

Hong Kong/ China

Sector

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100%+ upside for value investors



Potential for outsized returns. With the MSCI Hong Kong Small Cap Index 59.4% off its 12-month high, we see opportunities for long term investors to pick up value plays. We have identified three counters offering, on average, potential 100%+ returns over the next two to three years. Our selection includes two rated BUY calls and one conviction BUY call.

Near-term uncertainties. Our selected stocks are suitable for long-term investors who are prepared to weather current macro uncertainties and resulting counter volatility in the near term. We are well aware of near-term pressures and recommended companies with exposure to China's long-term investment themes, which remain intact despite the current global economic slowdown.

Emphasis on value and growth. Our list is based on the following criteria: 1) strategic business model and strong market positioning; 2) compelling valuation; 3) high growth and 4) solid balance sheet and cash flow. We have also evaluated the counters' relative liquidity.

SBI E2-Capital's Long-term Value Investment List

Company	Ticker	Recomm.	Share price*	Target price	Upside (%)
Anta	2020 HK	BUY	4.34	8.29	91
United Laboratories	3933 HK	BUY	2.27	6.00	164
Xinyu Hengdeli	3389 HK	NR	1.47	n/a	n/a

* All prices are as of market close of 8 Oct 2008

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100%+ upside for value investors

Value emerging in small/mid caps for long-term investors

The global credit crunch and sub-prime financial crisis pushed the HSI and HSCEI down 51.7% to 15,431.7 and 63.8% to 7,452.7, respectively, from their 12-month highs. Small/mid caps have been unable to escape this carnage and valuation-wise are trading significant discounts to large caps, despite their strong earnings growth momentum. The MSCI HK Small Cap Index fell 59.4% to 53.1 over the period and in our view, value is emerging in small/mid caps for investors with a two to three-year investment horizon. We see opportunities to pick up value plays and clock up outperformance.

Table 1 : Index valuations

	Year High Value	Year High % Chg	YTD Value	YTD % Chg	YTD Forward PER	YTD P/B
HSI	31,958.4	51.7	15,431.7	36.0	10.2	1.5
HSCEI	20,609.1	63.8	7,452.7	53.4	8.8	1.6
MSCI HK Small Cap	130.9	59.4	53.1	56.1	7.2	n/a

Note: YTD as at 8 Oct 2008

Source: Bloomberg

Back-to-basics approach

We adopt a “back-to-basics” approach in our stock selection, focusing on fundamentals. We target companies with a combination of: outsized returns, compelling valuations, strong earnings momentum and solid balance sheets. We have also assessed the stocks’ liquidity, which historically has been one of small/mid caps’ Achilles’ heel. We have identified a mini portfolio of small/mid cap counters with a low risk-to-reward ratio and, on average, potential for 100%+ returns over the next two to three years.

Selection criteria

In selecting our companies, we have looked for:

- *High growth* – average three-year CAGR of 28.3%;
- *Compelling valuation* – relative to their historical levels and comparable peers;
- *Liquidity* – six-month average daily trading volume of US\$1.0m and market cap of between US\$340m to US\$1,400m;
- *Solid balance sheets and cash flow* – net cash position or high interest coverage ratio, coupled with strong positive cash flow;
- *Strong market positioning* – strategic business models and strong market positioning within their respective industries.

Near-term uncertainties remain

Our stock selection is suitable for investors prepared to weather current macro uncertainties and resulting counter volatility in the near term. We are well aware of near-term pressures and recommended companies and all our picks have exposure to China’s long term investment themes, which remain intact despite the current global economic slowdown.

Our picks

Our picks are **Anta (2020 HK, HK\$4.34, BUY)**, China’s second largest sportswear retailer and **United Laboratories (3933 HK, HK\$2.27, BUY)**, one of China’s leading generic manufacturers poised to benefit from the government’s increasing rural and urban medical coverage spending. Our mini portfolio also includes a conviction BUY call, **Xinyu Hengdeli (3389 HK, HK\$1.40, NR)**, China’s largest retailer of Swiss luxury watches with around 35% of the market.

Company Profiles

Anta

Sportswear leader in China

Key points:

- Bright long-term outlook for China's sportswear industry
- China's second largest domestic sportswear brand with improving brand equity
- Gross margin to widen to 38.3% in FY12/08F
- Bottom line to grow at 3-year CAGR of 40.2%
- BUY with DCF derived target price at HK\$8.29, representing 16.2x FY12/09F P/E.

Industry overview

Robust market. China's sportswear market expanded rapidly over the past years (23.0% CAGR in 2003-2007). The growth moderated this year, partly due to the Sichuan earthquake in May. Though the current economic slowdown will depress the market in the short term, we believe the sector will remain healthy, maintaining a double digit-growth each year near term and strong long-term prospects.

Consolidation benefits leading brands. We estimate that aggregate retail sales of seven sportswear companies (Lining, Anta, Xtep, XDLong, China Dongxiang, Belle, Prime Success and Pou Sheng) surged 74.1% and 92.2%, respectively, in 2006 and 2007, which proves the strong market momentum while suggesting that the industry is under consolidation and leading brands are taking market share from smaller ones.

Company fundamentals

Growing brand equity. Anta is China's second largest domestic sportswear brand after Lining (2331 HK). With its abundant marketing resources and strong balance sheet, we expect the company to strengthen the brand, which will boost its selling prices. Through building brand equity, Anta has been able to improve its ASP (footwear from RMB47.5 per pair in FY12/04A to RMB92.1 in 1H FY12/08A) and market share (from 2.2% in FY12/04A to 11.7% in FY12/07A).

Expanding sales network. The number of retail stores reached 5,193 in Jun 2008 (net increase of 477 in 1H FY12/08A) and we expect it to top 5,500 by end-FY12/08F.

