

Peak Sport Products: A Highly Profitable Niche Player Trading at a 10% Premium to Net Current Asset Value

Peak Sport Products

2015 Target Price: HKD3.49

Closing Price (3/23/2015): HKD2.24

March 23, 2015

Recommendation: Buy

2015 Target Price Range: (HKD3.49-4.59)

Upside: 56%

EXECUTIVE SUMMARY

Peak Sport Products designs, develops, manufactures and markets sportswear in China and internationally. The company's focus is primarily basketball but it is expanding into running and tennis. It has a quality product at competitive prices offering good value for money. Peak is an attractive investment opportunity for a number of reasons.

1. Peak is highly profitable business with minimal investment requirements
2. The company has a net cash position equal to 66% of its market cap with an increasing dividend payout ratio
3. Peak's revenues and profitability stabilized and growth has returned
4. In addition to the Chinese Sportswear Market, Peak has significant international presence
5. Peak is a strong niche player with a quality product at cheap prices
6. Peak's management is honest, disciplined and incentivized to increase the company's share price
7. There is limited downside at current valuations and potential for significant upside

FACTOR RATINGS

Factor	Rating	Comment
Financial Health	5	The company has a huge net cash position in a business with low capital requirements and generates significant free cash flow
Business Quality	4	Industry with strong FCF generation and low capital requirements but market structure that is very fragmented and competitive. Peak is a second tier competitor within its industry
Management Quality	3	
Operations	3	Disciplined to remain in niche, strong product leading to high market share in niche, outperforming most peers during industry downturn, poor working capital management but strong fcf generation and profitability
Capital Allocation	3	Net cash position is too high should be used to buy back shares at large discount to intrinsic value or returned to shareholders, misallocation of capital toward manufacturing
Corporate Governance	4	Very small rent expense to a related company, Director's salaries averaged 1.1% of operating income, Management's wealth is tied directly to the share price as share ownership dwarfs annual salary, and accounting is in-line with industry standards
Valuation	5	Very profitable business trading just above conservative liquidation value
Growth Prospects	3	Industry maturing but should provide atleast 5% top line growth longer term with potential for upside

Scale 1 = worst 5 = best

Source: Reperio Capital Research



KEY STATISTICS

KEY STATISTICS	TTM	9Yr Ave Denom
Current Price (HK\$)	2.24	
Price Range	1.86 - 2.45	1.12 - 5.54
Ave Daily Vol (Shares mn)	2.24	4.36
Shares Outstanding (mn) basic	2,098	
Shares Outstanding (mn) diluted	2,129	
Market Cap (HK\$ mn) diluted	4,768	
Net Debt (HK\$ mn)	(3,147)	
Other Claims (HK\$ mn)	-	
Enterprise Value (HK\$ mn)	1,621	
EV per Share	0.77	
Net Debt/Equity	(0.59)	
Net Debt/EBIT	(5.89)	
Net Current Asset Value per Share	2.04	1.33
Tangible Invested Capital per Share	0.97	0.63
Net Tangible Operating Assets per Share	0.76	0.54
Tangible Book Value	2.51	1.61
Net Financial Assets per Share	1.65	1.06
Sales per Share	1.68	1.59
EBIT per Share	0.25	0.29
Earnings per Share	0.19	0.25
FCF per Share	0.26	0.16
Residual Income per Share	0.09	0.18
Insider Ownership	68.9%	
Fiscal Year End	December	

Source: Company data, Reperio Capital estimates

VALUATION METRICS	TTM	9Yr Ave Denom
P/NCAV	1.1	1.7
EV/IC	0.8	1.2
EV/NOA	1.0	1.4
P/TB	0.9	1.4
EV/Sales	0.5	0.5
EV/EBIT	3.1	2.6
PE	11.8	9.1
EV/FCF	3.0	4.8
EV/Residual Income	8.7	4.3
EBIT Yield	33%	38%
FCF Yield	33%	21%
Dividend Yield	6%	5%
PROFITABILITY		
RoTE	8%	27%
RoTIC	16%	69%
RoNOA	20%	79%
FCF RoTIC	17%	35%
FCF RoNOA	34%	26%
Gross Profit/Assets	18%	34%
Gross Margin	38%	35%
Operating Margin	15%	18%
Effective Tax Rate	34%	19%
FCF Margin	15%	9%
IC Turnover	1.7	3.7
Net Operating Asset Turnover	2.2	4.2

INVESTMENT THESIS

1. Peak is highly profitable business with minimal investment requirements

Since 2006, Peak consistently generates, on both an operating profit and cash flow basis, above cost of capital Returns on Net Tangible Operating Assets (RONA) and Returns on Tangible Invested Capital (ROTIC). Peak continues to show strong profitability despite a period of significant turbulence within the industry when other industry players are seeing continued losses or near losses (Li Ning, China Dongxiang, and Meike).



Profitability	2006	2007	2008	2009	2010	2011	2012	2013	2014
Return on Assets	31%	17%	26%	18%	20%	16%	6%	4%	5%
Return on Tangible Equity	73%	39%	49%	21%	24%	19%	8%	6%	8%
Return on Tangible Invested Capital	154%	76%	80%	68%	116%	58%	20%	21%	27%
Return on Net Tangible Operating Assets	190%	83%	88%	71%	128%	67%	23%	25%	33%
FCF Return on Tangible Invested Capital	131%	-7%	19%	9%	116%	3%	-2%	24%	19%
FCF Return on Net Tangible Operating Assets	0%	-5%	26%	10%	133%	12%	2%	33%	22%
Gross Profit to Total Assets	54%	35%	47%	34%	38%	38%	21%	17%	18%
Investment Requirements	2006	2007	2008	2009	2010	2011	2012	2013	2014
Working Capital Inv % Sales	-1%	6%	-6%	-13%	6%	-10%	-5%	6%	2%
Fixed Capital Inv % Sales	-1%	-7%	-7%	-4%	-3%	-4%	-6%	-3%	-1%
Total Inv % Sales	-2%	-1%	-13%	-17%	3%	-14%	-12%	4%	1%
Inv in NOA % Sales		-16%	-12%	-17%	5%	-13%	-8%	9%	1%
Inv in IC % Sales		-17%	-13%	-17%	4%	-15%	-11%	8%	2%

Source: Company data, Reperio Capital Research estimates

Since 2006, Peak's overall investment requirements averaged 6% of sales with working capital investment requirements averaging 2% of sales and fixed capital investments averaging 4% of sales.

2. The company has a net cash position equal to 66% of its market cap with an increasing dividend payout ratio

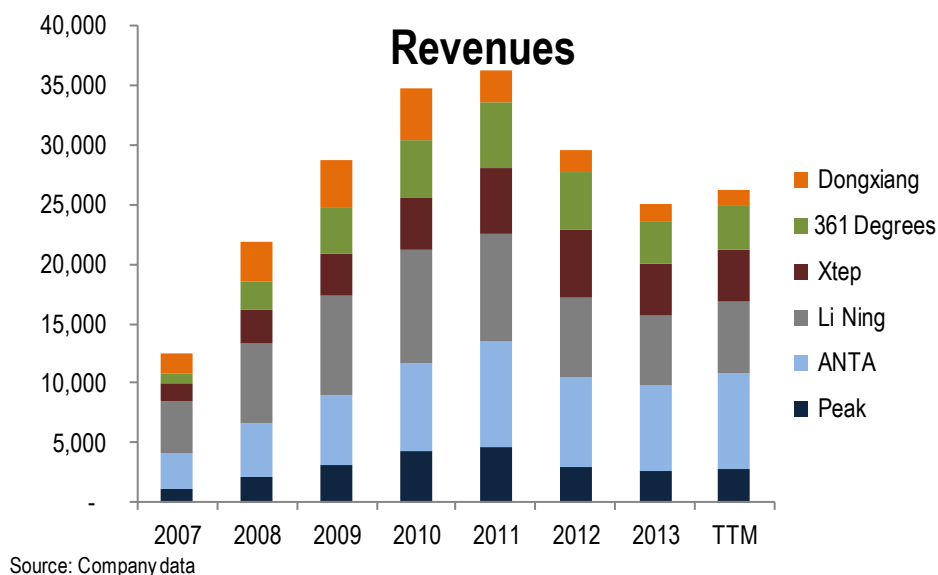
Peak has a net cash position equal to HKD1.47 per share on a diluted basis compared to a share price of HKD2.24 per share. Given the high returns generated and low capital requirements, Peak is paying out an increasing portion of earnings in the form of dividends with its formal dividend payout policy now to pay a minimum of 50% of earnings in dividends.

