Miko International- A Very Profitable Company with Double Digit Growth, A Net Cash Position, and No Major Corporate Governance Issues Trading on 1.45x EV/EBIT

Miko International
Ticker: 1247:HKG
6 Month Avg. Daily Vol. (USD): 685,980

Recommendation: Buy
Closing Price (6/25/2015): HKD1.13
Est. 5 Year Annualized Return: 25%

FACTOR RATINGS

Factor	Rating	Comment
Financial health	5	The compnay's net cash to market cap stands at 60%
Business quality	3	The company currently has strong profitability but there are no signs this profitability will continue once the market slows
Management quality	4	Management has done a good job maintaining financial strength and strong profitability
Operations	4	The company's ROIC over the past five years is 39%
Capital allocation	4	The company has not made any major capital allocation mistakes but is buying facilities
Corporate governance	3	There is a slight issue with a distributor being the brother of the founder but it seems at arms length
Valuation	5	This is one of the cheapest stocks I have ever seen
Growth Prospects	4	The market is expected to grow by 10-20% for the next five possibly ten years

Scale 1 = worst 5 = best

Source: Reperio Capital Research

KEY STATISTICS

Key Statistics	TTM	5Yr Ave
Current price (HKD)	**1.13**	
Price range		
Ave daily vol (shares mn)	529,746	
Shares outstanding (mn) basic	824	
Shares outstanding (mn) diluted	830	
Market capitalization (HKD mn) d	**938**	
Net debt (HKD mn)	(562)	
Other claims (HKD mn)		
Enterprise value (HKD mn)	**376**	
EV per share	0.46	
Net debt/equity	(0.49)	
Net debt/EBIT	(2.16)	
Per Share Values	**TTM**	**5Yr Ave**
Net current asset value per share	1.16	0.44
Invested capital per share	0.70	0.55
Tangible book value	1.40	0.58
Net debt (cash) per share	(0.68)	(0.02)
Sales per share	1.20	0.82
EBIT per share	0.32	0.22
NOPAT per share	0.23	0.17
Earnings per share	0.21	0.16
FCF per share	(0.03)	0.03
Residual income per share	0.14	0.11
Insider ownership	54.3%	
Fiscal year end	December	

Valuation	TTM	5Yr Ave
P/NCAV	0.97	2.59
EV/IC	0.65	0.84
EV/EBIT	1.45	2.12
EV/NOPAT	3.59	5.24
EV/FCF	(17.95)	16.99
EBIT yield	69%	47%
NOPAT yield	28%	19%
FCF yield	-6%	6%
Dividend yield	0.03	1%
Profitability	**TTM**	**5Yr Ave**
ROIC	33%	39%
FCF ROIC	3%	10%
Gross margin	38%	38%
Operating margin	26%	26%
NOPAT margin	19%	22%
FCF margin	-2%	4%
Working capital turnover	2.5	2.4
Fixed capital turnover	5.4	8.3
IC turnover	1.7	1.8
Growth		
Sales growth	20%	25%
Operating profit growth	8%	24%
NOPAT growth	5%	18%
FCF growth	NA	NA
Invested capital growth	43%	31%

Source: Company data, Reperio Capital estimates

INVESTMENT THESIS

The following factors are keys to Miko's investment thesis.

1. Extremely cheap valuations, the company current trades on an operating profit yield of 69%
2. A rapidly growing market keeping competitive rivalry low allowing excess profitability to continue for a few years (Expected growth in the market is between 10% and 20% over the next five years)
3. A strong financial position with net cash equal to 60% of the company's market cap
4. No major corporate governance issues

The company is undervalued as it IPO'd at a time of significant weakness in other parts of the Chinese apparel industry and it is a smaller company with no analyst coverage.

KEY METRICS TO WATCH

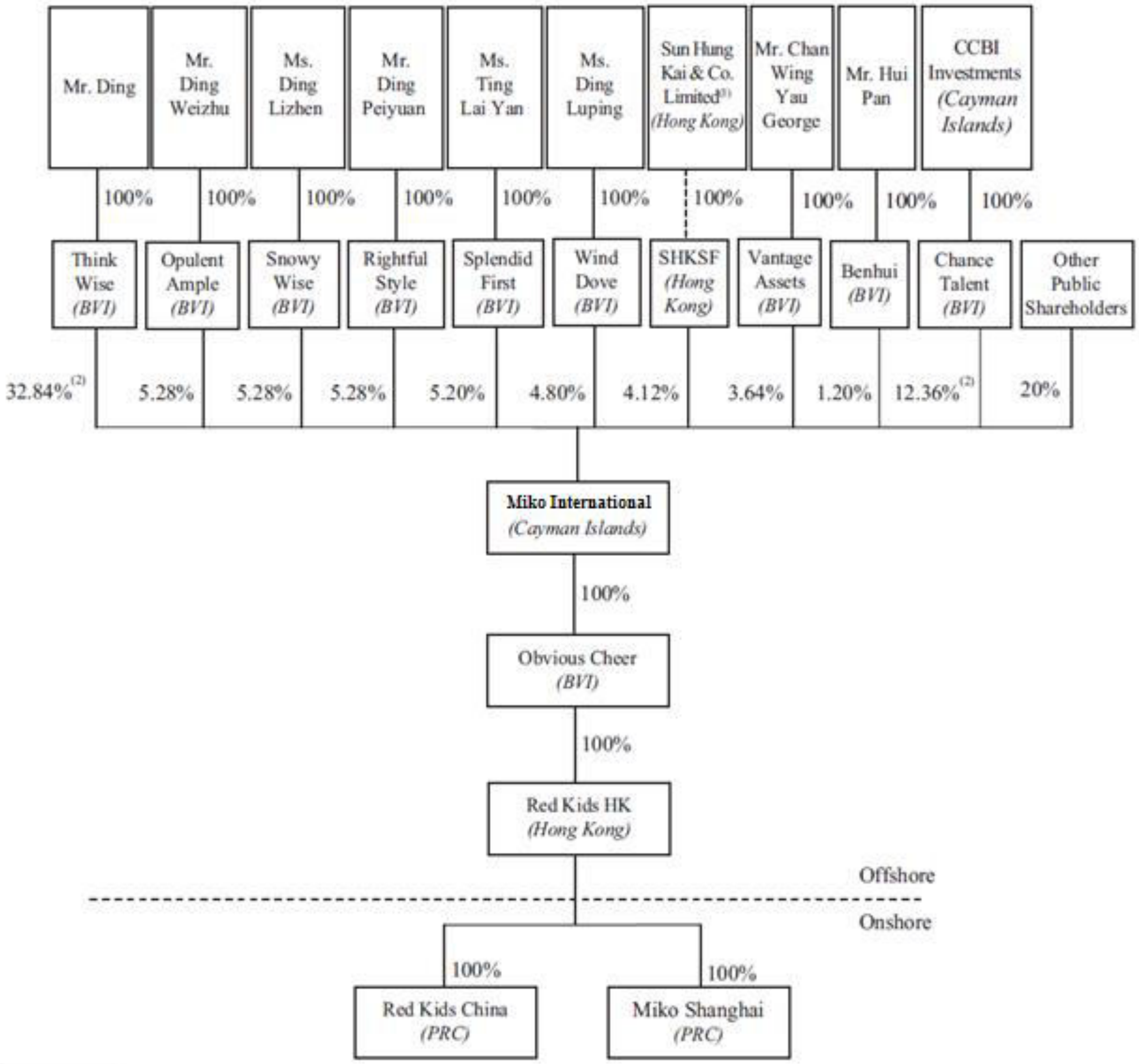
Revenue growth- growth is the key to the company's profitability. Other than strong profitability, there are no signs the company has a competitive advantage leading to the thesis that profitability is elevated due to the children's apparel's growth decreasing the competitive rivalry allowing for elevated profitability, as supply cannot keep up with growth. As growth slows, competitive rivalry will increase significantly decreasing profitability.

Gross margin- consistent gross margins illustrate pricing power and the ability not to succumb to competitive pressures. If the company is not able to fend off competition, the company's gross margin will deteriorate and returns will revert towards its cost of capital and the company's intrinsic value will equal its reproduction value.

COMPANY DESCRIPTION

History

Miko International dates back to Red Kids Light Textile Development Co., Ltd. started in 2000 to manufacture textile materials including mixed spin, textile products, garments, and baby diapers. Mr. Ding Peiji, the company's largest shareholder, has been the majority owner of the company since inception. The post-IPO shareholder and organizational structure is listed below.



Notes:

(1) Sun Hung Kai & Co. Limited, a company listed on the Stock Exchange (stock code: 86), indirectly controls 100% interest of SHKSF.

(2) The number of Shares to be transferred to Chance Talent upon exercise of the exchange rights by Chance Talent under the Exchangeable Notes will vary pursuant to the terms of the Exchangeable Notes. For illustration purposes only, adopting the mid-point of the indicative Offer Price range of HK$1.96 per Share, Chance Talent will hold approximately 12.36% Shares upon the Listing and correspondingly, Think Wise's interest in our Company will become approximately 32.84% upon the Listing.

Source:Company data

On March 15, 2013, Miko International, an investment holding company, incorporated in the Cayman Islands as a limited liability company.