Manufacturing facilities. Anta owns manufacturing facilities in Fujian province (Jinjiang, Xiamen and Changting). Output in FY12/07A was 11.4m pairs of footwear, representing 62.5% of the shipment volume during the same period. The company plans to add 12 footwear production lines in FY12/08F, bringing the total number to 27. Nevertheless, we expect increasing outsourcing in the next three years. For apparels, the company started self-production in 2007 with an output of 1.0m pieces (4.3% of total sales volume). It intends to self-produce around 20.0% of apparels in the future as an intension to boost operating flexibility.

BUY (unchanged)

China Consumer

Wed, 08 Oct 2008

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Stock data

Price	HK\$4.34
Target price	HK\$8.29 (+91%)
12 mth range	HK\$4.15-12.2
Market cap.	US\$1388.8m
Daily t/o, 3 mth	US\$3.7m
Free float %	27.7%
Ticker	2020.HK/2020 HK

Financial summary

Year to Dec	06A	07A	08F	09F	10F
T/O (RMBm)	1,250.13	1,825.54	703.56	1,822.27	829.0
NP (RMBm)	147.4	537.8	843.91	1,590.01	483.4
EPS (RMB)	0.082	0.253	0.339	0.465	0.596
EPS Δ %	203.3	208.4	34.2	37.3	28.0
P/E (x)	48.2	15.6	11.6	8.5	6.6
P/B (x)	29.85	2.37	2.04	1.79	1.57
EV/EBITDA (x)	61.0	13.7	7.7	5.1	3.5
Yield (%)	-	1.8	5.1	7.1	9.2
ROE (%)	84.5	24.5	18.8	22.5	25.3
ROCE (%)	73.7	21.3	18.3	23.4	27.8
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	+4.6	+10.1	-4.4
Actual price changes (%)	-19.0	-22.5	-47.0

	08F	09F	10F
Consensus EPS (RMB)	0.321	0.437	0.532
Previous forecasts (RMBm)	843.9	1,159.0	1,483.4
Previous EPS (RMB)	0.339	0.465	0.596

Price Chart

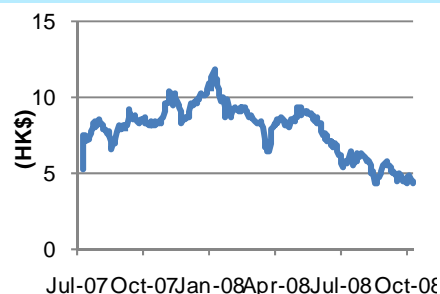


Table 1: Anta's main marketing resources

Sports events	Activities / sponsorship
Olympic Games	Launched "I Believe" promotional activities
CBA	Designated partner for equipment (2004 - 2007) Equipment sponsorship contract (2006 - 2012)
China Table Tennis Super League	Sole equipment sponsor (2005 - 2008)
China National Volleyball League / Grand Prize Cup / Championship Cup	Sole equipment sponsor (2003 - 2006) Title sponsor (2007 - 2009)
Dalian International Marathon	Sole equipment sponsor (2008)
NBA	Strategic alliance partner of Houston Rocket

Source: Company data

Cash rich. The company had RMB3,299.7m cash (nil debt) at the end of 1H FY12/08A. Total capex for the three-year period from FY12/08F to FY12/10F is projected to be RMB491.4m. Marketing expenses will be well covered by operating income. Hence we expect the company to raise its dividend payout ratio to 59.0% in FY12/08F (FY12/07A: 33.8%).

Gross margin. We estimate the blended gross margin to widen 5.1pcp in FY12/08F to 38.3% backed by: 1) 7.5% increase in footwear ASP to RMB94.6 and 5.5% in apparel ASP to RMB56.5; 2) better economies of scale, which would bring down unit costs such as fixed cost and commission paid to sub-contractors, as well as soften costs pressure from raw materials and direct labor. Excluding the discontinued retail business, the gross margin expanded 5.1pcp in 1H FY12/08A to 38.9%.

Forecast and valuation. We expect the company's top line to grow at a 35.0% CAGR from FY12/07A to FY12/10F. Meanwhile, net profit is projected to rise from RMB537.8m in FY12/07A to RMB1,483.4m in FY12/10F (CAGR: 40.2%). Our DCF derived target price for the counter is HK\$8.29, representing 16.2x FY12/08F P/E. **BUY.**

Table 2: P&L

Year to Dec (RMBm)	06A	07A	08F	09F	10F
Turnover	1,250.1	3,182.5	4,703.5	6,182.2	7,829.0
Cost of sales	(936.9)	(2,127.2)	(2,903.4)	(3,752.7)	(4,690.6)
Gross profit	313.2	1,055.3	1,800.0	2,429.5	3,138.3
Other revenue	2.0	137.8	166.7	136.5	146.5
Other net (loss) / income	0.5	(1.6)	0.0	0.0	0.0
Selling and distribution expenses	(132.3)	(476.1)	(813.7)	(989.1)	(1,252.6)
Administrative expenses	(35.3)	(114.5)	(212.8)	(241.0)	(261.2)
Profit from operations	148.3	600.9	940.2	1,335.8	1,770.9
Finance costs	(0.3)	(1.7)	0.0	0.0	0.0
Profit before taxation	148.0	599.1	940.2	1,335.8	1,770.9
Income tax	(0.6)	(61.3)	(96.3)	(176.8)	(287.6)
Profit for the period	147.4	537.8	843.9	1,159.0	1,483.4
Attributable to:					
Equity holders of the Company	147.4	537.8	843.9	1,159.0	1,483.4
Minority interests	-	-	-	-	-
EPS - Basic (RMB)	0.082	0.253	0.339	0.465	0.596
EPS - Diluted (RMB)		0.252	0.338	0.465	0.595
Proposed DPS (HK\$)		0.080	0.220	0.310	0.400
Proposed dividend	22.9	181.9	498.0	701.7	905.5