Dividend Payout	2006	2007	2008	2009	2010	2011	2012	2013	2014
Sales per Share	0.37	0.60	1.22	1.48	2.03	2.21	1.38	1.25	1.35
EBIT per Share	0.07	0.10	0.24	0.33	0.47	0.43	0.18	0.16	0.20
Earnings per Share	0.06	0.09	0.22	0.30	0.39	0.37	0.15	0.12	0.15
FCF per Share	0.06	(0.01)	0.07	0.05	0.49	0.08	0.02	0.21	0.14
Residual Income per Share	0.06	0.08	0.19	0.25	0.35	0.29	0.05	0.03	0.06
Dividends per Share	-	-	0.08	0.13	0.15	0.11	0.08	0.13	0.10
Dividend Payout	0.0%	0.0%	33.6%	42.4%	37.2%	30.7%	55.0%	108.8%	62.3%

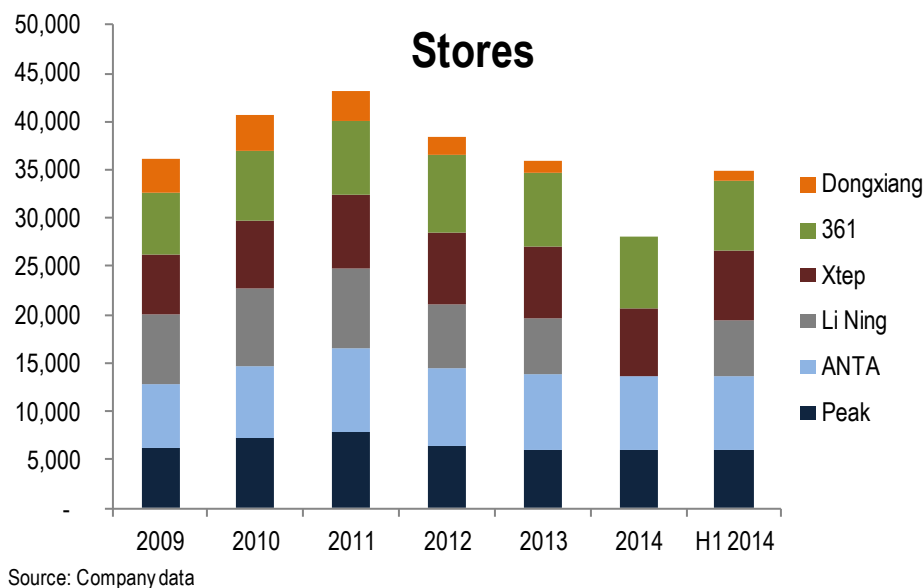
Source: Company data, Reperio Capital Research estimates

3. Peak's revenues and profitability stabilized and growth has returned

The Chinese Sportswear Industry recently went through a period of consolidation as illustrated by the cumulative revenues of ANTA, Li Ning, Xtep, 361 Degrees, Peak, and China Dongxiang. From 2011 to 2013, cumulative revenues declined by 31%. The first half of 2014 trailing twelve-month (ttm) cumulative revenues increased by 4.5% over 2013 revenues, the first sequential increase since 2012. Companies already reporting 2014 results (Peak, ANTA, Xtep, 361 Degrees) have cumulative revenue growth of 13%.



Stabilization of revenues is directly linked to the stabilization of retail capacity. The industry went through a period of significant retail expansion from 2007 to 2011 leading to overcapacity. Post 2011, the industry contracted retail capacity with the total number of retail outlets decreasing from a peak of 43,214 in 2011 to 34,906 at the end of the first half of 2014. The companies that have reported 2014 store count showed a decrease of -2.7% over the first half 2014. Going forward, retail outlet growth in China is unlikely to be a significant driver of growth for Peak or the overall industry.



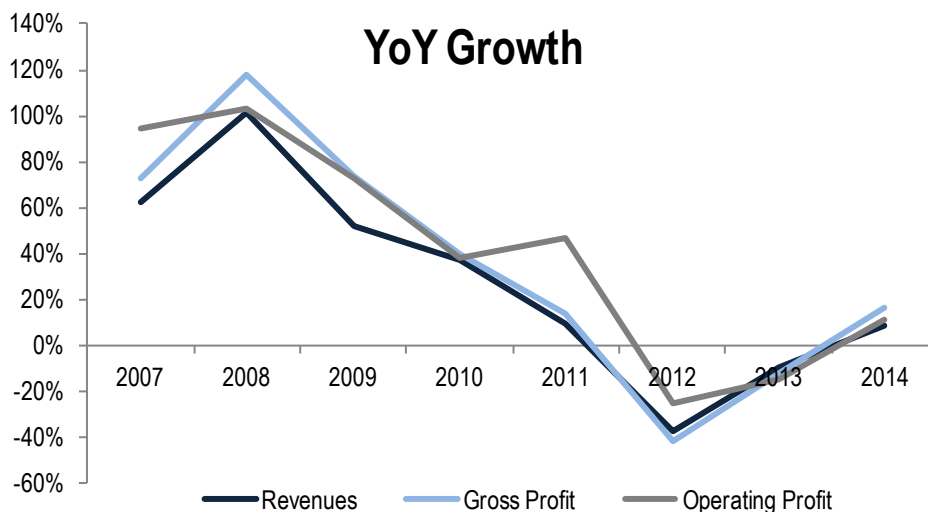
In addition to the stabilization of retail outlets, same store sales growth has returned to the industry. All firms reporting same store sales growth have reported positive same store sales growth since Q3 2013.



Same Store Sales Growth	Q1 2011	Q2 2011	Q3 2011	Q4 2011	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014	
Anta	8%	8%	5%	0%	-2%	-8%	-5%	-5%	0%	0%	0%	0%	mid single digit growth	mid single digit growth	low double digit growth	high single-digit	high single-digit
Xtep	8%	15%	8%	3%	-3%	-3%	-5%	-5%	0%	0%	0%	0%	low single digit growth	mid single-digit increase	mid single-digit increase		
361 Degrees	15%	18%	14%	9%	7%	5%	4%	4%	-2%	-1%	0%	2%	2%	3%	5%	6%	
Peak	13%	12%	6%	2%	0%	-18%	0%	0%	0%	0%	0%	0%	low single digit growth	low single digit growth	low single digit growth	low single digit growth	low single digit growth

Source: Company data

Peak revenues and profitability are growing after a decline similar to the industry. The company reported revenue and operating profit growth for three straight halves after four halves of declining revenues and operating profit.

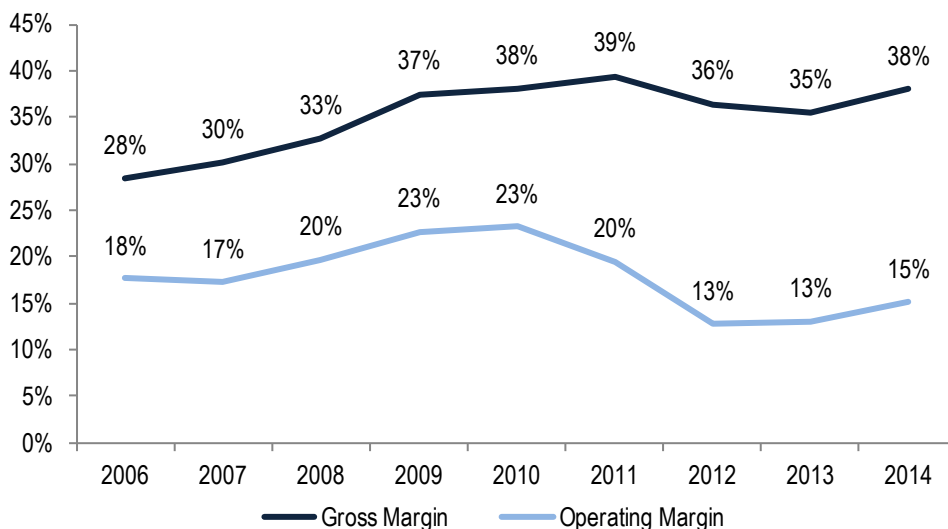


Source: Company data, Reperio Capital Research estimates

YoY Growth	H1 2010	H2 2010	H1 2011	H2 2011	H1 2012	H2 2012	H1 2013	H2 2013	H1 2014	H2 2014
Revenues	33%	40%	25%	-2%	-29%	-46%	-27%	12%	10%	8%
Gross Profit	24%	6%	37%	-4%	4%	-35%	-26%	-11%	32%	-6%
Operating Profit	38%	42%	23%	-30%	-43%	-79%	-58%	162%	31%	22%

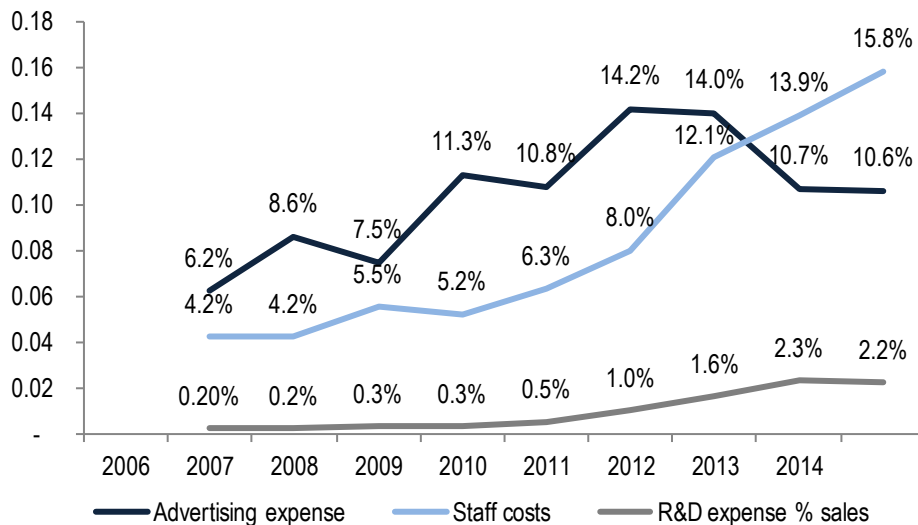
Source: Company data, Reperio Capital Research estimates

Further evidence of the stabilization and the return to growth is the improvements in Peak's margins. The company saw a significant decline in its gross margin in 2012 and 2013 due to heavy discounting to clear inventory from the channel and help struggling distributors and retailers. Gross margin is normalizing as the company eliminates discounts to distributors.