On January 2, 2013, Obvious Cheer, an investment holding company, incorporated in the British Virgin Islands as a limited liability company.

Red Kids HK incorporated in Hong Kong on July 29, 2005 as a limited liability company. It held a 100% ownership in Red Kids Light Textile Development Co., Ltd., which changed its name to Red Kids China on May 23, 2008.

Miko Shanghai was established on June 24, 2013 to manage Miko's self-operated retail outlets. Miko Shanghai is a wholly owned subsidiary of Red Kids HK.

Post-IPO, a number of insiders sold their position. At the end of 2014, only four insiders remained shareholders with free float increasing from 20% at the time of the IPO to over 40.52%. Keywise Capital Management is an external fund manager, who reported is 5.22% position in February 2015. According to its website, it uses a bottom up, fundamental investment style.

Ownership	
Think Wise- Mr. Ding	38.72%
Opulent Ample- Mr. Ding Weizhu	5.28%
Keywise Capital Management (HK) Ltd.	5.22%
Snowy Wise- Ms. Ding Lizhen	5.13%
Rightful Style- Mr. Ding Peiyuan	5.13%
Free float	40.52%

Source: Company data

Business Model

Miko International sells children's apparel in China with a focus on apparel for 3-12 year olds and the mid-to-high end segment. The company is the number two player in the mid-to-high end segment with a 4.3% market share in 2012. The company has a 1.2% market share in the overall children's apparel industry.

Mid-to-High End Children's Apparel Market Share	2012
Balabala	15.7%
redkids	4.3%
Annil Kidswear	3.8%
Dadida	3.5%

Source: Frost and Sullivan, Company data

The company sells its products primarily through distributors, which accounted for 79.5% of total sales in 2014. Distributors operate within a specific geographic location and exclusively sell the company's products. Distributors are required to open a minimum number of locations per year and spend a minimum amount on marketing and promotion. The company maintains control over new store openings, location, pricing, staff training, and store layout. While the company outsources its distribution, it maintains significant control over distributors, store layout, and pricing. The company also used IPO proceeds to build out an ERP to better manage distributors.

Sales Breakdown by Channel	2010	2011	2012	2013	2014
Distributors	95.5%	90.0%	82.6%	81.3%	79.5%
Online distributors	0.2%	7.6%	16.9%	18.6%	20.4%
Self-operated stores	0.0%	0.0%	0.0%	0.0%	0.1%
OEM services	4.3%	2.5%	0.5%	0.1%	0.1%

Source: Company data

Miko International sells products to distributors at a 35% of suggested retail prices. The low wholesale ASP and strong relationship with distributors illustrated Miko sees distributors as long-term partners. The use of distributors allows the company to build its distribution network at a faster pace taking advantage of the capital and geographical knowledge of distributors. It takes away the customer relationship, which is crucial to identify changing market preferences and to collect first-hand feedback from customers.

Post-IPO, Miko opened 50 self-operated stores and on June 23, 2015, the company announced it acquired 51 stores from a distributor. Both signal the company's intention to manage retail outlets. The initial set up costs for each store are between RMB0.8 million to RMB1.0 million. The company does not provide any more economics on the retail outlets.

Managing retail outlets allows the company to build a relationship with customers to stay ahead of industry trends. It also allows the company to generate a much higher gross margin as it currently sells its products to distributors at 35% of the suggested retail price. The investment in retail will also bring increased operating expenses and capital requirements. Using conservative assumptions, the move into retail should generate excess profits so it is a good capital allocation decision. Self-operated stores do not compete with distributors but complement them geographically.

Red Kids E-commerce, an independent distributor, sells Miko's products through online channels, such as Taobao, VIPShop, and V+. Red Kids E-commerce buys products from Miko at a slightly higher price than other distributors. Online sales are the fast growing distribution channel increasing from 0.2% in 2010 to 20.4% in 2014 as Chinese consumer purchase clothing more than any other item online.

Top 10 items purchased online by Chinese females, 2013	Female	Top 10 items purchased online by Chinese males, 2013	Male
Clothing, shoes, hats, bags, suitcases, and outdoor products	41.3%	Clothing, shoes, hats, bags, suitcases, and outdoor products	28.0%
Prepayment of telephone bills	15.4%	Prepayment of telephone bills	19.9%
Cosmetics and personal care	9.4%	Household items	8.1%
Household items	7.8%	Lottery	5.7%
Maternal and baby products	4.9%	Maternal and baby products	5.3%
Fresh food, fruits and other food	4.4%	IT products	4.8%
Books, audio, and video products	4.1%	Books, audio, and video products	4.8%
Home appliance	1.8%	Telecommunication products	3.7%
Game cards and props	1.4%	Fresh food, fruits and other food	3.1%
Virtual currency	1.4%	Virtual currency	2.8%

Source: iResearch Inc, Fung Business Intelligence Centre

E-commerce is creating significant disruption to existing distribution channels devaluing existing retail outlets. Miko's ownership of a small number of retail outlets provides it the benefit of the customer relationship while avoiding the devaluation of a material portion of assets. Miko's retail outlets are primarily in lower tier cities insulating the company from online disruption as occupants of lower tier cities make significantly less purchases online than higher tier cities. Fourth-tier cities account for 64% of Miko's retail network and Fourth-tier city occupants make 50% less purchases online than first-tier cities occupants.

2013	% of Households that Made an Online Purchase at least once	Online Purchase Frequency per Year per Household
First-tier	47%	6.0
Second-tier	31%	3.7
Third-tier	28%	3.4
Fourth-tier	16%	3.0
Fifth-tier	20%	2.8

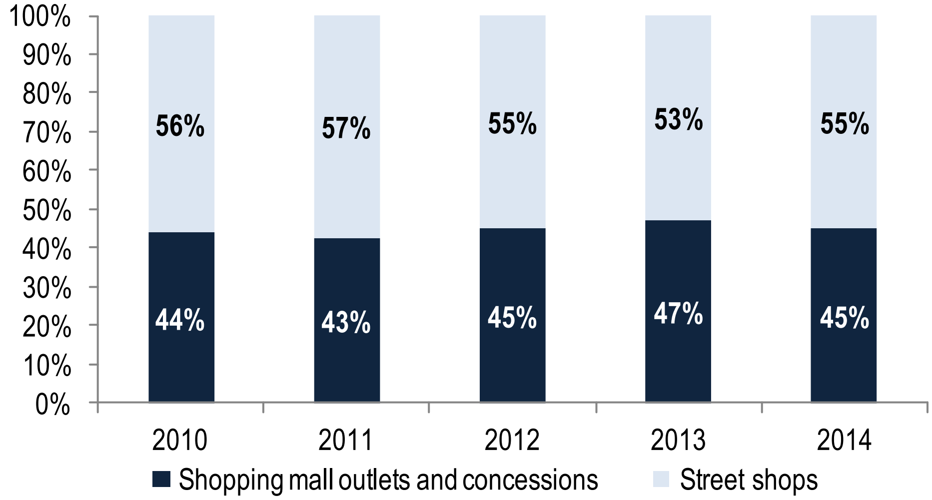
Source: Go Globe Hong Kong

Miko's retail outlets are primarily in third- and fourth-tier cities to avoid intense competition in first- and second-tier cities. In 2014, 75% of the company's 626 retail outlets were in third- and fourth-tier cities up from 70% in 2010. The emphasis has been on lower tier cities with fourth-tier cities now accounting for 64% of the overall outlets.

Stores by City Type	2010	2011	2012	2013	2014
First-tier	12%	11%	11%	16%	13%
Second-tier	18%	17%	18%	12%	12%
Third-tier	22%	26%	28%	8%	11%
Fourth-tier	48%	46%	42%	64%	64%
Total outlets	**476**	**560**	**594**	**601**	**626**

Source: Company data

Given the emphasis on lower tier cities, street shops account for roughly 55% of all stores with shopping malls and other concessions accounting for the other 45%.



Source: Company data

Street shops are individual stores located in prime commercial locations of third- and fourth-tier cities. The street shops are located in third- and fourth-tier cities due to the underdevelopment of shopping malls and department stores in these cities.

Miko International's Retail Network

Source: Company data

The company increasingly relies on OEM partners for production of its apparel with OEM services increasing from 15% of COGS in 2010 to 71% in 2014. The company intends to maintain its current production capacity and increasingly rely on OEM partners as the company grows. Given there is no differentiation in textile production, the only potential competitive advantage is being a low cost operator, which is difficult to obtain in China due to the rising labor costs that are much higher than many other countries in the region. China’s labor costs are three to four times Bangladesh and 150% of Vietnam.

Garments manufacturing labor costs (USD/hour) by Countries

Asian Competitors		US Regional Suppliers	
Bangladesh	0.22	Mexico	2.54
Cambodia	0.33	Honduras	1.72-1.82
Pakistan	0.37	Dominican Republic	1.55-1.95
Vietnam	0.38	Nicaragua	0.97-1.03
Sri Lanka	0.43	Haiti	0.49-0.55
Indonesia	0.44	**EU Regional Suppliers**	
India	0.51	Turkey	2.44
China(remote/inland areas)	0.55-0.80	Morocco	2.24
China (other coastal/core areas)	0.86-0.94	Russia	1.97
China (Prime coastal areas)	1.08	Tunisia	1.68
Malaysia	1.18	Bulgaria	1.53
Thailand	1.29-1.36	Jorden	1.01
		Egypt	0.83

Data Source: ILO Report, 2011 & NCM-April, 2013

Miko's increasing reliance on OEMs decreases the relevance of an activity with little potential for excess profits and provides the company flexibility to seek out the lowest cost provider.