Source: Company data, SBI E2-Capital

P & L (RMBm)	06A	07A	08F	09F	10F
Year to Dec					
Turnover	1,250.1	3,182.5	4,703.5	6,182.2	7,829.0
% chg	86.5	154.6	47.8	31.4	26.6
Gross profit	313.2	1,055.3	1,800.0	2,429.5	3,138.3
EBITDA	159.2	503.4	862.4	1,256.2	1,694.9
Depre./amort.	(12.2)	(29.8)	(42.2)	(50.4)	(64.0)
EBIT	147.0	473.6	820.2	1,205.8	1,630.9
Net int. income/(exp.)	1.0	125.5	120.0	130.0	140.0
Exceptionals					
Associates					
Jointly-controlled entit.					
Pre-tax profit	148.0	599.1	940.2	1,335.8	1,770.9
Tax	(0.6)	(61.3)	(96.3)	(176.8)	(287.6)
Minority interests					
Net profit	147.4	537.8	843.9	1,159.0	1,483.4
% chg	206.9	264.8	56.9	37.3	28.0
Dividends	(22.9)	(181.9)	(498.0)	(701.7)	(905.5)
Retained earnings	124.6	355.9	345.9	457.3	577.9
EPS (RMB) - Basic	0.082	0.253	0.339	0.465	0.596
EPS (RMB) - F.D.	0.082	0.252	0.338	0.465	0.595
DPS (HK\$)		0.080	0.220	0.310	0.400
No. sh.s o/s (m) - W.A.	1,800.0	2,129.3	2,490.0	2,490.0	2,490.0
No. sh.s o/s (m) - Y.E.	1,800.0	2,490.0	2,490.0	2,490.0	2,490.0
No. sh.s o/s (m) - F.D.		2,133.2	2,493.9	2,493.9	2,493.9
Margins (%)					
Gross	25.1	33.2	38.3	39.3	40.1
EBITDA	12.7	15.8	18.3	20.3	21.6
EBIT	7.0	14.9	17.4	19.5	20.8
Pre-tax	11.8	18.8	20.0	21.6	22.6
Net	11.8	16.9	17.9	18.7	18.9
Balance Sheet (RMBm)	06A	07A	08F	09F	10F
Year to Dec					
Fixed assets	160.8	328.4	421.1	553.5	665.0
Intangible assets	3.6	4.2	3.9	3.5	3.2
Other LT assets	100.8	162.1	138.7	153.4	148.9
Cash	181.2	3,233.1	3,539.2	3,816.0	4,224.9
Accounts receivable	202.1	467.7	691.3	908.6	1,150.7
Other receivables					
Inventories	154.5	434.8	642.6	844.6	1,069.6
Due from related co.s	52.2	0.3	0.3	0.3	0.3
Other current assets	1.2	0.0	0.0	0.0	0.0
Total assets	856.4	4,630.7	5,437.0	6,280.0	7,262.6
Accounts payable	(325.1)	(455.7)	(622.0)	(804.0)	(1,004.9)
Other payable					
Tax payable					
Due to related co.s	(1.6)	(1.5)	(1.5)	(1.5)	(1.5)
ST debts	(50.0)	0.0	0.0	0.0	0.0
Other current liab.	(241.8)	(22.9)	0.0	0.0	0.0
LT debts					
Other LT liabilities	0.0	0.0	0.0	0.0	0.0
Total liabilities	(618.4)	(480.0)	(623.5)	(805.4)	(1,006.4)
Share capital	51.2	241.7	249.0	249.0	249.0
Reserves	186.7	3,909.0	4,564.5	5,225.5	6,007.2
Shareholders' funds	237.9	4,150.7	4,813.5	5,474.5	6,256.2
Minority interest					
Total	237.9	4,150.7	4,813.5	5,474.5	6,256.2
Capital employed	287.9	4,150.7	4,813.5	5,474.5	6,256.2
Net (debt)/cash	131.2	3,233.1	3,539.2	3,816.0	4,224.9

Cash Flow (RMBm)	06A	07A	08F	09F	10F
Year to Dec					
EBIT	147.0	473.6	820.2	1,205.8	1,630.9
Depre./amort.	12.2	29.8	42.2	50.4	64.0
Net int. paid	1.0	125.5	120.0	130.0	140.0
Tax paid	(1.0)	(38.5)	(119.1)	(176.8)	(287.6)
Dividends received					
Gross cashflow	159.3	590.4	863.3	1,209.4	1,547.4
Chgs. in working cap.	(2.7)	(335.6)	(240.8)	(237.4)	(266.1)
Operating cashflow	156.5	254.8	622.5	972.0	1,281.3
Capex	(83.4)	(264.4)	(141.3)	(197.2)	(170.7)
Free cashflow	73.1	(9.5)	481.2	774.8	1,110.6
Dividends paid	(1.6)	(21.3)	(181.1)	(498.0)	(701.7)
Net distribution to MI					
Investments	(1.2)	0.0	0.0	0.0	0.0
Disposals	1.1	0.1	6.0	0.0	0.0
New shares	0.0	3,371.5	0.0	0.0	0.0
Others	(11.6)	(238.9)	0.0	0.0	0.0
Net cashflow	59.8	3,101.9	306.1	276.8	408.9
Net (debt)/cash - Beg.	71.4	131.2	3,233.1	3,539.2	3,816.0
Net (debt)/cash - End.	131.2	3,233.1	3,539.2	3,816.0	4,224.9

Interim Results (RMBm)	06A	07A
Six months to Jun		
Turnover	494.2	1,497.7
% chg		203.1
Profit from operations	53.7	234.3
Interest expenses	(0.2)	(1.4)
Associates		
Jointly-controlled entit.		
Pre-tax profit	53.5	232.9
Tax	(0.6)	(29.6)
Minority interests		
Net profit	52.9	203.3
% chg		284.6
EPS (RMB) - Basic	0.029	0.113
DPS (RMB)		

Shareholding Structure	Shares o/s (m)	%
Ding Shijia & Ding Shizhong	1,498.5	60.2
Ding Yali	175.5	7.0
Ding Hemu	126.0	5.1
Others	690.0	27.7
Total	2,490.0	100.0

Background
Anta was established by Mr. Ding Shiren in 1994. After yeas of expansion, the company has become a leading domestic sportswear company. It wholesale footwear, apparels and accessories to distributors across the country. In May 2008, the company quit from distribution of international brand.