Source: Company data, Reperio Capital Research estimates

Operating margin is also starting to improve after two weak years. The strength in operating margin is primarily due to the improvement in gross margin. Advertising and promotional expense moderated as a percentage of sales while R&D expense continues to increase at a moderately faster pace than top line growth. The fastest growing cost element is staff costs, which has grown from 4.2% of revenues in 2006 to 15.8% of revenues in 2014 or at a CAGR just above 22% on both an absolute and per employee basis.



Source: Company data, Reperio Capital Research estimates

The staff cost inflation is coming from the lower level employees as director's salaries have remained constant around CNY5.5 million since 2010.

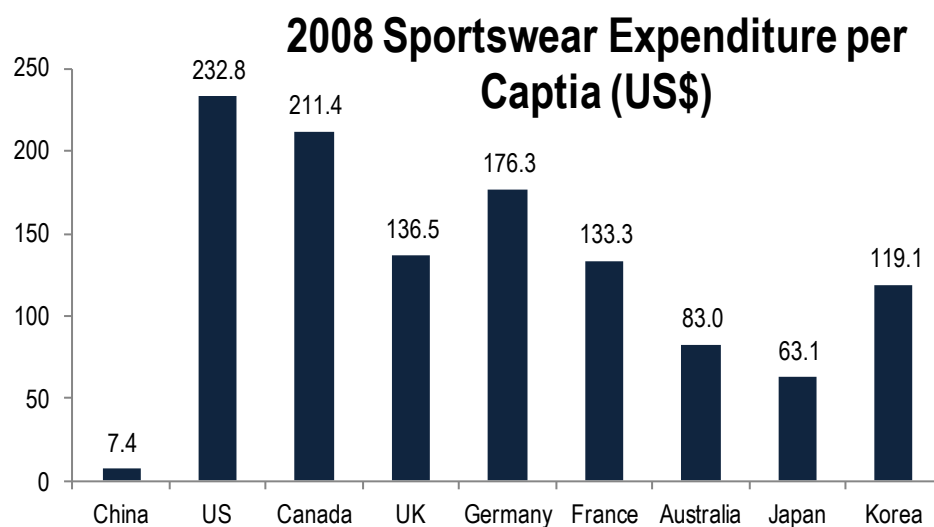
Additional evidence of improvement in Peak's operating environment is working capital improvements.

Working Capital Management	2006	2007	2008	2009	2010	2011	2012	2013	2014
Accounts Receivable Days	64	161	91	102	64	86	137	137	127
Inventory Days	59	57	30	25	29	33	49	51	44
Other Current Assets Days	7	-	-	-	-	-	-	-	-
Accounts Payable Days	89	141	66	40	52	44	47	58	54
Other NIBCLs Days	13	27	12	3	5	4	4	9	9
CCC	28	50	43	83	35	70	135	121	108

Source: Company data, Reperio Capital Research estimates

After a significant increase in inventory days and receivables days during the period of industry stress, Peak's cash conversion cycle is improving showing a decrease to 148 days in 2014 down from 171 days in 2013. Working capital still has a long way to go as the average cash conversion cycle was 62 days from 2009 to 2011. The company is putting greater emphasis on supplemental orders over seasonal orders to decrease the risk of inventory backlog. If successful, it should greatly decrease working capital requirements.

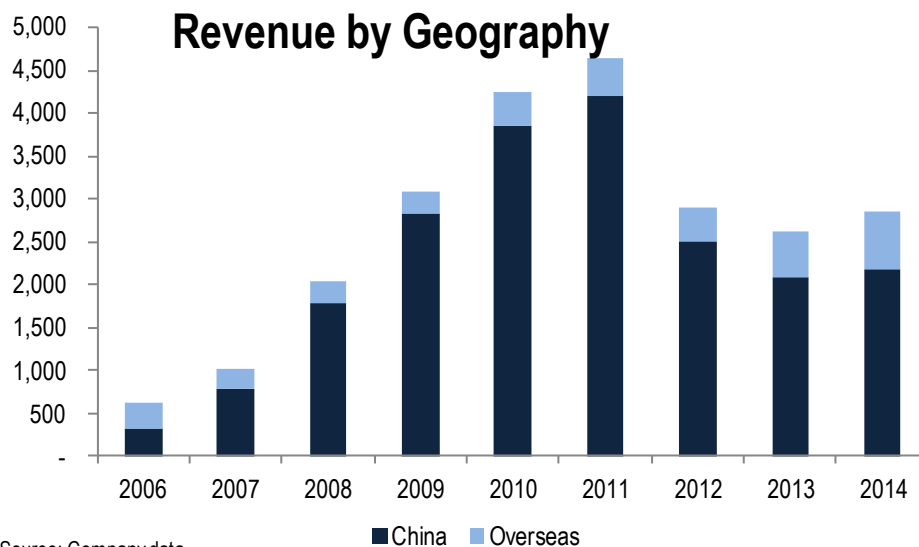
In the long term, the Chinese Sportswear market has growth potential with AT Kearney predicting 10% annual growth rate. The chart below illustrates the under penetration of sportswear in China. Assuming China per capita spending has double since 2008, it is still only at \$15 per person. Assuming it takes 20 years to reach Japan's per capita spend, the market will grow at 7.5% per annum. The Chinese Sportswear market should grow by 5-10% over the longer term with an equal split between volume growth and ASP growth.



Source: Frost & Sullivan

4. In addition to the Chinese Sportswear Market, Peak has significant international presence

Prior to the significant growth from the Chinese market, Peak's international revenues were equal to its Chinese revenues.



Given the growth in the market, Peak placed more emphasis on the Chinese market. With that market now stabilizing and growing at a much slower pace focus can be placed on Peak's international opportunity and expanding its international distribution network.



5. Peak is a strong niche player with a quality product at cheap prices

Despite the significant growth in the Chinese market and temptation to diversify, Peak has remained disciplined and focused on its niche within basketball. According to the China General Chamber of Commerce and the China National Commercial Information Center, Peak has been the top selling domestic basketball brand in China over the past six years (2008-2013) with a 9.8% market share at the end of 2013. This discipline allows Peak to focus its R&D and marketing effort providing a consistent message and a product with strong basketball functionality.

In addition to being the top selling domestic brand in China, Peak is getting very strong reviews from basketball shoe aficionados in the US without having a significant presence (two stores). Peak's basketball footwear is seen as very good quality for money in both the US and China. Peak's products are not flashy nor do they have the best materials but it provides high quality for the money. Peak's products are very functional. Given the focus in basketball rather than fashion, customers want functionality. They are looking for traction, cushion, comfort, fit, materials, support, and breathability.

Peak's TP1 shoes were voted among the top performance picks a website dedicated to reviewing basketball shoes (<http://weartesters.com/top-performance-picks/>). There were 15 other basketball shoes on the list. No other Chinese Sportswear company made the list. The average price of shoes on the list is \$129.99. Peak TP1's were priced at \$89.99, near the bottom of the price range. The TP1 is the one of Peak's most expensive product illustrating the company's value for money approach.

Wear testers Top Performance Picks	Price (USD)	Shoe
PEAK TP1	89.99	Men's
Nike Kobe X	179.99	Men's
Nike HyperRev 2015	129.99	Men's
adidas D Rose 5 Boost	139.99	Men's
Under Armour Curry One	89.99	Boy's
Air Jordan XX9	224.99	Men's
Nike LeBron 12	199.99	Men's
Jordan Super.Fly 3	104.99	Men's
Nike KD 7	149.99	Men's
Jordan Melo M11	159.99	Men's
Nike Hyperdunk 2014	99.99	Men's
Under Armour Anatomix Spawn 2	89.99	Men's
Nike Prime Hype DF	84.99	Men's
Nike KB Mentality	99.99	Men's
adidas D Lillard	104.99	Men's

Source: weartesters.com, eastbay.com, 3/2/2015

Peak's cushion system, Gradient Dual Cushion, scores very highly on cushion and comfort. Some customers like the Gradient Dual Cushion so much they take the cushioned sole out of their Peak basketball shoes and put it into other shoes. Peak ranks very high on traction, fit and the value for money of Peak's shoes. Peak's focus on basketball has allowed it to produce shoes that basketball players really like. Peak's non-athlete branded shoes are much cheaper at only \$62.99.

Peak's focus on basketball and functionality also insulates it from competition from fast fashion players within China. Sportswear competitors such as Xtep, 361 degrees and China Dongxiang (Kappa) are much more fashion oriented and prone to higher competitive pressures while Peak's customers mainly purchase their products not for fashion but for functionality.

6. Peak's management is honest, disciplined and incentivized to increase the company's share price

Peak's senior management is honest. Other than a rent expense amounting to 0.5% of 2014 operating income, there are no corporate governance issues.

Company's management is discipline staying in the company's niche of basketball and selectively branching into other sports markets.

Since 2009, Directors' salaries have remained constant around CNY5.5 million or average of 1.1% of operating income. The salaries of the five highest paid employees has also remained constant around CNY7 million.

Over the same period, the Xu family salaries averaged CNY4.37 million per year. The Xu family collectively holds 68.81% of Peak's shares. With the company's market cap at HKD4,811 million on a diluted basis, the Xu family share in Peak is worth roughly CNY2,628 million. The family's collective annual salary is only 0.18% of the value of the family's shares meaning they are highly incentivized to increase the company's share price.