Business Economics

	2010	2011	2012	2013	2014	CAGR
Average wholesale selling price (RMB)	47.4	51.6	58.4	62.4	63.2	7.4%
Sales volume (mn units)	6.9	7.6	8.9	10.6	12.6	16.2%
Sales (RMB mn)	327.0	392.4	520.0	661.4	795.7	24.9%

Source: Company data

The company grew its average selling price (ASP) by 7.4% per year from RMB47.4 in 2010 to RMB63.2 in 2014. Given the company sells its products to distributors at 35% of suggested retail price, there is potential for further increases in ASP, either through integrating the retail activity or increasing prices paid by distributors. Over the same period, the company grew its volume by 16.2% per annum and sales by 24.9% per annum.

Per Store (RMB)	2010	2011	2012	2013	2014	Average	CAGR
Volume	14,496	13,571	14,983	17,637	20,128	16,163	8.6%
Sales	**686,920**	**700,659**	**875,399**	**1,100,526**	**1,271,085**	**926,918**	**16.6%**
Gross profit	276,092	256,980	329,653	432,755	479,764	355,049	14.8%
Distribution expense	71,025	76,880	83,404	78,206	92,548	80,413	6.8%
Administrative expense	18,922	20,207	22,278	32,879	54,882	29,834	30.5%
Operating profit	186,145	159,893	223,971	321,671	332,334	244,803	15.6%
NOPAT	**162,834**	**140,682**	**197,695**	**235,311**	**237,087**	**194,722**	**9.8%**
Working capital	233,361	352,268	457,471	393,591	510,385	389,415	21.6%
Fixed capital	98,784	78,650	68,646	151,033	236,457	126,714	24.4%
Invested capital	**332,145**	**430,918**	**526,118**	**544,624**	**746,842**	**516,129**	**22.5%**
FCF		41,909	102,495	216,805	34,869	99,020	
ROIC	49%	33%	38%	43%	32%	38%	

Source: Company data, Reperio Capital Research estimates

Miko has done a good job of growing all the key metrics on a per store basis. Since 2010, the company has grown major income statement items on a per store basis with sales growing by 16.6% per year, gross profit growing at 14.8% per year, and net operating profit after tax (NOPAT) growing at 9.8% per year. Unfortunately, the amount of invested capital per store has outpaced NOPAT and all income statement items growing at 22.5% per year. Despite the decreasing capital efficiency, the company's ROIC is still well above its cost of capital at 32% in 2014 and averaging 38% since 2010.

In 2014, Miko's average store sold 20,128 units generating RMB1.27 million in sales and RMB237,087 in NOPAT. Working capital required per store was RMB510,285 and fixed capital required per store was RMB236,457 leading to total invested capital required per store of RMB746,842. The level of invested capital per stores is slightly below the company's estimates of initial set up costs of RMB0.8 to RMB1.0 million per store, mentioned in the 2014 Annual Report.

Per Unit (RMB)	2010	2011	2012	2013	2014	Average	CAGR
Sales	**47.39**	**51.63**	**58.43**	**62.40**	**63.15**	**56.60**	**7.4%**
Gross profit	19.05	18.94	22.00	24.54	23.84	21.67	5.8%
Distribution expense	4.90	5.66	5.57	4.43	4.60	5.03	-1.6%
Administrative expense	1.31	1.49	1.49	1.86	2.73	1.77	20.2%
Operating profit	12.84	11.78	14.95	18.24	16.51	14.86	6.5%
NOPAT	**11.23**	**10.37**	**13.19**	**13.34**	**11.78**	**11.98**	**1.2%**
Working capital	16.10	25.96	30.53	22.32	25.36	24.05	12.0%
Fixed capital	6.81	5.80	4.58	8.56	11.75	7.50	14.6%
Invested capital	**22.91**	**31.75**	**35.11**	**30.88**	**37.11**	**31.55**	**12.8%**
FCF		1.53	9.83	17.58	5.55	8.62	

Source: Company data, Reperio Capital Research estimates

On a per unit basis, from 2010 to 2014, Miko's ASP grew by 7.4% per year to RMB63.15. The pricing increase is evidence of strong end demand. It is a bit of a concern that pricing barely increased in 2014 after a few years of strong increases. Competitive pressures will increase once the market no longer has the appetite for further price and volume increases. The company has been able to increase its gross profit per unit by 5.8% over the same period. Gross profit growth per unit has lagged sales per unit potentially illustrating the company's lack of pricing power and inability to fend off competition.

Operating profit per unit increased from RMB12.84 in 2010 to RMB16.51 in 2014 on the back of ASPs increasing at a faster pace than COGS and leverage associated with fixed costs. NOPAT lagged operating profit per unit due to an increasing tax rate. Invested capital per unit increased from RMB22.91 per unit in 2010 to RMB37.11 per unit in 2014.

INDUSTRY

Industry Structure

The Chinese children's apparel industry is fragmented and very competitive. With the exception of 2008 to 2011, the top ten companies by market share are illustrated below. If the market share figure is blank, the company is in the others category or had no market share.

Children's Apparel Market Share	2005	2006	2007	2008	2009	2010	2011	2012	2013
Balabala		2.8%	3.8%	3.8%		3.9%	5.5%	4.4%	4.8%
Adidas					5.9%	5.5%	4.2%	4.0%	4.1%
Nike					5.0%	5.3%		3.6%	3.8%
Annil	2.3%							4.1%	3.7%
Les Enphants	3.6%	3.6%	5.5%	5.0%				3.0%	2.8%
Souhait						3.8%	4.1%	2.1%	2.3%
Paw in Paw								2.1%	2.0%
Eland									1.8%
Snoopy									1.7%
Goodbaby			2.4%						1.7%
Dadida			3.5%		6.1%	5.1%	4.4%	2.1%	
Paclantic					6.5%	5.5%	5.9%	2.0%	
ABC		2.5%						1.8%	
Yaduo	3.7%	3.7%	3.6%	4.3%	5.5%	4.6%			
LawLandee	4.4%	4.1%	4.8%	6.6%					
Shuihaier	3.8%	3.8%	5.0%	5.0%					
Mickey's	3.5%	3.2%	3.7%						
Littlebobdog	2.6%	3.1%	1.7%						
Pepco	3.1%	2.9%	1.7%						
M-linge	3.1%	2.7%							
Smiling	2.3%								
Others	67.7%	67.8%	64.3%	75.4%	71.0%	66.3%	75.9%	70.8%	71.4%

Source: China National Commercial Information Centre, Fung Business Intelligence Centre

The table above highlights three pieces of evidence all pointing to a lack of barriers to entry. First, assuming the others all had a market share equal to the lowest market share, there would have been at least 40 competitors in 2005 and at least 53 competitors in 2013. Second, the top ten players only accounting for 28.6% of the total market in 2014 down from 32.2% in 2005. The first two pieces of evidence illustrate increasing fragmentation pointing to a lack of barriers to entry as markets with a competitive advantage usually have a small number of participants. Third, the market share of the top players fluctuates drastically from year to year also pointing to a lack of barriers to entry as market participants can freely take share from one another. The change of market share would not be so drastic in an industry with barriers to entry as new entrants by definition have difficulty taking customers from the incumbent.

The lack of barriers to entry is further confirmed by many new entrants into the children's apparel sub-sector from other apparel sub-sectors. Competitors from sportswear brands, Anta, 361 degrees, and XTEP, to international luxury brands, Burberry, Armani Junior, Dior and FENDI, to mass market brands, Zara, H&M and GAP, even home appliance giant Haier, have penetrated into China's children's apparel market.

The intensity of rivalry is weak as the overall growth of the market is 20% by some estimates. Once growth slows, the rivalry will increase very rapidly as the market is very fragmented, there is product homogeneity, buyers have low switching costs. Any slowdown in growth typically catches industry insiders off guard as they continue to build supply based on backward looking estimates leading to oversupply and discounting as inventory builds as seen in the sportswear segment in 2013 and 2014.

The power of buyers is medium as low switching costs is offset by fragmentation of customers.