Key Ratios	06A	07A	08F	09F	10F
Net gearing (%)	Cash	Cash	Cash	Cash	Cash
Net ROE (%)	84.5	24.5	18.8	22.5	25.3
EBIT ROCE (%)	73.7	21.3	18.3	23.4	27.8
Dividend payout (%)	15.5	33.8	59.0	60.5	61.0
Effective tax rate (%)	0.4	10.2	10.2	13.2	16.2
Net interest coverage (x)	na	na	na	na	na
A/R turnover (days)	45.0	38.4	45.0	47.2	48.0
A/P turnover (days)	61.5	44.8	41.8	42.1	42.2
Stock turnover (days)	41.6	50.6	67.7	72.3	74.5

United Laboratories

Rare pricing power

Key points:

- World's largest producer of 6-APA intermediates and China's leading antibiotics supplier
- Based on the 11th Five-year Plan, medical insurance coverage will be available to all citizens by 2010
- Sizeable overseas exposure (23.4% of revenues in FY12/07A), including supplying to global giant, Wyeth
- Net profit CAGR of 20.6% from FY12/07A to FY12/10F
- Hong Kong bourse's largest pharmaceutical play with an earnings base of HK\$510.5m in FY12/07A
- Attractive entry level, hence our BUY call and target price of HK\$6.00, representing 9.0x FY12/09F P/E

Industry overview

Healthcare reform. China's healthcare sector reform is high on the agenda of the government's 11th Five-year Plan. The government aims to extend 100% medical coverage to all citizens by 2010.

High industry growth sustained. In 2007, pharmaceutical sales increased 24.9% YoY to RMB639.3b, with chemical medicines up 23.6%, chemical raw materials 25.1% and Chinese medicines 24.1%. In the first two months of 2008, total pharmaceutical sales rose 25.3% YoY to RMB110.6b.

Company fundamentals

Competitive advantage. In 2002, the government allowed ULI to set prices of five of its finished antibiotics above standard caps imposed by the NDRC and SFDA, giving the company a significant competitive advantage and allowing it to achieve above-average margins. In FY12/07A, the operating margin of its finished product segment was 24.3%, against the industry average of around 15.0%. We estimate that the five concession products generated HK\$485.0m in revenue, or 50.2% of the company's finished product revenue, in FY12/07A.

High market share. ULI's oral Amoxicillin (阿莫仙) and oral Ampicillin (安必仙), which are among the five finished antibiotics with price concessions, were the most popular antibiotic products purchased in 2004-2006 by 257 hospitals surveyed by the China Pharmaceutical Association. In that particular survey, 安必仙 accounted for 85.1-90.5% of the same type antibiotics purchased by the sample hospitals and 阿莫仙 for 50.5-65.3% over the survey period.

Sales force fit for targeting rural expansion. With a sizeable sales force (2,200 at end-1H 2008), the company is well positioned to tackle the rapidly expanding rural healthcare market, which we expect to fuel demand for generic medicines such as antibiotics. Medicine sales in rural areas jumped from RMB17.8b in 2003 to RMB58.0b in 2007 (CAGR of 34.4%).

World's largest 6-APA producer. ULI is also the world's largest supplier of 6-APA intermediates. We estimate that, including its

BUY (unchanged)

China Pharmaceuticals

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Stock data

Price	HK\$2.27
Target price	HK\$6.00 (+164%)
12 mth range	HK\$2.10-7.20
Market cap.	US\$349.2m
Daily t/o, 3 mth	US\$1.0m
Free float %	27.9%
Ticker	3933.HK/3933 HK

Financial summary

Year to Dec	06A	07A	08F	09F	10F
T/O (HK\$m)	2,080.52	2,594.93	2,962.34	1,957.4	634.2
NP (HK\$m)	173.8	510.5	681.5	796.8	896.1
EPS (HK\$m)	0.145	0.425	0.568	0.664	0.747
EPS Δ %	49.1	193.6	33.5	16.9	12.5
P/E (x)	15.7	5.3	4.0	3.4	3.0
P/B (x)	2.1	1.1	1.0	0.8	0.7
EV/EBITDA (x)	34.5	7.4	5.8	4.4	3.5
Yield (%)	-	7.5	8.8	10.2	11.5
ROE (%)	15.0	27.1	26.3	26.2	25.4
ROCE (%)	18.3	26.9	29.4	29.5	30.1
N. Gear. (%)	80.7	33.0	49.0	26.0	13.1

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	(12.2)	(35.9)	(28.4)
Actual price changes (%)	(32.0)	(54.9)	(45.4)
	08F	09F	10F
Consensus EPS (HK\$)	0.565	0.700	0.825
Previous forecasts (HK\$m)	-	-	-
Previous EPS (HK\$)	-	-	-

Price Chart



5,000 tonne/year Inner Mongolia plant, ULI accounts for 36.9% of China's 6-APA manufacturing capacity, which represents about 29.5% of the global total (China accounts for 80-90% of the global 6-APA output).