7. There is limited downside at current valuations and potential for significant upside

Despite the strengths mentioned above, Peak is current trading just above its liquidation value (9% downside) with its net current asset value per share equal to HKD2.04 compare to the company's current price of HKD2.24.

On a diluted basis, the current market price only values Peak at an EV/ttm EBIT of 3.1 times and an EV/ttm FCF of 3.0 times. A very profitable business with a runway for growth, strong financial health, and honest, disciplined management should not be trading on an EBIT yield and FCF Yield over 30%.

Given the current valuation and the strengths already mentioned, the market is giving no credit to the company's ongoing profitability, which seems to be excessively pessimist.

The table below illustrates Peak Sport's target price using various valuations methods.

Valuation Assumption	2015	
	Target	Upside
Liquidation Value	2.04	-9%
Reproduction Value	2.73	22%
Earnings Based Valuations (DCF/EVA/EPV)		
No Growth, Trough Margins	3.19	42%
No Growth, Current Margins	3.49	56%
No Growth, Hist. Ave Margins	3.91	75%
No Growth, Peak Margins	4.51	102%
5% Growth, Trough Margins	4.00	78%
5% Growth, Current Margins	4.59	105%
5% Growth, Hist. Ave Margins	5.42	142%
5% Growth, Peak Margins	6.62	195%
Average Earnings Valuations Upside	4.46	99%

Source: Reperio Capital Research estimates

The worst-case scenario for any company is liquidation value. This is an appropriate valuation when the company operates in an industry that is not viable or the company does not have a viable position within its industry. The Chinese Sportswear industry is very viable given under penetration of sportswear in China and continued profitability among players within the industry. The industry's recent period of weakness saw some smaller weaker companies exit the industry and some larger players reporting losses but Peak remained profitable. In addition to consistent profitability, the strength of the company's position within the basketball segment, the quality of the company's product and the value of Peak's product relative to quality makes liquidation very unlikely. Despite these factors, there is only 9% downside to Peak's net current asset value per share of HKD2.04.

Net Current Asset Value (HK\$ mn except for per share)	2006	2007	2008	2009	2010	2011	2012	2013	2014	Current
Current Assets	302	828	1,322	3,477	4,372	5,158	5,272	5,895	6,360	6,346
Total Liabilities	188	511	749	452	840	1,025	1,200	1,689	2,036	2,032
NCAV	114	317	573	3,025	3,532	4,133	4,072	4,206	4,324	4,314
NCAV per share	0.07	0.19	0.34	1.44	1.67	1.96	1.93	1.99	2.03	2.03
Current Price	0.16	0.36	3.35	3.55	4.12	4.90	1.97	1.46	2.15	2.24
Upside	-58%	-47%	-90%	-59%	-59%	-60%	-2%	36%	-6%	-10%

Source: Company data, Reperio Capital Research estimates

Reproduction value assumes no barriers to entry within the industry meaning supply can freely enter an industry and profitability will revert to the cost of capital within the industry. Under this scenario, the value of a company is no more than the cost of reproducing its assets. Peak has been able to generate consistent returns (RoIC and RONOA) above its cost of capital even during this period of industry stress and heavy discounting.

Profitability	2006	2007	2008	2009	2010	2011	2012	2013	2014
Return on Assets	31%	17%	26%	18%	20%	16%	6%	4%	5%
Return on Tangible Equity	73%	39%	49%	21%	24%	19%	8%	6%	8%
Return on Tangible Invested Capital	154%	76%	80%	68%	116%	58%	20%	21%	27%
Return on Net Tangible Operating Assets	190%	83%	88%	71%	128%	67%	23%	25%	33%
FCF Return on Tangible Invested Capital	131%	-7%	19%	9%	116%	3%	-2%	24%	19%
FCF Return on Net Tangible Operating Assets	0%	-5%	26%	10%	133%	12%	2%	33%	22%
Gross Profit to Total Assets	54%	35%	47%	34%	38%	38%	21%	17%	18%

Source: Company data, Reperio Capital Research estimates

Demand within the industry grew significantly between growth from 2006 to 2011 with the top Chinese Sportswear companies growing sales by 31% per year and store count growing by 16%. Supply was not able to keep up with demand and profitability was extraordinary illustrated by all profitability measures in the table.

Post 2011, the industry saw significant weakness with demand cooling and supply being withdrawn leading to heavy discounting in 2013 by sportswear brands to help distributors and retailers clear inventory from the channel. 2014 saw both pricing and profitability begin to normalize. Going forward, returns over the past few years are probably more likely than the returns of 2006 to 2011. Throughout the period of weakness, Peak still generated an average return on net operating assets 27% well above the assumed cost of capital of 10% evidence that reproduction value is a floor level and earnings based valuations are more appropriate for Peak. Despite reproduction value being a floor valuation, there is still 22% upside to the reproduction value. Reproduction value assumes R&D expense and marketing expense have a five-year life and are amortized on a straight-line basis. The reproduction value also assumes Peak's distribution channel will take five years to replicate.



Reproduction Value (HK\$ mn except for per share)										
	2006	2007	2008	2009	2010	2011	2012	2013	2014	Current
Assets	361	1,070	1,901	4,433	5,016	6,119	6,438	6,883	7,342	7,342
Cash	80	181	554	2,257	2,663	2,697	2,763	3,281	3,752	3,752
A/R	109	478	576	981	744	1,089	1,093	978	987	987
Inventories	100	169	192	239	335	421	386	366	346	346
PPE- net	23	98	285	365	433	621	749	774	720	720
R&D Asset	1	3	10	18	34	74	105	144	178	178
Selling & Distribution Asset	48	141	284	573	808	1,216	1,342	1,340	1,360	1,360
Liabilities	188	511	723	416	671	777	899	1,247	1,540	1,540
A/P, AT, AL	173	499	494	416	671	616	403	480	488	488
Debt	14	12	229	-	-	161	496	766	1,053	1,053
Reproduction Value	174	559	1,177	4,017	4,345	5,342	5,539	5,637	5,802	5,802
Shares Outstanding (diluted)	1,678	1,678	1,678	2,098	2,112	2,111	2,110	2,116	2,129	2,129
Reproduction Value per share	0.10	0.33	0.70	1.91	2.06	2.53	2.63	2.66	2.73	2.73
Current Price	0.16	0.36	3.35	3.55	4.12	4.90	1.97	1.46	2.15	2.24
Upside	-36%	-7%	-79%	-46%	-50%	-48%	33%	82%	27%	22%

Source: Company data, Reperio Capital Research estimates

Given Peak's continued excess returns, strong competitive position within a niche segment and growth from international opportunities, earnings based valuation seems to be the most appropriate valuation methodology. For the earnings, based valuation, an average valuation of DCF, Residual Income and an Earnings Power valuation is used. All these valuation methods assume a 10% discount rate, a tax rate of 35%, in-line with legal tax rate and incremental fixed capital investment of 32.8% and incremental working capital investment rate of 51.2%, in-line with historical averages.

Assumptions	First 5 Years	Terminal Rate
WACC	10.0%	10.0%
Tax Rate	35.0%	35.0%
Fixed Capital Investment Rate	32.8%	32.8%
Working Capital Investment Rate	51.2%	51.2%

Source: Reperio Capital Research estimates

Given accurate forecasting is nearly impossible, different sales growth and operating margin scenarios are used to arrive at a range target prices to determine what the market is pricing in and a potential intrinsic value based on conservative assumptions. The table below illustrates assumptions for each scenario and the target prices for 2015 and 2020. Given the potential for the Chinese Sportswear market, Peak's international revenues and the company's strong product; no growth in sales seems to be extremely conservative while 5% sales growth into perpetuity is aggressive as markets eventually mature.

Scenario Assumptions	Sales Growth	Operating Margin	2015 TP	2020 TP	2015 Upside	2020 Upside
No Growth, Trough Margins	0.0%	12.7%	3.19	3.48	42%	55%
No Growth, Current Margins	0.0%	15.1%	3.49	3.85	56%	72%
No Growth, Hist. Ave Margins	0.0%	18.4%	3.91	4.38	75%	96%
No Growth, Peak Margins	0.0%	23.2%	4.51	5.14	102%	130%
5% Growth, Trough Margins	5.0%	12.7%	4.00	4.60	78%	105%
5% Growth, Current Margins	5.0%	15.1%	4.59	5.44	105%	143%
5% Growth, Hist. Ave Margins	5.0%	18.4%	5.42	6.62	142%	196%
5% Growth, Peak Margins	5.0%	23.2%	6.62	8.33	195%	272%

Source: Reperio Capital Research estimates

Using the worst-case scenario assumptions of no revenue growth and a trough operating margin of 12.7%, Peak has 42% upside to its 2015 Target Price and 55% upside to its 2020 Target Price. This illustrates the market's pessimism towards Peak.

Assuming 5% revenues growth into perpetuity and a peak operating margins of 23.2% is probably too aggressive, therefore Peak's 2015 Target Price is between HKD3.19 and HKD6.62. Using no growth and current margins is still extremely conservative on the growth side while 5% growth into perpetuity with current margins is probably a little too aggressive. A tighter range would make Peak about 56-105% undervalued on 2015 Target Price and 72-143% undervalued on 2020 Target Price. The key factor in determining the future path of the company's stock will be operating margins.