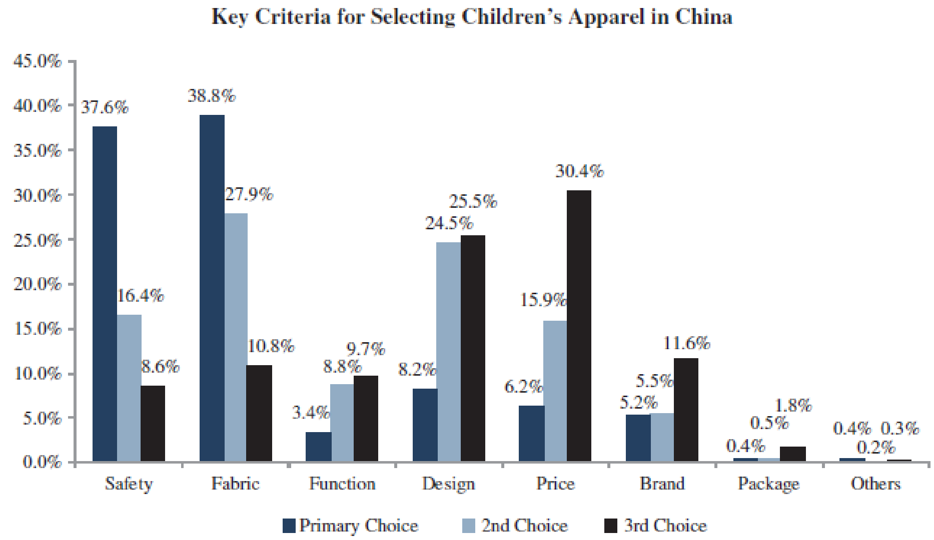
The power of suppliers is low as there are many OEMs selling a product based primarily on price, although quality does play a factor. Apparel companies can also manufacture products internally and can easily switch OEMs with very little pain.

The threat of substitute for the product is low, as children need clothes and there are not many other options. The threat of substitute is high at the retail level as online sales of apparel are growing very rapidly devaluing traditional brick and mortar stores.

The strongest forces are the threat of entrants and rivalry.

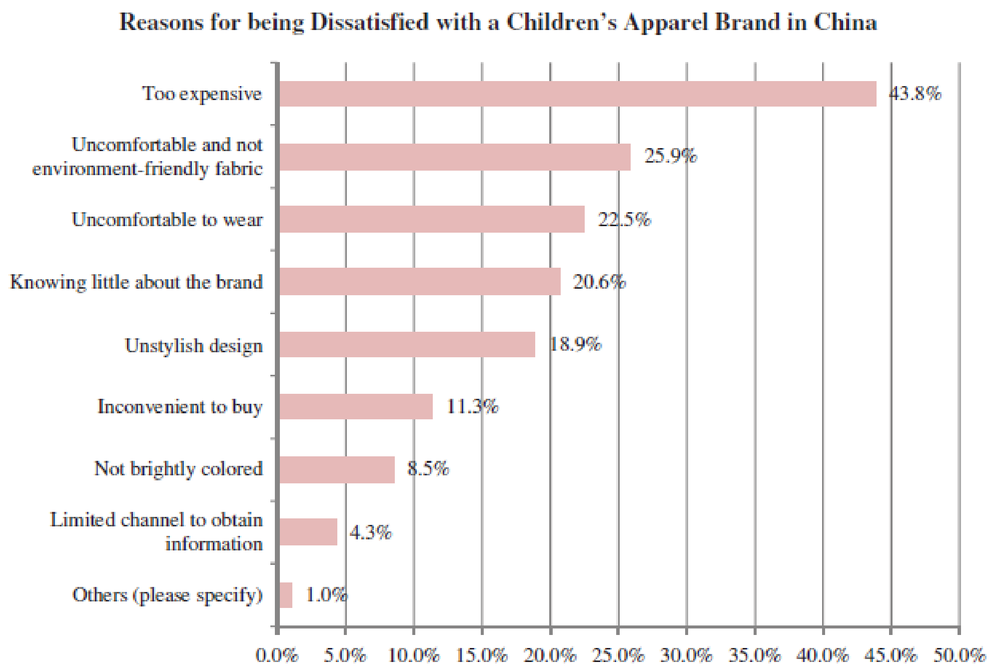
Consumer Behavior

In Miko's 2013 IPO prospectus, Frost & Sullivan published its findings on children's apparel consumer behavior. The primary criteria for purchasing children's apparel are fabric at 38.8% followed closely by safety at 37.6%, and design is the third highest primary criteria at 8.2%. The secondary criteria include fabric followed by design, safety, and price. Price is the highest tertiary criterion followed by design, brand, fabric, function, and safety. Price is not the ultimate criterion but differentiating on fabric, safety, or design will be difficult in a market with so many different competitors and offerings that can quickly replicate any feature that customers value.



Number of respondents in survey — 1,834
Source: Frost & Sullivan customer primary research conducted in June 2013

While price was not the primary criteria for purchase, it is the primary criteria for dissatisfaction.



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Source: Frost & Sullivan end customer primary research conducted in June 2013

Growth

Frost & Sullivan estimated the children's apparel market will grow by 20.5% per year, increasing from RMB83 billion in 2012 to RMB212 billion in 2017. The mid-to-high end of the market is expected to grow the fastest at 29.9% per year from 2012 to 2017, followed closely by the top end growing at 28.6% per year. Finally, the low end of the market is expected to grow at 12.2% per year. The children's apparel market is commonly divided into three price segments, based on the average retail price of single piece winter clothing with the top end priced above RMB600, mid-to-high end priced between RMB200 to RMB600, and low end priced below RMB200.

China Children's Apparel Market (RMB billion)	2008	2009	2010	2011	2012	2013E	2014E	2015E	2016E	2017E	08-'12 CAGR	12-'17 CAGR
Low end	27.6	32.0	37.6	43.2	49.4	55.2	61.8	69.1	77.9	88.0	15.7%	12.2%
Mid-to-high end	8.4	10.4	13.2	17.0	22.5	29.1	37.7	49.0	63.8	83.2	27.9%	29.9%
Top end	4.4	5.3	6.8	8.9	11.5	14.9	19.1	24.3	31.2	40.5	27.1%	28.6%
Market	**40.4**	**47.7**	**57.6**	**69.1**	**83.4**	**99.2**	**118.6**	**142.4**	**172.9**	**211.7**	**19.9%**	**20.5%**

Source: Frost and Sullivan, Company data

According to Euromonitor, the children's apparel market in China will reach RMB130 billion in 2014 and is expected to grow to near RMB180 billion in 2017, representing a CAGR of 11.25%.

The children's apparel market growth comes from continued economic growth, the relaxation of the one-child policy, and changes in consumer mentality and values following the shift of major consumer base to the post-80s and 90s generations who are more willing to consume and possess much higher consuming power than the post-70s

The children's apparel market is earlier in its life cycle relative to other apparel sub-sectors. It is still growing rapidly and store count continues to increase at many competitors, while many other apparel sub-sectors, such as footwear and sportswear, past store expansion has shifted to store productivity highlighting the potential maturation in those sub-sectors.

MANAGEMENT

Operational Execution

Management has executed strongly. The company grew its store count from 476 in 2010 to 626 in 2014, a 7.1% CAGR, while maintaining an average ROIC of 38%. Miko scores very highly compared to apparel peers.

		Sales growth		Gross margin		Operating margin		Working capital turnover		Fixed capital turnover		Invested capital turnover		ROIC	
Company	Ticker	Current	3Yr avg	Current	3Yr avg	Current	3Yr avg	Current	3Yr avg	Current	3Yr avg	Current	3Yr avg	Current	3Yr avg
Miko	1247:HKG	20.3%	26.6%	37.7%	38.2%	24.7%	27.0%	2.6	2.9	17.3	17.2	2.2	2.5	55.7%	68.3%
Semir	002563:SHE	11.7%	1.6%	36.0%	35.1%	18.3%	16.3%	3.8	7.1	5.7	4.8	2.3	2.7	41.6%	43.9%
Metersbonwe	002269:SHE	-16.1%	-12.7%	44.7%	44.8%	1.7%	6.2%	11.8	5.8	3.6	3.8	2.7	2.3	4.8%	14.3%
Septwolves	002029:SHE	-13.8%	-6.5%	43.3%	45.7%	10.5%	16.8%	1.5	2.5	5.4	9.4	1.2	2.0	12.3%	36.7%
Goodbaby	1086:HKG	46.0%	15.8%	25.0%	22.3%	2.4%	3.9%	4.4	3.6	8.6	7.1	2.9	2.4	7.1%	8.8%
Bosideng	3998:HKG	-11.7%	5.4%	49.3%	50.2%	10.0%	14.5%	1.7	3.0	8.4	10.3	1.4	2.3	13.9%	36.2%
China Lilang	1234:HKG	5.8%	-3.5%	42.6%	41.8%	28.0%	26.2%	3.8	3.2	9.3	8.9	2.7	2.3	75.0%	61.7%
Giordano	709:HKG	-5.2%	-0.4%	58.0%	59.1%	9.8%	13.9%	4.3	14.6	16.0	16.4	3.4	7.1	33.1%	101.5%
Bossini	592:HKG	1.2%	-1.2%	51.6%	48.7%	6.5%	3.3%	5.0	5.4	28.9	23.9	4.3	4.4	27.8%	15.0%
Anta	2020:HKG	22.6%	0.1%	45.1%	41.6%	22.6%	21.5%	3.9	18.4	8.7	8.5	2.7	4.6	61.3%	96.4%
Belle	1880:HKG	10.3%	15.2%	57.5%	57.1%	15.6%	16.7%	5.3	4.5	10.0	10.8	3.5	3.1	53.8%	52.1%
Daphne	210:HKG	-0.9%	6.5%	55.4%	56.8%	2.5%	6.8%	4.1	3.9	7.2	8.5	2.6	2.6	6.6%	18.0%
361	1361:HKG	9.0%	17.9%	40.9%	40.1%	18.5%	15.3%	0.8	1.3	3.6	4.0	0.7	1.0	12.7%	14.9%
XTEP	1368:HKG	10.0%	-4.8%	40.8%	40.6%	16.9%	19.3%	3.6	44.0	8.3	10.8	2.5	5.0	42.8%	100.5%
Goldlion	533:HKG	-17.8%	-5.1%	55.7%	55.4%	32.5%	30.7%	1.2	3.2	7.4	8.4	1.0	2.2	32.7%	67.5%
Peak Sport	1968:HKG	8.7%	-15.1%	38.0%	36.7%	17.9%	15.9%	1.2	2.3	4.3	4.9	0.9	1.5	16.7%	23.6%
Le saunda	738:HKG	3.4%	10.9%	67.2%	66.3%	14.5%	15.1%	2.7	2.8	10.4	9.4	2.2	2.2	31.4%	33.2%
C banner	1028:HKG	16.1%	11.3%	63.4%	62.9%	12.9%	15.1%	2.2	2.2	14.1	16.6	1.9	2.0	24.3%	30.4%
Fast Retailing	9983:TKS	21.0%	19.0%	51.1%	50.4%	11.1%	11.6%	7.4	13.3	12.9	13.4	4.7	6.4	52.1%	76.9%
H&M	HM B:STO	17.8%	11.2%	58.7%	59.1%	16.8%	17.4%	6.5	8.1	6.2	6.1	3.2	3.5	53.3%	60.5%
Inditex	ITX:MCE	8.3%	9.5%	58.5%	59.1%	17.8%	18.5%	6.2	(2.4)	3.2	3.4	2.1	3.0	37.3%	55.8%
Average		**5.5%**	**3.4%**	**47.3%**	**46.9%**	**14.8%**	**15.8%**	**3.6**	**7.3**	**9.8**	**10.2**	**2.3**	**2.9**	**30.8%**	**45.7%**
Fast Fashion Average		**15.7%**	**13.3%**	**56.1%**	**56.2%**	**15.2%**	**15.8%**	**6.7**	**6.3**	**7.4**	**7.7**	**3.3**	**4.3**	**47.6%**	**64.4%**