Export credentials to boot. ULI sells its intermediate and bulk medicine products to Germany, South Korea and India. The company is China's only manufacturer to obtain both the Certificate of Suitability (from the European Directorate for the Quality of Medicines) and GMP certification (from SFDA) for its Amoxicillin bulk medicines. Overseas sales accounted for 23.4% of overall revenues in FY12/07A. The segment grew at a 3-year CAGR of 72.4% from FY12/04A to FY12/07A.

Beneficiary of new environmental standards. We expect the new "Water Pollution Discharge Standards for the Chemosynthesis Pharmaceutical Industry (制药工业污染物排放标准)" (issued on 1 Aug 2008), which lift the discharge standard from the current 300 COD to 120 COD by 2010, to benefit ULI as it will: 1) force out small players; 2) accelerate consolidation and 3) raise entry barriers. ULI will escape largely unaffected as all of its environmental systems are designed to meet the new requirements.

Comfortable with net gearing. The company's net gearing of 49.0% for 1HFY12/08A is a bit high in part due to its aggressive expansion strategy. However, we are comfortable with this level given: 1) ULI's good track record; 2) cash position of HK\$830.8m at end-1H FY12/08A; 3) strong operating cash flow (HK\$348.9m in FY12/08F) and 4) adequate interest coverage of 7.4x (FY12/08F).

Valuation and forecast. We project ULI's net profit to grow from HK\$510.5m in FY12/07A to HK\$896.1m in FY12/10F, representing a 3-year CAGR of 20.6%. We like ULI for its vertically integrated model (which brings margin stability), leadership in 6-APA and finished antibiotic products in China and overseas export exposure. Our BUY call comes with a target price of HK\$6.00, representing 10.0x FY12/08F and 9.0x FY12/09F P/E, derived from a sum-of-the-parts valuation. The company's strong market position and large earnings base warrant a premium over peers.

Table 1: P&L

Year to Dec (HK\$m)	06A	07A	08F	09F	10F
Turnover	2,080.5	2,594.9	3,962.3	4,195.7	4,634.2
Cost of sales	(1,344.2)	(1,389.2)	(2,318.0)	(2,298.5)	(2,524.3)
Gross profit	736.3	1,205.8	1,644.3	1,897.2	2,110.0
Other income and gains	9.9	25.8	25.0	16.0	19.2
Selling and distribution costs	(284.1)	(381.5)	(488.9)	(562.5)	(625.6)
Administrative expenses	(123.0)	(173.3)	(209.5)	(241.1)	(268.1)
Other operating expenses	(37.8)	(38.4)	(10.0)	(10.0)	(10.0)
Operating profit	301.3	638.3	960.9	1099.6	1,225.4
Finance costs, net	(85.5)	(80.0)	(129.8)	(103.6)	(76.6)
Share of results of an associate	(2.7)	-	-	-	-
Gain on disposal of an associate	8.6	-	-	-	-
Profit before taxation	221.8	558.3	831.1	996.0	1,148.9
Taxation	(47.9)	(47.9)	(149.6)	(199.2)	(252.8)
Profit after tax	173.8	510.5	681.5	796.8	896.1
Minority interests	-	-	-	-	-
Profit attributable to shareholders	173.8	510.5	681.5	796.8	896.1