INVESTMENT RISKS

1. Renewed weakness in the Chinese Sportswear Industry

If the current stabilization in the industry turns into a renewed decline it could affect the company's operating performance and share price. The company is trading just above NCAV and has a ttm EBIT yield and FCF yield above 30% providing sufficient margin of safety in case of renewed declines.

2. Industry competition may lead to increased marketing and R&D requirements

Competitors within the sportswear industry aim to differentiate products through marketing and product features. Given marketing and product features are not related to volume, larger players such as Nike, Adidas, ANTA, and Li Ning could outspend smaller players like Peak creating an ever-widening competitive advantage. This is particularly concern as the growth in the industry is slowing and customers are more sophisticated after having a great deal of contact with sportswear brands creating the need to differentiate products through both the offering (R&D) and customer perception (marketing). Outspending by larger players would lead to lose of share by Peak and decreased utilization of assets deteriorating profitability. Peak's focus on basketball, value for money offering, and overseas distribution insulate the company slightly but this is still a very big concern.

3. ANTA is aiming to be the number one domestic basketball brand in the next two years.

ANTA aspires to dethrone Peak as the number one domestic basketball brand within the next two years. ANTA recently signed a sponsorship agreement with the NBA in China, a sponsorship Peak had from 2007 until 2014. It has signed a number of well-known NBA players such as Rajon Rondo, Kevin Garnett, Chandler Parsons, and Luis Scola.

Despite ANTA increased aggression in the basketball market, consumers do not perceive ANTA's basketball product to have as good functionality or quality as Peak. In fact, ANTA's first Rajon Rando (one of the NBA player it endorses) basketball shoe was not view favorably by basketball sneaker aficionados.

ANTA is much larger and can spend significantly more than Peak on both R&D and marketing. From 2007 to 2014, ANTA spent just under 2 billion on R&D while Peak only spent about CNY250 million. Over the same period, ANTA spent over CNY5 billion on marketing and advertising while Peak only spent CNY2.7 billion.

ANTA is probably the top overall domestic sportswear company and is very well managed therefore it is definitely a concern but for now Peak's focus on basketball since 1991 resonates with consumers as does Peak high quality product at very competitive prices illustrated Peak being the top domestic basketball brand in China for six consecutive years. Valuations also provided sufficient comfort regarding increased competition from ANTA.

4. Macroeconomic weakness

Given the inability of top economists to reliable predict the economic outlook, any attempt on my part is futile. Valuations and long-term industry potential provide sufficient comfort over any potential macroeconomic concerns.

COMPANY BACKGROUND

Peak Sport Products designs, develops, manufactures and markets sportswear in China and internationally. The company's focus is primarily basketball but it's expanding into running and tennis.

History

Peak Sport Products' history starts when its predecessor, Feng Deng, was founded in 1988 as a sino-foreign joint venture. It was established by Quanzhou City Dengzhou and Refuse Processing Plant and Hong Kong Wah Company and was formed to provide OEM services for sports footwear. Mr. Xu Jingnan was the Chairman, General Manager and legal representative of Feng Deng.

Feng Deng began to promote Peak sports footwear in 1991 with the goal of creating an international sportswear brand with significant market share in China and abroad. Around the same time, the company began to establish offices in cities across China to promote and sell Peak sports footwear in major shopping malls and department stores. In December 1992, Feng Deng formed Fujian Peak to enhance and develop the Peak brand. Fujian Peak continued to develop by expanding its production capacity and extending its distribution network. In 2003 and 2004, Mr. Xu Jingnan acquired ownership of Feng Deng, Fujian Peak and related companies under an umbrella company, Peak Shoes Hong Kong.

In late 2004, Mr. Xu Jingnan created Peak Sports to take advantage of the growing popularity of the Peak brand. This shifted the business model away from OEM services to the development of an international sportswear brand.

In April 2007, Peak Hong Kong disposed of Feng Deng and Peak Material to C&D Int'l Investment Co. The production lines in Feng Deng and Peak Material became obsolete and the local government required redevelopment of the production sites. Peak Hong Kong received CNY5.39 million for Feng Deng and USD490,000 for Peak Material. Fujian Peak received CNY5.61 million and USD510,000 for its holding in Feng Deng and Peak Material, respectively.

In July 2007, Haojia made an investment of HKD5 million in Peak Hong Kong for 1.843% interest of the share capital of Peak Hong Kong placing a total value on the company of HKD271 million. The valuation reference point was 2005 financial performance. Haojia first expressed interest in making an investment in Peak Hong Kong in December 2005 and agreement was not made until January 2007 with the payment in July 2007.

Also in July 2007, Peak Hong Kong raised USD6 million through the sale of 7.837% of the company in the form of new equity to fund the expansion of production capacity and promotional/marketing expenses. Pre IPO Capital Partners Limited and Sequoia Capital were the investors in the fundraising round. This transaction valued Peak Hong Kong at HKD593 million. The valuation reference point was 2006 financial performance.

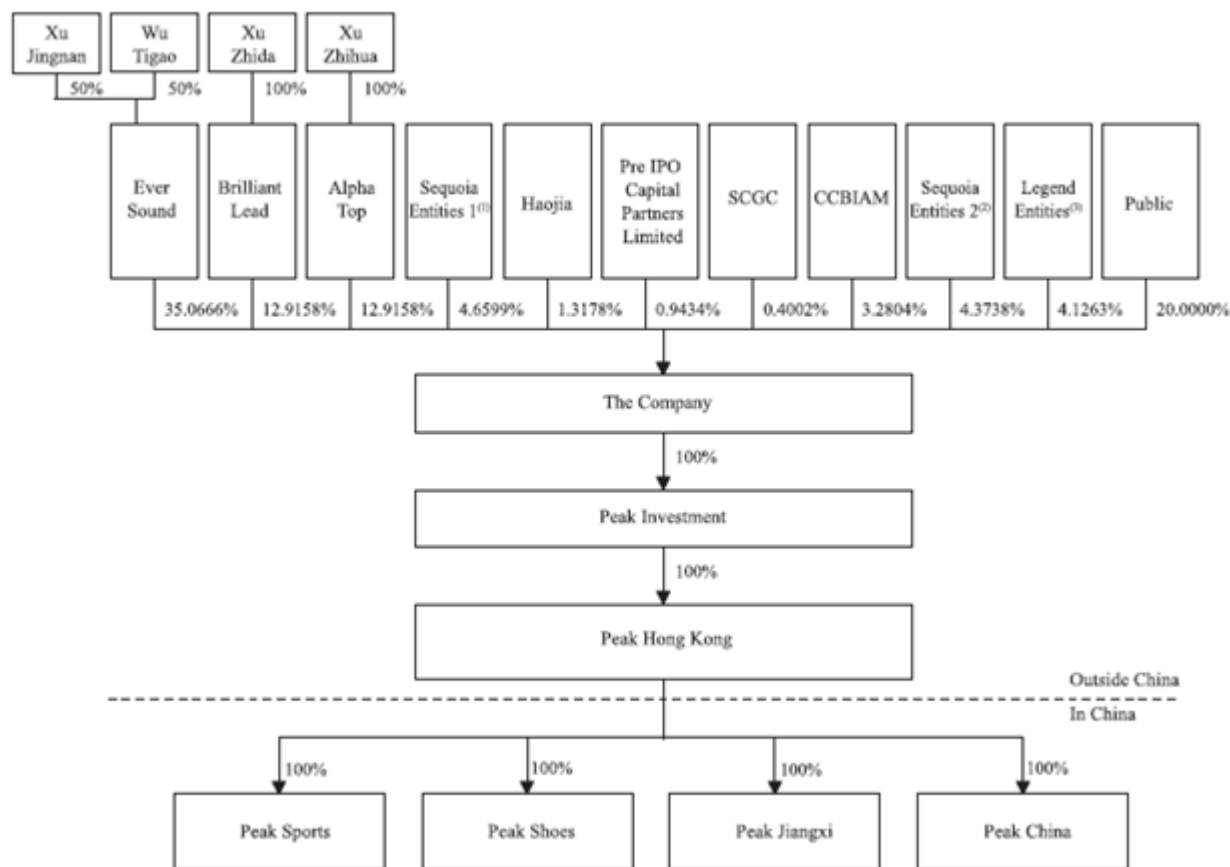
In January 2008, Peak Investment was incorporated in the British Virgin Islands as a shelf company with shares transferred to existing shareholders on a pro-rata basis.

In June 2008, Mr. Xu Jingnan and Ms. Wu Tigao sold 5.421% of Peak Sport to a number of investors for HKD304.9 million valuing Peak Sport Products at HKD5,624 million. The valuation reference point was 2009 financial performance and was affected by general market conditions.

In April 2009, Peak raised an additional USD40 million by issuing new shares equivalent to 10.63% of the company. The new funds were used for the expansion of production facilities and additional promotional/marketing expenses. This transaction valued the company at HKD2,924 million. The valuation reference point was 2009 financial performance and was affected by general market conditions.

At the same time, Mr. Xu Jingnan and Ms. Wu Tigao under their investment company Ever Sound sold 48.019 million shares to CCBIAM acquired for USD5 million and 5.197 million shares to SCGC for HKD2.19 million.