Source: Company data, Reperio Capital Research estimates

Of its Chinese apparel peers, Miko's sales growth of 20.3% was the third strongest in 2014 only behind Goodbaby and ANTA. It had the highest three-year average sales growth of 26.6%. The company's sales growth was well above the peer group average of 5.5% and 3.4% for 2014 and three-year average, respectively.

Miko's 2014 gross margin of 37.5% is well below its peer group average of 47.3%. Similarly, Miko's three-year gross margin average of 38.2% is well below its peer group average of 46.9%. The company's weaker gross margin does not translate to a weaker operating margin as Miko had the third highest operating margin in 2014 at 24.7% well above its peer group average of 14.8%. Miko's three-year average operating margin of 27.0% was also well above its peer group average of 15.8%. The weak gross margin can be explained by Miko's wholesale prices is 35% of the suggest retail price. The strength of the operating margin points to Miko relying heavily on distributors for distribution expenses such as opening new stores and marketing.

Miko has weaker working capital turnover but much better fixed capital turnover than peers leading to overall capital efficiency in line with peers. The weak working capital turnover may point to either Miko maintaining inventory within itself rather than in the channel or a much higher inventory level throughout its distribution channel. The growth of the market, the company's ASPs, and the company's volumes point to the former rather than the latter. Miko's stronger than peer group fixed capital turnover again points to shifting the capital expenditure for new shops to distributors rather than keeping it in house.

The strong operating margin and average capital efficiency leads to Miko having the third highest ROIC in 2014 and fifth highest ROIC over the last three years. Miko's ROIC is higher in the comparison relative to previous ROIC figures listed as operating profit rather than NOPAT is used to eliminate any potential tax differences among peers allowing for a true measure of operating performance.

Miko compares very favorably on a per store basis as well. Due to lack of transparency, Chinese listed peers are eliminated, as are companies that do not report a store count.

Per Store (last annual report, USD) Company	Ticker	Revenue	Gross profit	Operating expenses	Operating profit	NOPAT	Working capital	Fixed capital	Invested capital
Miko	1247:HKG	204,308	77,115	23,697	53,418	38,108	82,037	38,007	120,044
Bosideng	3998:HKG	113,641	56,820	44,888	11,932	8,532	58,208	13,533	71,741
China Lilang	1234:HKG	127,012	54,107	18,556	35,551	25,732	33,689	13,710	47,400
Giordano	709:HKG	291,736	169,207	140,691	28,516	22,297	67,998	18,238	86,236
Bossini	592:HKG	341,691	174,604	153,818	20,786	17,044	59,698	12,488	72,186
Anta	2020:HKG	188,171	84,865	42,288	42,577	32,891	47,750	21,669	69,419
Belle	1880:HKG	178,809	102,815	74,984	27,831	20,692	31,462	16,637	48,099
Daphne	210:HKG	208,682	115,610	110,330	5,280	4,345	50,456	29,049	79,505
361	1361:HKG	85,781	35,085	19,184	15,900	10,605	101,200	23,514	124,714
XTEP	1368:HKG	108,016	44,071	25,782	18,289	11,539	29,787	12,975	42,762
Goldlion	533:HKG	169,334	94,319	39,266	55,053	43,519	145,519	23,010	168,529
Peak Sport	1968:HKG	76,058	28,902	15,302	13,600	8,922	63,678	17,643	81,321
Le saunda	738:HKG	300,823	202,153	158,485	43,668	32,292	109,947	28,995	138,942
C banner	1028:HKG	158,435	100,448	80,061	20,387	14,758	72,521	11,234	83,755
Fast Retailing	9983:TKS	4,095,031	2,072,086	1,685,950	386,135	226,121	781,114	341,146	1,122,260
H&M	HM B:STO	5,312,519	3,123,761	2,226,184	897,577	692,391	635,182	883,505	1,518,686
Inditex	ITX:MCE	3,078,129	1,794,549	1,251,200	543,349	420,335	444,478	972,110	1,416,588
Average		**182,321**	**95,723**	**67,667**	**28,056**	**20,805**	**68,139**	**20,050**	**88,189**
Fast Fashion Average		**4,161,893**	**2,330,132**	**1,721,112**	**609,020**	**446,282**	**620,258**	**732,253**	**1,352,511**

Source: Company data, Reperio Capital Research estimates

Miko's stores are slightly more efficient than the average over the past year. The same pattern reveals itself, gross profit is weaker than peers, but operating profit per store is much better than peers. Invested capital requirements are much higher than peers although the weak capital efficiency is much more pronounced in fixed capital on a per store basis.

Company Strategy

A company strategy aims to create a sustainable competitive advantage by making trade-offs to deliver a product or service using a unique value chain. The company does not have any unique activity within its value chain. The company's profitability is due to a low competitive rivalry from a rapidly growing market. As long as the market continues to grow at a rapid pace, the company should generate strong profitability. Given the increasing levels of competition, when the market growth slows, profitability will eventually decrease towards the cost of capital either through inability to raise prices, discounting, or decreased capital efficiency.

Capital Allocation

Capital Allocation (RMB mn)	2010	2011	2012	2013	2014	2010-2014
Cash flow from operations	**85**	**83**	**121**	**149**	**148**	**585**
Working capital investment	(94)	(85)	(106)	31	(83)	(337)
Maintenance fixed capital investment	(3)	(4)	(3)	(3)	(3)	(16)
Growth fixed capital investment	1	3	3	(50)	(61)	(104)
Free cash flow	**(11)**	**(3)**	**15**	**126**	**1**	**128**
Other investing	0	0	0	1	(53)	(52)
Cash from/(to) debtholders	62	(50)	(10)	126	(43)	85
Cash from/(to) shareholders	-	-	-	(1)	267	266
Total change in cash	**51**	**(52)**	**5**	**251**	**172**	**427**
Year end cash balance	55	7	13	260	487	