Source: Company data, SBI E2-Capital

P & L (HK\$m)	06A	07A	08F	09F	10F	Cash Flow (HK\$m)	06A	07A	08F	09F	10F
Year to Dec						Year to Dec					
Turnover	2080.5	2594.9	3962.3	4195.7	4634.2	EBIT	301.4	638.3	960.9	1,099.6	1,225.5
% chg	20.9	24.7	52.7	5.9	10.5	Depre./amort.	194.0	186.6	267.7	298.4	304.2
Gross profit	736.3	1205.8	1644.2	1897.2	2110.0	Net int. paid	(85.5)	(80.0)	(129.8)	(103.6)	(76.6)
						Tax paid	(54.3)	(72.0)	(149.6)	0.0	(199.2)
EBITDA	107.4	451.7	693.2	801.1	921.3	Dividends received	0.0	0.0	0.0	0.0	0.0
Depre./amort.	194.0	186.6	267.7	298.4	304.2	Gross cashflow	368.0	683.3	790.5	1,089.5	992.7
EBIT	301.4	638.3	960.9	1099.6	1225.5	Chgs. in working cap.	(82.5)	(323.0)	(441.6)	(39.6)	(53.8)
Net int. income/(exp.)	(85.5)	(80.0)	(129.8)	(103.6)	(76.6)	Operating cashflow	285.5	360.3	348.9	1,049.9	938.8
Exceptionals	8.6	0.0	0.0	0.0	0.0	Capex	(146.9)	(824.0)	(812.5)	(342.5)	(347.5)
Associates	(2.7)	0.0	0.0	0.0	0.0	Free cashflow	138.5	(463.7)	(463.6)	707.4	591.4
Jointly-controlled entit.	0.0	0.0	0.0	0.0	0.0	Dividends paid	0.0	0.0	(204.2)	(238.5)	(278.9)
Pre-tax profit	221.8	558.3	831.1	996.0	1148.9	Net distribution to MI	0.0	0.0	0.0	0.0	0.0
Tax	(47.9)	(47.9)	(149.6)	(199.2)	(252.8)	Investments	(146.9)	(819.9)	(812.5)	(342.5)	(347.5)
Minority interests	0.0	0.0	0.0	0.0	0.0	Disposals	0.2	4.0	0.0	0.0	0.0
Net profit	173.8	510.5	681.5	796.8	896.1	New shares	0.0	825.0	0.0	0.0	0.0
% chg	49.1	193.6	33.5	16.9	12.5	Others	(45.7)	762.6	1,529.5	(94.7)	63.2
Dividends		(204.2)	(238.5)	(278.9)	(313.6)	Net cashflow	(53.9)	307.9	49.2	31.7	28.2
Retained earnings	173.8	306.3	443.0	517.9	582.5	Net (debt)/cash - Beg.	147.1	93.3	401.2	450.4	482.1
EPS (HK\$) - Basic	0.193	0.480	0.568	0.664	0.747	Net (debt)/cash - End.	93.3	401.2	450.4	482.1	510.3
EPS (HK\$) - F.D.	0.145	0.425	0.568	0.664	0.747						
DPS (HK\$)		(0.2)	(0.2)	(0.2)	(0.3)	Interim Results (HK\$m)	07A	08A			
No. sh.s o/s (m) - W.A.	900.0	1064.3	1200.0	1200.0	1200.0	Six months to Jun.					
No. sh.s o/s (m) - Y.E.	900.0	1064.3	1200.0	1200.0	1200.0	Turnover	1216.0	1971.7			
No. sh.s o/s (m) - F.D.	1200.0	1200.0	1200.0	1200.0	1200.0	% chg	-	0.6			
Margins (%)						Profit from operations	249.8	419.7			
Gross	35.4	46.5	41.5	45.2	45.5	Interest expenses	(40.4)	(51.7)			
EBITDA	5.2	17.4	17.5	19.1	19.9	Associates					
EBIT	14.5	24.6	24.3	26.2	26.4	Jointly-controlled entit.					
Pre-tax	10.7	21.5	21.0	23.7	24.8	Pre-tax profit	209.4	368.0			
Net	8.4	19.7	17.2	19.0	19.3	Tax	(35.1)	(67.9)			
						Minority interests	-	-			
						Net profit	174.3	300.0			
						% chg	-	72.1			
						EPS (HK\$) - Basic	0.2	0.3			
						DPS (HK\$)	-	-			
Balance Sheet (HK\$m)	06A	07A	08F	09F	10F	Shareholding Structure					
Year to Dec									Shares o/s (m)	%	
Fixed assets	1640.1	2349.8	2899.8	2949.8	2999.8	Management			859.6	71.6	
Intangible assets	6.6	8.3	9.6	11.6	13.6	Capitall worldd Inves			66.2	5.5	
Other LT assets	87.9	178.5	174.6	179.8	185.3	Value Partners Ltd.			59.7	5.0	
Cash	315.8	755.5	1004.7	936.3	814.5	Other publics			214.5	17.9	
Accounts receivable	798.4	905.5	1479.1	1505.7	1664.1	Total			1,200.0	100.0	
Other receivables	1.8	0.0	0.0	0.0	0.0						
Inventories	344.1	550.2	853.2	853.2	951.6	Background					
Due from related co.s	515.7	0.0	0.0	0.0	0.0	United Laboratories International (ULI) is a vertically-integrated producer and distributor of intermediate antibiotics, bulk medicines and finished products. The company was listed on the main board of the HKEx on 15 Jun 2007, with an offer price of HK\$2.75 per share. It is China's largest 6-APA producer with an estimated market share of around 35% in 2007 and one of the largest in the world.					
Other current assets	1.9	2.3	2.0	2.0	2.0						
Total assets	3712.2	4750.1	6422.9	6438.4	6630.9	Key Ratios	06A	07A	08F	09F	10F
Accounts payable	(894.3)	(890.9)	(1325.9)	(1313.0)	(1516.0)	Net gearing (%)	80.8	33.0	49.0	26.0	13.1
Other payable						Net ROE (%)	15.0	27.1	26.3	26.2	25.4
Tax payable	(24.1)	(12.6)	(39.3)	(52.3)	(66.3)	EBIT ROCE (%)	18.3	26.9	29.4	29.5	30.1
Due to related co.s	0.0	0.0	0.0	0.0	0.0	Dividend payout (%)	-	40.0	35.0	35.0	35.0
ST debts	(1047.5)	(833.3)	(1533.3)	(1133.3)	(833.3)	Effective tax rate (%)	21.6	8.6	18.0	20.0	22.0
Other current liab.	(6.7)	(3.4)	0.0	0.0	0.0	Net interest coverage (x)	3.5	8.0	7.4	10.6	16.0
LT debts	(252.1)	(543.1)	(743.1)	(593.1)	(443.1)	A/R turnover (days)	125.4	119.8	109.8	129.8	124.8
Other LT liabilities	(176.0)	(14.2)	(44.5)	0.0	(59.2)	A/P turnover (days)	234.6	234.5	174.5	209.5	204.5
Total liabilities	(2400.6)	(2297.6)	(3686.1)	(3091.7)	(2918.0)	Stock turnover (days)	84.0	117.5	110.5	135.5	130.5
Share capital	0.4	12.0	12.0	12.0	12.0						
Reserves	1311.2	2440.5	2724.8	3334.7	3700.9						
Shareholders' funds	1311.6	2452.5	2736.8	3346.7	3712.9						
Minority interest	0.0	0.0	0.0	0.0	0.0						
Total	1311.6	2452.5	2736.8	3346.7	3712.9						
Capital employed	1739.7	3009.9	3524.4	3939.8	4215.3						
Net (debt)/cash	(983.8)	(621.0)	(1271.8)	(790.1)	(461.9)						

Xinyu Hengdeli

Luxury life

Key points:

- Exports of Swiss luxury watches to China up 59.6% in Jan-Aug 2008.
- China's largest retailer of luxury watches with around 35.0% market share.
- Dual branding strategy: brand watches and branded stores.
- Undemanding valuation at 6.2x FY12/08F and 5.0x FY12/09F P/E

Industry overview

Encouraging market. Switzerland is the major supplier of prime & luxury watches in the world. The country's watch exports to China increased 59.6% in Jan-Aug 2008 to CHF548.2m.