On Sept 29, 2009, Peak Sports completed its initial public offering of 419.580 million shares at HKD4.10 per share representing 20% of the company. The offering was 20 times oversubscribed and valued the company at HKD8,315 million. The post-IPO ownership structure is illustrated below. Mrs. Wu Tigao is Mr. Xu Jingnan's wife. Mr. Xu Zhihua and Mr. Xu Zhida are Mr. Xu Jingnan's sons.



Source: Company data

Since the IPO, the overall share count increased from 2,097.903 million shares to 2,098.029 shares due to options awarded to employees. The latest shareholder structure is illustrated below. Mr. Xu and his family retain control of 68.81% of the company's shares. Ever Sound, Brilliant Lead, and Alpha Top are all Xu family investment vehicles.

Shareholder Name	% of Shares	Date of Record
Ever Sound	42.60%	9/8/2014
Brilliant Lead	13.20%	9/8/2014
Alpha Top	13.01%	9/8/2014
Value Partners Ltd.	1.63%	6/30/2014
DJE Kapital AG	1.62%	11/28/2014
Radin Capital Partners, Inc.	1.49%	9/30/2014

Source: Company data, FT.com

Production

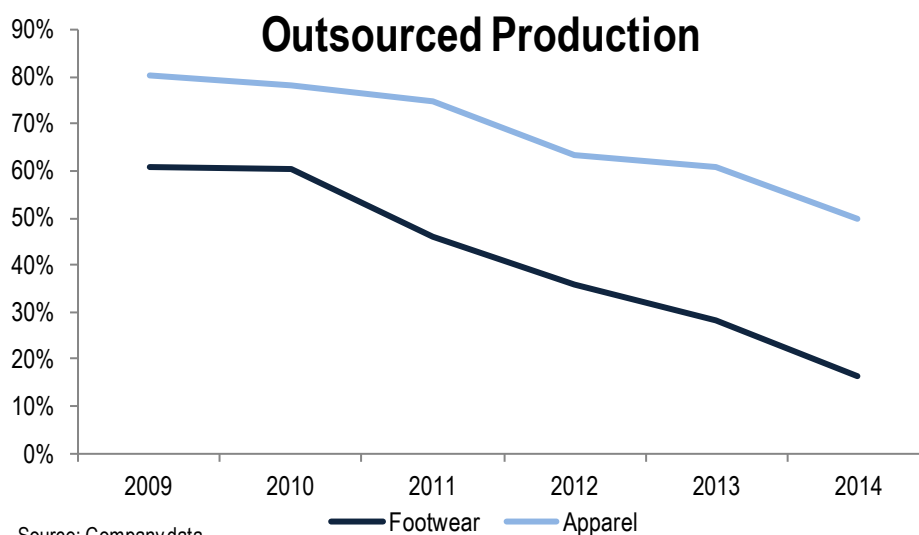
Peak's current production capacity is 10.2 million pairs of footwear and 12.8 million pieces of apparel. Footwear and apparel are produced in three production facilities in Fengze Quanzhou Fujian Province (Fengze), Hui'an Quanzhou Fujian Province (Hi'an) and Shang'gao Yichun Jiangxi Province (Shang'gao). Fengze is the oldest production facility opened in August 1994. Shang'gao and Hi'an facilities were opened in June 2008 and September 2008, respectively.



Footwear Production Capacity (mn pairs)	2006	2007	2008	2009	2010	2011	2012	2013	2014
Fengze Quanzhou Fujian Province	1.6	2.5	3.3	3.7	3.7	3.0	3.0	2.3	2.5
Hui'an Quanzhou Fujian Province	-	-	-	-	-	1.5	2.0	1.7	2.7
Shang'gao Yichun Jiangxi Province	-	-	2.5	3.5	5.0	8.5	6.0	5.0	5.0
Total Footwear Production Capacity	1.6	2.5	5.8	7.2	8.7	13.0	11.0	9.0	10.2
Apparel Production Capacity (mn pieces)	2006	2007	2008	2009	2010	2011	2012	2013	2014
Fengze Quanzhou Fujian Province	1.4	1.3	1.0	1.2	2.3	2.7	3.0	2.3	2.5
Hui'an Quanzhou Fujian Province	-	-	2.6	5.0	7.3	9.0	10.5	7.5	10.0
Shang'gao Yichun Jiangxi Province	-	-	-	-	-	-	0.4	0.3	0.3
Total Apparel Production Capacity	1.4	1.3	3.6	6.2	9.6	11.7	13.9	10.1	12.8

Source: Company data

Despite Peak's growing production capacity, the company continues to outsource some of its production, although more and more production is being brought in-house. In 2009, the percentage of footwear production outsourced was 61% while apparel outsourced 80% of total production. In 2014, the percentage of total production outsourced decreased to 16% for footwear and 50% for apparel.



Source: Company data

From 2009 to 2014, the average COGS per unit of internal production has CNY45 compared to CNY43.6 for external production.

Marketing

The company's primary focus is basketball with a recent expansion into running and tennis. Peak promotes its products as having premium functionality and performance with a low price. Its promotion partners include sports associations, leagues, federations, event organizers, and individual athletes throughout the world. Promotion media includes national and local television commercials, outdoor media, online advertising, newspapers, and magazines.

The company recently announced a shift in marketing strategy towards a “Star Strategy.” The company will continue to work with current NBA players and teams while attempting to sign more NBA All-Star level players to increase awareness among consumers. The only current NBA All-Star level player Peak works with is Tony Parker.



Peak’s strategy of endorsing NBA players started with NBA player Shane Battier in 2006. Over the years, it has collaborated with some of the NBA’s top players like Jason Kidd, Ron Artest, and Jason Richardson.

Currently, Peak’s top NBA endorsement is Tony Parker of the San Antonio Spurs. Tony Parker is a French basketball player, which give him popularity in Europe and he was married to Hollywood celebrity Eva Longoria giving him popularity around the world. He is also very skilled on the court winning four NBA championships and six All Star selections.

Besides Tony Parker, Peak endorses seven other NBA players with all of them being marginal to good but not great NBA players and have little marketing value. Peak stated signing these players was very low cost.



NBA players

NBA teams

Andrew Nicholson	Orlando Magic
Anthony Morrow	Oklahoma City Thunder
Beno Udrih	Memphis Grizzlies
Carl Landry	Sacramento Kings
Chase Budinger	Minnesota Timberwolves
George Hill	Indiana Pacers
Miles Plumlee	Phoenix Suns
Tony Parker	San Antonio Spurs

Source: Company data

Peak also collaborates with sporting organizations around the world. The company was the official marketing partner of NBA in China from 2007 until 2014. This relationship ended in October 2014. ANTA is now NBA's partner in China.

Peak sponsors the NBA's Houston Rockets, Miami Heat, and San Antonio Spurs. The company can display the Peak signage at the home stadiums of these teams. Since 2008, the company has been the official and exclusive footwear partner of the International Basketball Federation (FIBA) worldwide and the exclusive sportswear (apparel and headwear) partner of FIBA in Asia since August 2011. Under this agreement, Peak supplies footwear to all staff, referees, and volunteers at all FIBA and FIBA Zones Championships, and has an exclusive right to use globally specified logos and mascots associated with FIBA. FIBA is similar to FIFA for soccer. It is the main governing body of international basketball and runs the major international championships.

Peak also sponsors a number of national basketball federations. This is a cheap but effective way of marketing internationally. Peak is the only Chinese Sportswear company that sponsors overseas basketball federations.

- Basketball Australia
- Basketball Federation of Montenegro
- Basketball Federation of Serbia
- Basketball New Zealand
- Cameroon Basketball Federation
- Cote d'Ivoire Basketball Federation
- German Basketball Federation
- Iran Basketball Federation

In addition to the basketball marketing above, Peak participates in a number of other basketball promotional events.

Peak is a worldwide sponsor of the World Tennis Association. In 2014, the company was the official footwear and apparel partner for the following WTA tournaments:

- ASB Classic (Auckland, New Zealand)
- Brisbane International (Brisbane, Australia)
- Apia International Sydney (Sydney, Australia)
- Hobart International (Hobart, Australia)
- PTT Pattaya Women's Open (Pattaya, Thailand)
- Guangzhou International Women's Open (Guangzhou, China)
- BMW Malaysian Open (Kuala Lumpur, Malaysia)
- Ningbo International Tennis Open (Ningbo, China)
- Tianjin Open (Tianjin, China)
- WTA Finals (Singapore)

The company has a license to develop, manufacture, market and sell the WTA-PEAK co-branded products in the Asia Pacific region. The tennis players sponsored by Peak are listed below.

Tennis players	Country
Agnes Szatmari	Romania
Aleksandrina Naydenova	Bulgaria
Anastasiya Shleptsova	Belarus
Ao Lehan	China
Ekaterina Bychkova	Russia
Galina Voskoboeva	Kazakhstan
He Sirui	China
Hulya Esen	Turkey
Julia Cohen	USA
Kamila Kerimbayeva	Kazakhstan
Klaudia Jans-Ignacik	Poland
Liu Xinrui	China
Lutfiye Esen	Turkey
Lenka Juríková	Slovakia
Margarita Lazareva	Russia
Olga Govortsova	Belarus
Teodora Mircic	Serbia
Vesna Dolonc	Serbia
Wang Ziyi	China
Yu Lu	China
Zhao Xueqi	China
Zuzana Luknarova	Slovakia

Source: Company data

In addition to tennis, Peak sponsors five National Olympic Committees.