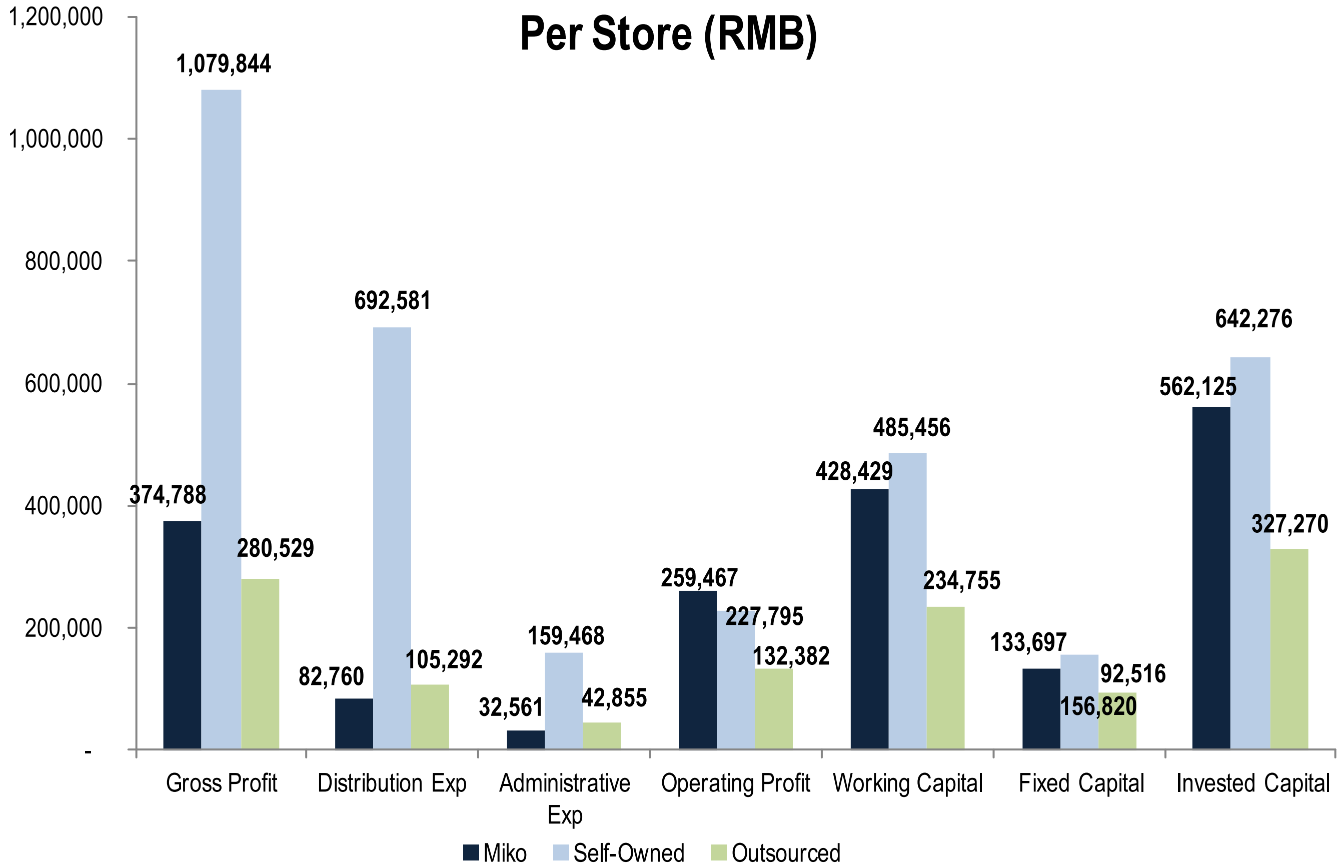
Source: Company data

From 2010 to 2012, cash flow from operations matched the working capital investment with no investment to growth fixed capital and minimal maintenance investment requirements. In 2013 and 2014, Miko's started making fixed capital investments in retail outlets increasing the company's fixed capital requirements.

On June 23, 2015, Miko International announced it acquired 51 stores from one of its distributors for RMB89.38 million. In the company's 2014 Annual Report, it reported the initial set up costs for each shop were between RMB0.8 million to RMB1.0 million so at the top end of the range it would have cost RMB51 million to open the stores. It seems as if the company may have overpaid as replacement cost is about half of the acquisition price.

The opening of 50 self-operated stores and the acquisition of 51 stores are a clear indication that Miko wants to be more involved in the distribution and retailing of its product. The company believes the ability to increase gross margin and to create customer relationships allowing a better understanding of customer behavior and changing trends in the market outweighs the risks of a much higher cost base from expanded distribution and retailing.

Miko's gross margins will clearly benefit as the company sells its products to distributors at 35% of suggested retail price, but less clear is the operational expenses and invested capital required to run retail and distribution. To assess whether a move into distribution and retail would truly be beneficial and help profitability, the Chinese apparel retailers listed in Hong Kong financial statements are classified based on the amount of distribution owned.



Source: Company data, Reperio Capital Research estimates

As illustrated above, the average gross profit for self-owned distribution channels is much higher than for companies outsourcing distribution. In addition to gross profit, self-owned distribution expense, administrative expense, and operating profit are much higher than companies outsourcing distribution. The increased operating profit of owning your own distribution channel comes with increased capital requirements leading to a slightly lower ROIC of 35% for self-owned distribution compared to 40% for outsourced distribution. The costs associated with owning your own distribution channel may not increase all that much as distributors may essentially be nothing more than off the balance sheet group companies. In good times, the cost of distribution will remain off your financial statements, as distributors will most likely not need your help. During a downturn, like the sportswear industry recently saw, the external distribution channel may still need to be helped with discounting and other incentives, as a brand company cannot let its whole distribution channel go bankrupt without hurting its financial statements tangibly and intangibly.

The table below illustrates two scenarios. The first scenario assumes Miko ASP increases to 70% of suggested retail price from 35%, all additional revenue flows directly to gross profit, and the company's operating costs and invested capital requirements moves to the self-owned industry average.

A second scenario assumes a similar ASP increase, a 50% increase in the costs of goods sold, operating expenses at the mean of peers that own their distribution, and a 196% increase in invested capital similar to the increase from the average outsourced distributor invested capital per store to the average self-owned invested capital per store.

Per Store (RMB)	2014	Self-owned	Self Owned Incr in IC
Sales	**1,271,085**	**2,542,169**	**2,542,169**
Gross profit	**479,764**	**1,750,848**	**1,355,188**
Distribution expense	92,548	692,581	692,581
Administrative expense	54,882	159,468	159,468
Operating profit	**332,334**	**898,799**	**503,139**
NOPAT	**237,087**	**674,099**	**377,354**
Working capital	510,385	485,456	1,001,643
Fixed capital	236,457	156,820	464,053
Invested capital	**746,842**	**642,276**	**1,465,696**
ROIC	**32%**	**105%**	**26%**

Source: Company data, Reperio Capital Research estimates

Under both scenarios, the company is able to increase its return on invested capital. The scenario of moving to self-owned average is going to increase profitability drastically as the company increases profitability by 184% while decreasing capital requirements per store leading to a 105% overall ROIC.

The more conservative second scenario leads to an incremental ROIC of 19% decreasing the overall ROIC to 26%. ROIC falls as NOPAT increases by 59% while invested capital increases by 96%. Given incremental ROIC is well above the cost of capital even under conservative assumptions the move into retail seems like a good capital allocation.

In June 2013, Miko agreed to a pre-purchase agreement for a building under construction in Shangzhifang Fashion Culture Creative Park. There have been a number of delays to the building and in March 2015, the company agreed to purchase another building in the complex for RMB59.18 million. The initial building was to be bought for RMB92 million and had a gross floor area of 10,709.6 sqm, while this building has a gross floor area of 2,069.13 sqm. Miko is paying 64% of the price for 20% of the floor area in the exact same complex. Despite this inconsistency, the company is allocating capital to real estate. This is a problem seen in many Chinese companies. Rather than returning cash to shareholders either through dividends or share buybacks, a company will buy investment property. This is a red flag as managers are essentially saying they have no interest in returning the company's cash flow to minority shareholders. In Miko's case, the company will occupy the building. The company owns a few other buildings it occupies so while it may be a poor capital allocation decision, it seems to be more of a management error in purchasing the building rather than a problem of diverting cash from shareholders to investment properties. It is a potential concern that must be watched. If the company starts purchasing real estate unrelated to the business, it will be a major concern. Currently, Miko's valuation is too tempting and the company has no significant corporate governance issues.

Corporate Governance

Miko has one continuing related party transaction. Mr. Ding's brother is 80% owner of Minghao Xemen, one of Miko's distributors. Minghao Xemen accounted for approximately 3% of sales over the past three years.

Transaction with Minghao Xiamen	2012	2013	2014
Sales to	17.1	20.4	22.9
Trade receivables	5.4	5.0	8.5

Source: Company data

There is a potential conflict of interest and a public company should not even give a hint of a potential conflict of interest. There are no other related party transactions, the above transactions seem to be at arm's length, and it is a relatively small amount. Given Miko's valuation, the appearance of a normal business transaction, and the small amount, the related party transaction can be overlooked but it will be monitored closely.

Salaries

At Miko, the salaries of the top five paid employees were 3.3% in 2014 an increase from the average of 1.5% from 2010 to 2013. Salary levels compare favorably to the 4.7% average of the company's Hong Kong listed apparel peers. The founder and Chairman is an owner operator with 38.72% of shares outstanding aligning interests with minority shareholders.