Mild slowdown. Xinyu Hengdeli (XH)'s same-store-sales growth dropped to 10.0 – 15.0% in Jul and Aug from over 20.0% in 1H FY12/08A, which suggests a slight slowdown in the market. Nevertheless, we remain bullish on its long-term outlook, given China's expanding wealthy class.

Company fundamentals

Summary. XH is China's largest retailer of luxury watches with around 35.0% of the market, according to the company. It operates three types of stores: Xinyu Elegant (ASP: RMB50,000), Prime Time (ASP: RMB15,000) and Temptation (ASP: RMB5,000), targeting different market segments.

Extensive portfolio. We view China as a supplier's market due to its high demand for Swiss watches. Thanks to its relationships with various brands and strong reputation, XH has built a competitive product portfolio and secure supply.

Network expansion. The company opened 24 new stores in 1H FY12/08A, bringing the total to 190 (10 Xinyu Elegant, around 130 Prime Time and remaining Temptation). We believe that it may not be able to meet its target of opening 50 new stores in FY12/08F due to the current economic slowdown.

Operating margin. Its gross margin should be relatively stable, as procurement costs and selling prices have been stated in contracts with brands. The operating margin shrunk 9.6pcp in 1H FY12/08A to 13.8% mainly due to the rolling out of new stores. We expect it to improve gradually along with the maturity of green stores, especially if the company slows down its expansion in 2H FY12/08F, as we expect.

Financial status. At end-Jun 2008, XH had RMB1,308.8m in debt (RMB393.7m short-term bank loans, RMB41.2m long-terms bank loans and RMB873.9m convertible bonds, expiring in 2012). This suggests a net gearing ratio of 42.7%. As its cash reserve (RMB385.5m) can cover most of short-term debt and interest coverage ratio of 4.7x, we think the balance sheet is secured.

Not Rated

China Consumer

Wed, 08 Oct 2008

Norman Zhang

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Stock data

Price	HK\$1.47
Target price	n/a
12 mth range	HK\$1.0-4.8
Market cap.	US\$469.4m
Daily t/o, 3 mth	US\$0.8m
Free float %	25.0%
Ticker	3389.HK/3389 HK

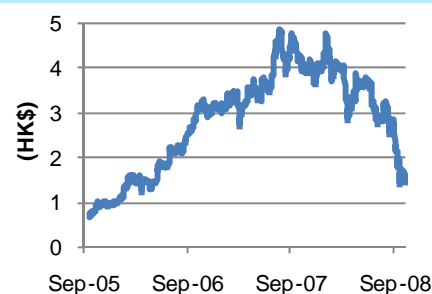
Financial summary

Year to Dec	05A	06A	07A	08F	09F
T/O (RMBm)	1,396.5	2,404.7	4,578.7	5,968.3	7,349.7
NP (RMBm)	121.0	199.1	417.5	527.1	651.1
EPS (RMB)	0.073	0.090	0.168	0.208	0.257
EPS Δ%	24.1	23.3	86.7	23.8	23.6
P/E (x)	18.3	14.8	8.0	6.2	5.0
P/B (x)	3.2	2.0	1.9	1.5	1.3
EV/EBITDA (x)	17.8	11.6	6.5	5.4	4.3
Yield (%)	3.3	1.9	4.1	5.4	6.8
ROE (%)	17.4	18.4	25.6	26.3	26.9
ROCE (%)	16.0	17.5	19.3	n/a	n/a
N. Gear. (%)	5.2	2.9	9.4	n/a	n/a

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	(10.9)	(26.0)	(36.4)
Actual price changes (%)	(31.0)	(47.9)	(64.7)
	08F	09F	
Consensus EPS (RMB)	0.208	0.257	
Previous forecasts (HK\$m)	n/a	n/a	
Previous EPS (HK\$)	n/a	n/a	

Price Chart



Valuation. Based on consensus estimates, the counter now is trading at 6.2x FY12/08F and 5.0x FY12/09F P/E, which seem undemanding, in our view, given the bright prospects of China's luxury market and XH's leading position.

Table 2: P&L

Year to Dec (RMBm)	05A	06A	07A	08F	09F
Turnover	1,396.5	2,404.7	4,578.7	5,968.3	7,349.7
Cost of sales	(1,032.4)	(1,841.8)	(3,548.7)		
Gross profit	364.2	562.9	1,030.1		
Other revenue	18.4	31.8	54.7		
Other net (loss) / income	-	6.4	31.7		
Selling and distribution expenses	(96.6)	(175.9)	(312.4)		
Administrative expenses	(63.0)	(98.3)	(156.3)		
Other operating expenses	(2.7)	(6.0)	(14.8)		
Profit from operations	220.2	321.0	633.0		
Finance costs	(23.4)	(27.0)	(81.6)		
Share of profits/(losses) of jointly controlled entity	(0.2)	(0.1)	0.3		
Profit before taxation	196.7	293.8	551.7		
Income tax	(64.9)	(80.2)	(109.5)		
Profit for the period	131.8	213.6	442.2		
Attributable to:					
Equity holders of the Company	121.0	199.1	417.5	527.1	651.1
Minority interests	10.8	14.5	24.6		
EPS - Basic (RMB)	0.073	0.090	0.168		
EPS - Diluted (RMB)	0.073	0.090	0.165		
Proposed DPS (RMB)	0.048	0.028	0.060		
Proposed dividend	49.8	69.6	149.1		