- The National Olympic Committee of Cyprus
- The National Olympic Committee of Jordan
- The National Olympic Committee of Lebanon
- The National Olympic Committee of New Zealand
- The National Olympic Committee of Slovenia

Peak increased marketing spend as a percentage of sales from 6.2% in 2006 to 10.7% in 2014. From 2009 to 2014, Peak spent an average of 11.9% of sales and a cumulative spend of CNY2,428 million. Over the period, Peak was second in marketing spending as a percentage of sales and third to Li Ning and ANTA in absolute marketing spend.

Marketing % Sales	2008	2009	2010	2011	2012	2013	2014	2008-2013 Average
Peak	7.5%	11.3%	10.8%	14.2%	14.0%	10.7%	10.6%	11.4%
ANTA	7.0%	9.1%	8.9%	8.5%	9.7%	10.3%	12.0%	8.9%
Li Ning	17.5%	15.4%	15.1%	17.6%	19.6%	24.2%		18.2%
Xtep	5.5%	5.3%	4.7%	4.8%	7.1%	9.3%	9.4%	6.1%
361	7.8%	7.3%	8.6%	9.2%	10.2%	12.8%	15.5%	9.3%
Dongxiang	7.8%	7.1%	9.5%	15.3%	15.9%	11.1%		11.1%

Marketing Expense (CNY	2008	2009	2010	2011	2012	2013	2014	2008-2013 Cummulative R&D Spend
Peak	153	350	459	660	406	280	301	2,308
ANTA	324	535	659	757	739	750	1,071	3,764
Li Ning	1,171	1,292	1,431	1,571	1,309	1,409	-	8,183
Xtep	143	177	198	258	394	404	449	1,574
361	65	174	333	512	505	459	604	2,048
Dongxiang	259	282	405	420	282	157	-	1,804

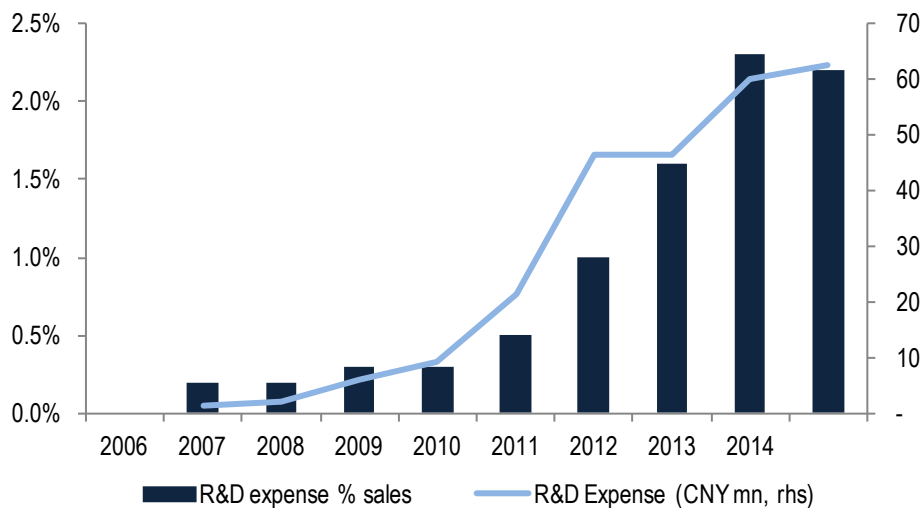
Source: Company data

Positioning

Peak positions its products on functionality and performance rather than fashion. It also prices its products for mass-market consumers within the lower tier cities as 86% of its distribution is in third tier cities or below. Peak's main sport is basketball where it has been the top domestic basketball sportswear company for the past six years with a 9.8% market share in 2013. Its biggest competitors in the basketball segment are Nike, Adidas, Li Ning, and ANTA. Nike and Adidas are premium brands whose products are at a much higher price point than Peak. Li Ning occupies a position between premium and mass market while Peak and ANTA battle for the mass market and the value for money tag. Overseas, Peak sells its products at a much cheaper price than international rivals really focusing on value for money. Peak has also expanded into tennis and running using the same positioning of high quality, functional product at good value.

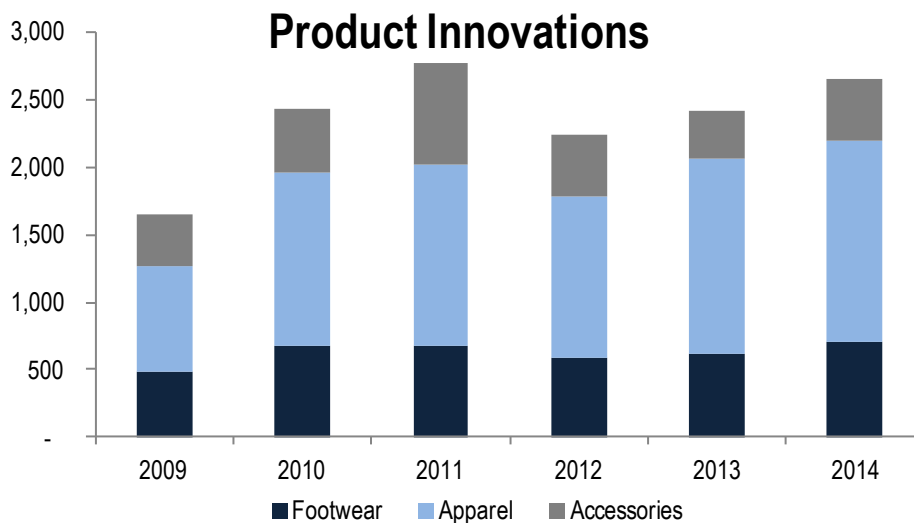
Research & Development

Peak is increasing R&D spend with 2014 R&D expense at 2.2% of sales up from 0.2% in 2006. In absolute terms, R&D expense increased from CNY1.25 million in 2006 to CNY62.51 million in 2014.



Source: Company data

The increase in R&D spend comes as the Chinese Sportswear consumer grows increasingly sophisticated and the product offering of different competitors becomes well known. The increased R&D spend allows Peak to differentiate its product relative to smaller competitors but poses a concern for competing against larger competitors. With increased R&D, spending comes increased product innovations. Peak has increased its total number of product innovations from 1,647 in 2009 to 2,655 in 2014.



Source: Company data

Compared to Chinese peers, Peak's R&D spending is relatively modest. Peak spent only 1.0% of sales and a cumulative CNY255 million between 2006 and 2014. Peak's focus on basketball helps more effectively spend on R&D, as the other companies do not have Peak's focus. Peak also accepts a lower Gross Margin than peers as it competes more on price than differentiation.

In 2013 and 2014, Peak's spending as a percent of sales was more in-line with its peer group, but absolute figures are what count. It is not clear what is spent on various sports by each competitor but what is clear is ANTA and Li Ning can outspend

Peak. Peak's basketball product continues to outperform both ANTA and Li Ning on market share and user reviews but the inability to compete on R&D spending will be a significant disadvantage in the future. Peak's current valuation provides comfort over this disadvantage.

R&D % Sales	2008	2009	2010	2011	2012	2013	2014	2008-2013 Average
Peak	0.3%	0.3%	0.5%	1.0%	1.6%	2.3%	2.2%	1.0%
ANTA	3.0%	3.0%	3.2%	3.7%	3.8%	4.0%	4.3%	3.5%
Li Ning	2.7%	2.7%	2.6%	2.6%	2.9%	3.0%		2.8%
Xtep	1.6%	1.6%	1.8%	1.8%	1.7%	2.6%	2.2%	1.9%
361	0.2%	0.4%	0.7%	1.5%	1.7%	2.4%	2.4%	1.1%
Dongxiang	1.8%	1.7%	2.3%	2.8%	4.0%	5.0%		2.9%

R&D Expense (CNY mn)	2008	2009	2010	2011	2012	2013	2014	2008-2013 Cumulative R&D Spend
Peak	6	9	21	46	46	60	63	190
ANTA	139	176	237	329	290	291	384	1,463
Li Ning	181	226	246	232	194	175	-	1,254
Xtep	42	53	76	97	94	113	105	475
361	2	8	25	84	84	86	94	289
Dongxiang	60	67	98	77	71	71	-	444