Accounting

Company	Ticker	Land rights use	Buildings	Leashold improvements	Machinery	Motor vehicles	Furniture, fixtures and equipment	Trademarks	License rights	Computer software	Customer relationships	R&D	Inventory valuation
Miko	1247:HKG		20		10	5	5			10			Weighted average
Goodbaby	1086:HKG		20	Lease term	10	5	5	Indefinite		5	5-20	Product life	Weighted average
Bosideng	3998:HKG		20-60	up to 3	5-10	2-10		10-20			8-15		Weighted average
China Lilang	1234:HKG		up to 40	up to 5	10	5	5			5			Weighted average
Giordano	709:HKG		up to 50		5	3-5	5						Weighted average
Bossini	592:HKG		20-50	3-6.67	4-11	3-6.67	3-6.67						FIFO
Anta	2020:HKG		up to 20	1-2	10	5	3-10	10-40		3-10			Weighted average
Belle	1880:HKG	30-70	20-40	1-5	10	5	3-5						Weighted average
Daphne	210:HKG	10-50	20-50	1-3	5			20	5-30				Weighted average
361	1361:HKG	50		5-10		5	2-10						Weighted average
XTEP	1368:HKG		up to 20	up to 5	3-10	5	5	5					Weighted average
Goldlion	533:HKG	50-70	20-50		5-10	4-5	3-5						Weighted average
Peak Sport	1968:HKG		20		5-10	5	5			5			Weighted Average
Le saunda	738:HKG	50-70	25-33	5-20	10	5	3-5						FIFO
C banner	1028:HKG		22	2-5.6	11	6	6						Weighted average
Fast Retailing	9983:TKS		3-50		5	5				3-5			Weighted average
H&M	HM B:STO		33		8	5	5				10		
Inditex	ITX:MCE		25-50		4-13		7-13						FIFO

Source: Company data

As illustrated above, with the exception of amortizing computer software and depreciating machinery over a ten-year period, Miko's accounting assumptions are in line with peers and earnings are not overstated.

VALUATION

Asset Valuation

Valuation Assumption	2015 Target Price (HKD)	Upside
Liquidation value	1.16	3%
Reproduction value	2.73	141%

Source: Reperio Capital Research estimates

Miko International has 3% upside to its net current asset value per share and 141% upside to its reproduction value per share. Given the company is trading at a discount to its net current asset value per share, the market is given the company no credit for its extremely profitable and growing operations. In an industry with no competitive advantage, a company's intrinsic value is its reproduction value as competition will freely enter the market at time of excess profits and exit the market at times of weak profitability. Reproduction value takes into account distribution expenses as well as research and development expenses, which are both amortized over a five-year period, as these expenses need to be replicated to reproduce Miko's current competitive position. Clearly, the market is undervaluing Miko relative to its assets.

Earnings Valuation

Miko is valued using the average valuation of three methods discounted cash flow, residual income, and earnings power valuation. Discounted cash flow and residual income valuations assume a five-year forecast period with a fade to terminal assumptions in year ten.

All valuations scenarios assume a 10% discount rate and a 25% tax rate equal to the company's statutory tax rate.

The table below illustrates Miko's 2015 and 2020 target price under various assumptions.

Earnings Based Valuations (DCF/EVA/EPV)	2015 Target Price (HKD)	2015 Upside	2020 Target Price (HKD)	2020 Upside
No growth, trough margins & capital turnover	2.65	134%	2.65	134%
No growth, current margins & capital turnover	3.10	174%	3.10	174%
No growth, average margins & capital turnover	3.18	182%	3.16	180%
No growth, peak margins & capital turnover	3.62	221%	3.59	218%
5% growth, trough margins & capital turnover	4.11	264%	4.86	330%
5% growth, current margins & capital turnover	4.87	331%	5.83	416%
5% growth, average margins & capital turnover	5.01	343%	5.98	429%
5% growth, peak margins & capital turnover	5.73	407%	6.89	510%
5% forecast period growth, trough margins, fade to no excess profits	2.58	128%	2.41	113%
10% forecast period growth, trough margins, fade to no excess profits	2.79	147%	2.76	144%
15% forecast period growth, trough margins, fade to no excess profits	3.05	170%	3.21	184%
20% forecast period growth, trough margins, fade to no excess profits	3.37	199%	3.78	235%
5% forecast, 0% terminal growth, trough margins & capital turnover	2.91	158%	3.11	175%
10% forecast, 0% terminal growth, trough margins & capital turnover	3.26	188%	3.72	229%
15% forecast, 0% terminal growth, trough margins & capital turnover	3.69	226%	4.50	298%
20% forecast, 0% terminal growth, trough margins & capital turnover	4.24	275%	5.51	388%
Average Earnings Valuations Upside	**3.64**	**222%**	**4.07**	**260%**

Source: Reperio Capital Research estimates

2015 target prices range from HKD2.58 per share to HKD5.73 per share, while 2020 target prices range from HKD2.41 to HKD6.89. No growth 2015 target prices range from HKD2.65 to HKD3.62, while 5% growth 2015 target prices range from HKD4.11 to HKD5.73.

On the most conservative valuation assumptions, there is 113% upside over the next five years. This scenario assumes 5% growth over the next five years with trough margins. After five years, growth fades to 0% and profitability fades to the cost of capital. Given the relative immaturity in the sub-sector and the current market growth rates, 5% seems conservative, but as illustrated in the risk section, growth in other apparel growth can turn quickly, although this occurred in a much more mature market without the tailwinds of the loosening of the one child policy. Trough operating margins for the next five years also seems conservative as the current growth in the market weakens the competitive rivalry allowing current/average operating margins to remain. Again, as growth goes so goes profitability in this sector. This scenario allows for the strategic assumption of growth slowing and competitive rivalry intensifying between year five and year ten leading to terminal profitability equal to the cost of capital. This is probably an appropriate assumption given the evidence that the industry lacks barriers to entry. If supply cannot be constrained, it will eventually catch up with demand both leading to excess profits being eliminated.

Our base case scenario assumes 10% growth over the next five years with trough operating margins fading to no excess profits in year ten leading to 147% upside. This scenario assumes a growth rate half of the current market growth with competitive pressures increasing in year six to year ten. The logic behind the assumptions seem sound as does the fact that the upside is roughly in line with the upside seen under the reproduction valuation. Given the lack of barriers to entry and the uneasiness on which excess profitably currently stands, reproduction value seems like an appropriate valuation methodology. It is conservative in the short run as Miko has a few years of excess profits but it will eventually converge with the company’s intrinsic value.

Expected Return

Expected return eliminates any forecasting, but assumes current profitability will be constant.

Expected Return	TTM	Mean Reversion
NOPAT yield	27.9%	13.9%
-Dividend yield	2.7%	2.7%
=Reinvested earnings yield	25.2%	11.2%
xFranchise value	2.00	1.00
=Value of reinvested earnings	50.5%	11.2%
+Dividend yield	2.7%	2.7%
+Organic growth	5.0%	0.0%
Expected return	**58.1%**	**13.9%**

Source: Reperio Capital Research estimates

The trailing twelve-month expected return assumes a continuation of current earnings. The reinvestment rate is assumed to be 20% half of the current five-year average of 39% leading to an expected return of 58.1%.

The second column labeled mean reversion assumes current profitability returns to the cost of capital, or a fall in trailing twelve-month earnings by 50%, and any reinvestment is at the cost of capital. This scenario still leads to a 14% expected return.

<u>WHY IS IT CHEAP</u>

Miko International is a busted IPO that listed during period of significant weakness in the apparel industry.

Same Store Sales Growth	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014
Anta	-5%	-5%	0%	0%	0%	5%	5%	10%
Xtep	-5%	-5%	0%	0%	0%	0%	2%	2%
361 Degrees	4%	4%	-2%	-1%	0%	2%	2%	3%
Peak	0%	0%	0%	0%	2%	2%	2%	2%
Giordano	-2%	-1%	-7%	-8%	-5%	-8%	-10%	1%
Le saunda	9%	8%	15%	18%	14%	10%	15%	12%
Belle	3%	3%	5%	1%	1%	1%	-2%	-3%
C.banner	6%	3%	2%	-10%	-10%	-8%	-9%	-2%
Daphne	5%	2%	-3%	-14%	-18%	-5%	-10%	-2%
Stella	-8%	-1%	9%	-9%	7%	-6%	-9%	-9%

Source: Company data

The table above illustrates same store sales growth for a number of Chinese apparel peers. From Q2 2013 to Q1 2014, the average same store sales growth of Miko's peers was 1.2%. In addition, growth from additional store count stagnated with store count growth decreasing from 18% in 2011 to -2% in 2013 and 2014.

Store Count Growth	Miko	Bosideng	China Lilang	Giordano	Bossini	Anta	Belle	Daphne	361	XTEP	Goldlion	Peak Sport	Le saunda	Average
2011	18%	68%	13%	14%	8%	11%	24%	19%	2%	8%	17%	8%	20%	18%
2012	6%	6%	6%	-1%	-11%	-7%	24%	12%	3%	-1%	0%	-17%	7%	2%
2013	1%	30%	-1%	0%	-23%	-4%	18%	-8%	-10%	-2%	-14%	-7%	-6%	-2%
2014	4%	-10%	-11%	-7%	-5%	-2%	9%	1%	0%	-3%	1%	0%	-3%	-2%

Source: Company data

The weakness in the industry is also seen in the Chairman's Statement in many 2014 Annual Reports.

Bosideng's March 2014 Annual Report stated, "Last year was a tough year for the entire apparel industry. Faced with shrinking market demand, inventory backlog, competition from e-commerce and overseas fast fashion brands, the profitability across the industry decreased. Given the changing market environment, the apparel industry can no longer rely on low cost and mass production as in the past, the industry is undergoing a new era of transformation."

