capacity	23.3m	

Source: SBI E2-Capital

Strong demand for lingerie in China. According to "The Industry Research Report of China: Underwear Industry 2006", by China Industry Research Center, cotton underwear sales are expected to grow 20% p.a. in the next ten years.

Competition is intense and Embry does not have superior operating efficiency. Embry experienced slower sales growth compared with the +20% p.a. growth of the cotton underwear industry in China. Embry's sales actually slowed down from 18% in 2004 to 8.4% in 2005, despite the fact that it captured the largest market share in China in 2005. The market widely expects Embry to command a higher margin than OEM lingerie manufacturers since it carries its own brands. Although Embry's gross margin is very high at 75% compared to 30% by Top Form (333 HK), which is mainly an OEM lingerie manufacturer, Embry's operating margin of 10.2% is comparatively lower than Top Form's 15.7% in 2005. The above implies that 1) the lingerie market in China is fragmented and Embry does not possess a dominant market position, even though it captured the largest market share; 2) brand awareness is low in China and 3) competition is intense and Embry does not have superior operating efficiency. We see selling and distribution expenses as the major swing factor.

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Expansion plans. Embry expects to have 300 gross additional outlets by 2007, and to double its existing production capacity by 2008.

Valuation. The trading range of lingerie comparables, such as Brazin Ltd., Calida, Delta Galil, Hanesbrand, Maidenform, Tefron, Wacoal and Warnaco is between 13.1x to 19.4x 2007F, while Top Form only trades at 11x. Although it is in a net cash position, net cash reduced from HK\$131m in 2004 to HK\$25m in 2005. One positive point is that, there is no direct listed comparables for Embry in H.K.. It will draw some attraction from the market.

Table 4: Peer comparisons

Stock	Ticker	Mkt Cap (US\$m)	P/E (x)		Operating margin (%)	ROA (%)	ROE (%)
			06A	07F			
Top Form	333 HK	240.1	16.3	11.2	**9.96	15.96	25.66
Wacoal	3591 JP	1,800.2	n.a.	n.a.	6.8	1.6	1.8
Brazin Ltd.	BRZ AU	161.5	15.3	13.1	2.41	4.18	14.43
Calida	CALN SW	143.2	*21.0	18.4	5.21	5.77	8.8
Delta Galil	DELT US	185.0	n.a.	n.a.	(4.12)	(7.19)	(17.93)
Hanesbrand	HBI US	2,315.2	n.a.	14.4	9.69	7.07	11.06
Maidenform	MFB US	469.5	*20.4	18.7	8.77	(3.39)	(28.73)
Tefron Ltd.	TRF US	224.2	*12.5	n.a.	9.5	1.75	6.49
Warnaco	WRNC US	1,167.4	*24.9	19.4	6.74	4.38	8.61
Average			18.4	15.9	6.1	3.4	3.4

* Represents FY2005 figures

** Operating margin for Top Form is disrupted by the Sino-US & EU trade disputes in 2005/2006. Normally, operating margin is around 15%.

Source: SBI E2-Capital

Table 5: Financials

Year to Dec (HK\$m)	2003A	2004A	2005A
Sales	429	508	550
Operating profit	22	56	56
Net profit	15	45	46
YoY %			
Sales (%)	n.a.	18.4	8.3
Operating profit (%)	n.a.	154.5	0.0
Net profit (%)	n.a.	200.0	2.2
Key ratios:			
Margins %			
- Gross (%)	73.0	75.4	75.1
- Operating (%)	5.1	11.0	10.2
- Net (%)	3.5	8.9	8.4
Current ratio (x)	5.4	7.0	3.7
Gearing ratio	net cash	net cash	net cash
ROE (%)	4.3	11.0	15.7
Effective tax rate (%)	30.8	21.0	19.0

Source: Company data