Source: Company data, Bloomberg

P & L (RMBm)	05A	06A	07A	Cash Flow (RMBm)	05A	06A	07A
Year to Mar				Year to Mar			
Turnover	1,396.5	2,404.7	4,578.7	EBIT	176.8	273.0	505.1
% chg	(8.0)	72.2	90.4	Depre./amort.	(12.1)	(16.1)	(30.2)
Gross profit	364.2	562.9	1,030.1	Net int. paid	20.0	20.9	46.4
EBITDA	189.0	289.1	535.3	Tax paid	(49.4)	(68.2)	(121.0)
Depre./amort.	(12.1)	(16.1)	(30.2)	Dividends received	0.0	10.0	11.1
EBIT	176.8	273.0	505.1	Gross cashflow	135.3	219.7	411.3
Net int. income/(exp.)	20.0	20.9	46.4	Chgs. in working cap.	(80.6)	(266.9)	(577.4)
Exceptionals	-	-	-	Operating cashflow	54.8	(47.2)	(166.0)
Associates	-	-	-	Capex	(39.7)	(312.4)	(131.4)
Jointly-controlled entit.	(0.2)	(0.1)	0.3	Free cashflow	15.0	(359.6)	(297.4)
Pre-tax profit	196.7	293.8	551.7	Dividends paid	(92.2)	(49.8)	(69.6)
Tax	(64.9)	(80.2)	(109.5)	Net distribution to MI	-	-	-
Minority interests	(10.8)	(14.5)	(24.6)	Investments	(5.0)	0.0	(15.0)
Net profit	121.0	199.1	417.5	Disposals	(41.8)	49.4	0.1
% chg	24.1%	64.5%	109.7%	New shares	364.3	454.6	0.0
Dividends	(49.8)	(69.6)	(149.1)	Others	38.2	(87.8)	247.3
Retained earnings	71.2	129.5	268.5	Net cashflow	278.5	6.8	(134.5)
dividend per share				Net (debt)/cash - Beg.	(320.0)	(41.5)	(34.7)
EPS (RMB) - Basic	0.073	0.090	0.168	Net (debt)/cash - End.	(41.5)	(34.7)	(169.2)
EPS (RMB) - F.D.	0.073	0.090	0.165	Interim Results (RMBm)	06A	07A	08A
DPS (RMB)	0.048	0.028	0.060	Six months to Sep			
No. sh.s o/s (m) - W.A.	1,652.2	2,219.7	2,484.5	Turnover	907.7	1,921.6	2,725.6
No. sh.s o/s (m) - Y.E.	1,652.2	2,219.7	2,544.1	% chg	38.3	111.7	41.8
No. sh.s o/s (m) - F.D.	1,652.2	2,219.7	2,544.1	Profit from operations	113.3	220.2	406.7
Margins (%)				Interest expenses	(9.3)	(11.4)	(86.2)
Gross	26.1	23.4	22.5	Associates			
EBITDA	13.5	12.0	11.7	Jointly-controlled entit.			
EBIT	12.7	7.0	11.0	Pre-tax profit	103.9	208.8	320.5
Pre-tax	14.1	12.2	12.0	Tax	(33.6)	(52.8)	(66.4)
Net	8.7	8.3	9.1	Minority interests			
				Net profit	70.1	145.4	237.6
				% chg	41.5	107.4	63.4
				EPS (RMB) - Basic	0.060	0.059	0.096
				DPS (HK\$)			
Balance Sheet (RMBm)	05A	06A	07A	Shareholding Structure			
Year to Mar					Shares o/s (m)	%	
Fixed assets	96.2	251.1	288.7	Best Growth Intern	1,341.0	54.0	
Intangible assets	33.1	33.0	43.4	Swatch Group	201.0	8.1	
Other LT assets	22.6	221.0	295.4	LVMH	185.4	7.5	
Cash	272.5	375.2	1,070.7	Temasek	100.0	4.0	
Accounts receivable	214.1	321.0	560.4	Others	657.1	26.5	
Other receivables	-	-	-	Total	2,484.5	100.0	
Inventories	662.1	1,262.4	1,667.0				
Due from related co.s				Background			
Other current assets	42.8	0.0	0.0	Xinyu Hengdeli is the wholesaler and retailer of mid-to-high end international branded watches in China. The company operates 3 types of stores: Xinyu Elegant, Xinyu Prime Time and Xinyu Temptation. By the end of 2007, the company owns 166 retail shops which sell over 50 international renowned brands of watches in Mainland China and Hong Kong. It also owns 300 wholesaler customers in Mainland China. The company was listed on HKEx Main Board on September 2005.			
Total assets	1,343.5	2,463.6	3,925.6				
Accounts payable	(185.4)	(370.7)	(476.1)	Key Ratios	05A	06A	07A
Other payable	-	-	-	Net gearing (%)	5.2	2.9	9.4
Tax payable	(49.4)	(74.5)	(87.6)	Net ROE (%)	17.4	18.4	25.6
Due to related co.s				EBIT ROCE (%)	16.0	17.5	19.3
ST debts	(314.0)	(387.8)	(245.3)	Dividend payout (%)	41.1	34.9	35.7
Other current liab.	0.0	0.0	0.0	Effective tax rate (%)	33.0	27.3	19.9
LT debts	0.0	(22.1)	(994.6)	Net interest coverage (x)	na	na	na
Other LT liabilities	(0.6)	0.0	(139.6)	A/R turnover (days)	56.0	40.6	35.1
Total liabilities	(549.4)	(855.1)	(1,943.2)	A/P turnover (days)	48.5	42.2	33.8
Share capital	10.8	12.9	12.9	Stock turnover (days)	234.1	190.7	150.6
Reserves	683.8	1,459.2	1,772.6				
Shareholders' funds	694.6	1,472.1	1,785.5				
Minority interest	99.5	136.5	196.9				
Total	794.2	1,608.6	1,982.4				
book value per share							
Capital employed	1,108.2	2,018.4	3,222.3				
Net (debt)/cash	(41.5)	(34.7)	(169.2)				



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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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