China Lilang 2014 Annual Report stated "This was also a year that our brands gave full play to its creativity, vigor, and perseverance to overcome adversities in economy and the menswear industry… The menswear industry in China continued to close down stores and offered promotional discounts, with a view to disposing of excess inventory and addressing the issue of low efficiency at the stores which was resulted from the economic environment"

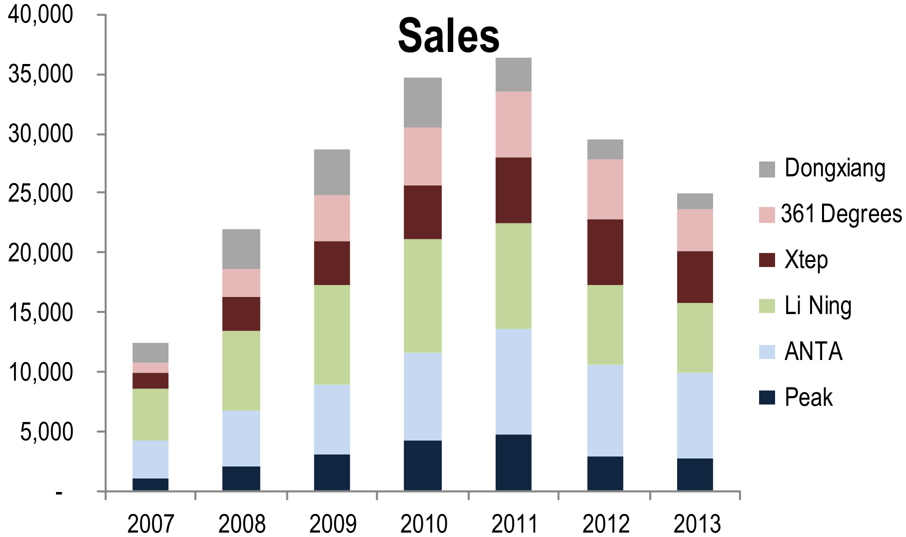
Daphne International 2014 Annual Report stated, "The year 2014 was extremely challenging for retailers in Mainland China, and the Group was not exempt. Moderate growth is now recognized as the new norm for China's economy. Overall consumption sentiment remained soft. During the year, stiff competition from local regional players and online retailers, as well as rising operating costs persisted, if not intensified, in China."

Goldlion's Annual Report stated, "During the year under review, the Group has experienced one of the most severe operating environment in recent years."

In addition to the weak operating environment for the apparel industry, the company also has no analyst coverage.

RISKS

A slowing children's apparel market could intensify the competitive rivalry within the sub-sector leading to weaker profitability. The recent history of the sportswear industry past provides a good case study in increasing competitive rivalry. From 2007 to 2011, revenues within the sub-sector were growing at 30% per year in the run up to and directly after the 2010 Olympics in Beijing.



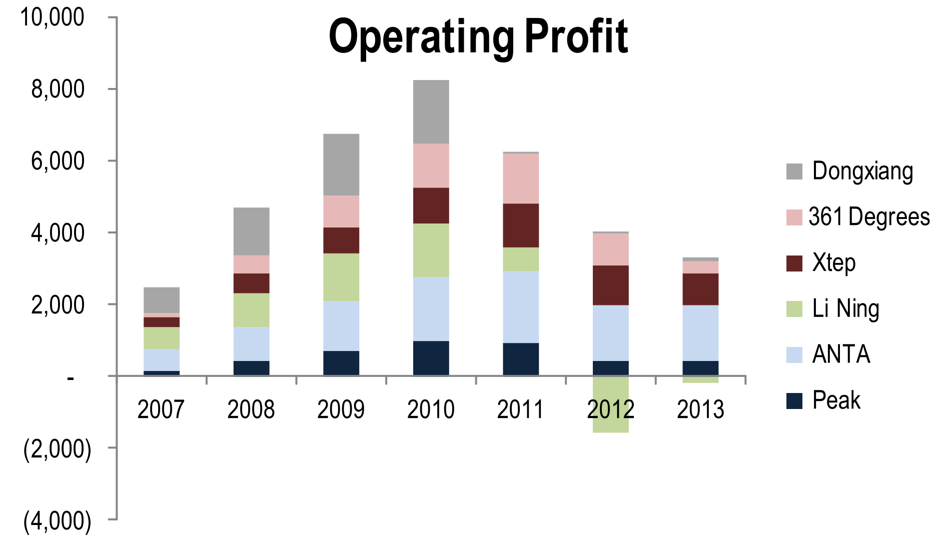
Source: Company data

In 2012, industry growth stalled as cumulative revenues decreased by 31% in 2012 and 2013, surprising industry participants leading to a significant increase in inventories and cash conversion cycle with the cash conversion cycle increasing from 27 days in 2010 to 143 days in 2013.

Cash Conversion Cycle (days)	2006	2007	2008	2009	2010	2011	2012	2013
Peak	42	31	38	64	55	67	159	171
ANTA	-	7	19	19	19	27	38	32
Li Ning	58	54	40	30	33	55	75	89
Xtep	168	94	53	32	27	64	90	95
361	(37)	5	14	4	11	45	90	115
Dongxiang		(2)	3	7	17	135	326	359

Source: Company data

The weakness in sales growth lead to a drastic decrease in the sub-sector's operating profit with the six largest domestic sportswear companies registering a 50% decline in operating profits over the two year period.



Source: Company data

The drop in profitability led to a sharp fall in valuations with the average EV/EBIT falling from 11.9 times in 2009 to 4.8 times in 2013 after eliminating outliers.

EV/EBIT	2008	2009	2010	2011	2012	2013
Peak	10.8	8.0	6.9	1.4	1.6	2.6
ANTA	5.0	15.8	12.9	7.4	5.9	8.9
Li Ning	11.5	19.6	9.1	8.1	NM	(36.2)
Xtep	3.1	8.9	8.2	2.5	3.0	4.9
361	0.2	5.1	7.4	4.5	2.7	2.9
Dongxiang	2.9	14.1	5.8	7.8	NM	19.8
Average	**5.6**	**11.9**	**8.4**	**5.3**	**3.3**	**0.5**

Source: Reperio Capital Research estimate

This drop in profitability and valuations took place in a far more concentrated sub-sector than children's apparel. In 2013, the top ten-sportswear companies accounted for 53.31% of the market compared to 28.6% of the market in children's apparel. This lack of concentration could lead to even greater rivalry.

The company lacks a long operating history with financial statements only going back to 2010. The lack of operating history does not allow an assessment of how the company will perform during an industry downturn when competitive pressures are elevated.

The company faced quality control issues as the company's products manufactured by its OEMs did not meet regulatory guidelines on a few occasions leading to recalls.

Corporate governance seems to be good with the exception of the company's distribution agreement with the brother of the founder and Chairman is potentially a conflict of interest.

The company sells its products through distributors and the company does not have complete control over its supply chain.

If the company does not respond to changes in the consumer preferences, the company's brand, sales, and profits could be hurt.

The market is growing and the company may not be able to meet customers' needs in new markets.

FINANCIAL STATEMENTS

Financial Summary (RMB mn)	2010	2011	2012	2013	2014
Sales	**327**	**392**	**520**	**661**	**796**
Gross profit	131	144	196	260	300
Selling and distribution expenses	(34)	(43)	(50)	(47)	(58)
Adminstrative expenses	(9)	(11)	(13)	(20)	(34)
Operating profit	**89**	**90**	**133**	**193**	**208**
Other income	0	1	0	(12)	(11)
Financial income (expense)	(2)	(2)	(2)	(4)	(3)
Profit before tax	**87**	**88**	**131**	**177**	**193**
Income tax	(11)	(11)	(15)	(48)	(55)
Profit after tax	**76**	**77**	**115**	**130**	**138**
Cash	55	7	13	260	487
Accounts receivables	49	116	202	236	292
Inventory	71	82	28	39	42
Other current assets	44	28	82	22	41
PP&E	47	44	41	91	148
Intangibles	0	0	0	1	4
Other non-current assets	7	5	6	5	6
Total assets	**273**	**281**	**371**	**653**	**1,020**
Accounts payable	6	8	11	16	17
Other NIBCLs	46	20	28	44	39
ST debt	180	132	95	222	38
LT debt	-	-	-	-	-
Other liabilities	-	-	0	-	1
Total liabilities	**232**	**160**	**135**	**281**	**95**
Equity	41	121	236	371	925
Shares outstanding, basic end	640	640	640	640	824
Shares outstanding, diluted end	640	640	640	647	830

Total debt	180	132	95	222	38
Net debt	124	125	82	(38)	(449)
Invested capital	158	241	313	327	468
Tangible invested capital	158	241	312	327	464
Net operating assets	187	300	402	441	611
Net tangible operating assets	187	300	402	441	607
Net financial assets	(117)	(121)	(76)	43	455
Cash flow from operations	**85**	**83**	**121**	**149**	**148**
Working capital investment	(94)	(85)	(106)	31	(83)
Fixed capital investment	(2)	(1)	(0)	(54)	(64)
Free cash flow	**(11)**	**(3)**	**15**	**126**	**1**
Other investing	0	0	0	1	(53)
Cash from/(to) debtholders	62	(50)	(10)	126	(43)
Cash from/(to) shareholders	-	-	-	(1)	267

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