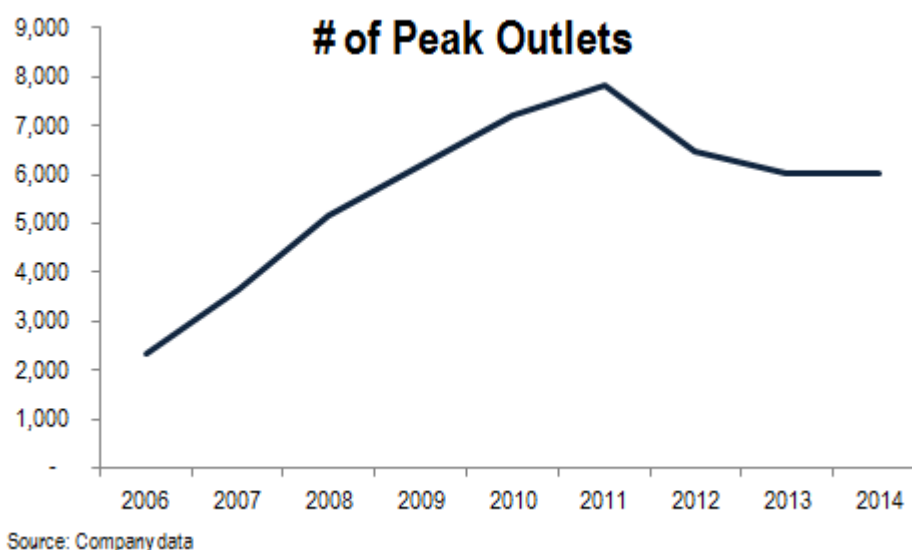
Source: Company data

Distribution

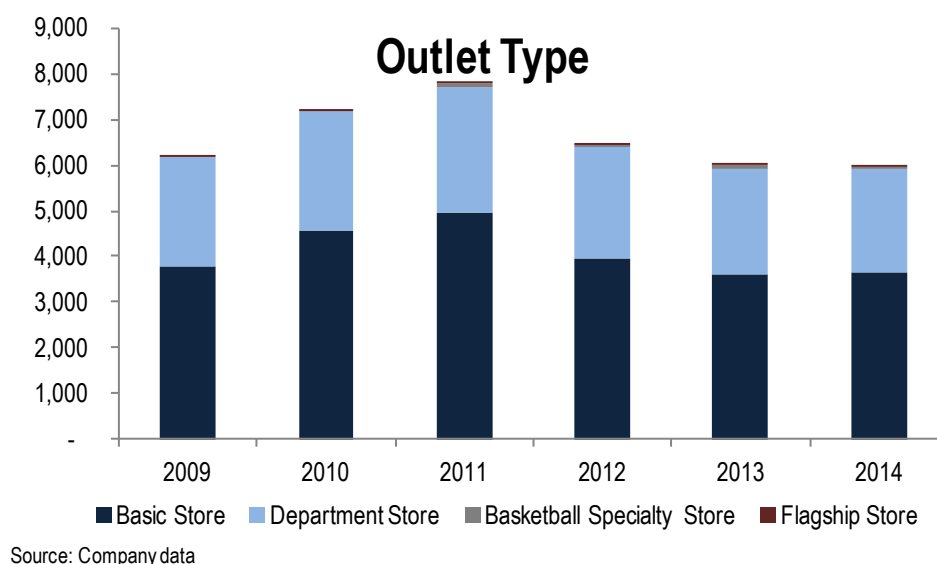
Peak outsources distribution to companies that run retail operations and distribute to retailers. Each distributor has exclusivity within a specific geographical region and can only distribute products of Peak's competitors. Peak focus on manufacturing and marketing is a wise strategy as distribution is characterized by a large number of firms competing aggressively leading to low profitability over a full cycle. The internet is also become a very strong retail outlet leading to a devaluation of brick and mortar retail outlets. In addition, the key success factors for retailing are very different from the key success factors for manufacturing and marketing sportswear. China also has a very diverse landscape with different consumer preferences, which regional distributors are better able to understand and satisfy.

At the end of 2014, Peak had 6,004 authorized outlets with an average floor area of 89.95 square meters per outlet. Peak expects the number of outlets to remain stable as the focus shifts from growth in outlets to profitability and efficiency. Peak's focus has always been lower tier cities with 5,081 of the 6,004 outlets in third tier cities and below.

Peak's current outlet count is a drastic reduction from Peak's maximum outlet count of 7,806 at the end of 2011. Peak's reduction in distribution and retail capacity reflects an over expansion post-Olympics. As the Chinese economy slowed and the sportswear industry saw an increase in working capital due to weakness at distributors, distribution and retail capacity has been eliminated from the system. The closing of capacity has slowed and excess inventories are being worked out of the system. In the second half of 2014, Peak's store count increased sequentially for the first time since 2011.



Peak's distribution channel is primarily department stores and basic stores with the two channels accounting for 99% of retail outlets. Basic stores account for 61% of outlets and department stores account for 38% of outlets. A basic store is not a flagship store, a department store, or a basketball specialty store. A flagship store is situated in prime locations in major cities and has a floor area of at least 200 square meters. Basketball specialty outlets are either street-level stores or shopping mall outlets and offer mainly premium basketball sports products to basketball enthusiasts.



Peak strictly monitors its distributors and retail operations. The company hosts four sales fairs a year to introduce new product collections for each season. The company's domestic distributors and retail outlet operators attend the sales fairs and place orders, generally six months in advance of the delivery.

Peak is actively trying to increase the number of distributors who are retailers, and increase the store count of distributors in a process it calls Channel Flattening. In addition, the company changed its ordering model with an increased replenishment order ratio to better control inventory and respond to consumer demands.

The company regularly evaluates the performance of distributors with poor performers losing distribution rights. Peak now has a management information system linked to all distributors.

Peak has been distributing its products overseas since the early 1990's, a key differentiating feature from other Chinese Sportswear companies. It now sells its product in over 70 countries. Overseas customers include distributors, retailers, sports teams, and clubs. All overseas customers are invited to the trade fairs in China.



The company's E-commerce efforts include its own online store (www.epeaksport.com) as well as third party websites such as amazon.cn, dangdang.com, JD.com, paipai.com, Tmall.com, vjia.com and yhd.com. E-commerce currently contributes a low proportion of total sales, but is growing at a very rapid pace. Online sales consist primarily of new, medium and high end products leading to a higher average spend per customer and a higher gross margin through online channels.

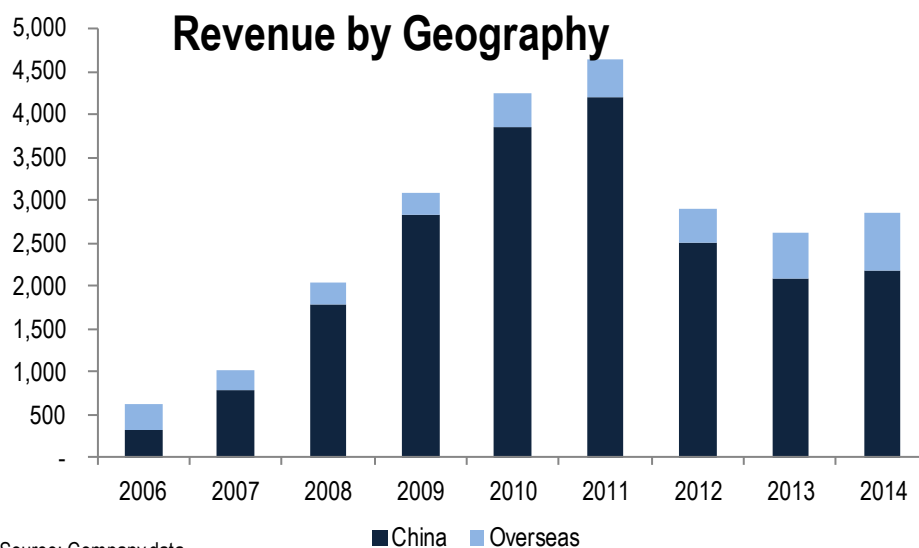
Revenue

Revenue by Product (CNY mn)	2006	2007	2008	2009	2010	2011	2012	2013	2014
Footwear	367	571	1,029	1,397	1,814	2,041	1,348	1,044	1,150
Apparel	255	386	962	1,606	2,318	2,487	1,481	1,509	1,633
Accessories	2	58	52	92	118	119	74	60	58
Total	624	1,015	2,042	3,095	4,249	4,647	2,903	2,613	2,841

Source: Company data



Peak sells footwear, apparel, and accessories with apparel being the biggest seller for the company accounting for 57% of sales in 2014. Footwear accounted for 40% of sales and accessories accounted for the remainder. Historically, apparel accounted for 53% of sales, footwear accounted for 45% of sales, and accessories accounted for the remainder of sales. Footwear was much harder hit by the downturn in the footwear industry falling 49% from peak to trough while apparel only fell 40% from peak to trough.



At the end of 2014, China accounted for 77% of sales up from 51% in 2006 but down from over 91% in 2009. The drastic increase in China revenue is on the back of the distribution network expansion. With China slowing, 2014 growth was up 5%, increasing the competitive rivalry in the market, Peak is looking to overseas markets to grow revenues with a focus on less developed countries, where there is less competition, and its value for money strategy fits with current consumer demand. In 2014, Peak's overseas revenues increased by 22.5% in 2014.

Sales Volume by Product	2006	2007	2008	2009	2010	2011	2012	2013	2014
Footwear (mn pairs)	4.7	7.2	11.7	16.5	21.7	22.8	15.1	11.6	12.3
Apparel (mn pieces)	4.1	7.1	18.3	30.1	40.9	41.8	24.7	24.7	23.5
Total Sales Volume	8.8	14.3	30.0	46.6	62.6	64.6	39.8	36.3	35.8
ASP by Product (CNY)	2006	2007	2008	2009	2010	2011	2012	2013	2014
Footwear	78.0	79.2	87.9	84.7	83.6	89.5	89.3	90.0	93.5
Apparel	62.3	54.4	52.5	53.4	56.7	59.9	60.0	61.1	69.5
Blended ASP	70.9	71.0	68.1	66.4	67.9	71.9	72.9	72.0	79.4

Source: Company data

Sales volume increased from 8.8 million units in 2006 to a maximum volume of 64.6 million units in 2011 and back to 35.8 million units in 2014. Peak saw a return to growth in footwear volume while apparel volume continues to decline.

Average selling price (ASP) remained relatively stagnant from 2006 to 2013. Both footwear and apparel remained stable during a period of industry consolidation and heavy discounting. In 2014, ASP saw a 10% increase driven by both footwear and apparel.



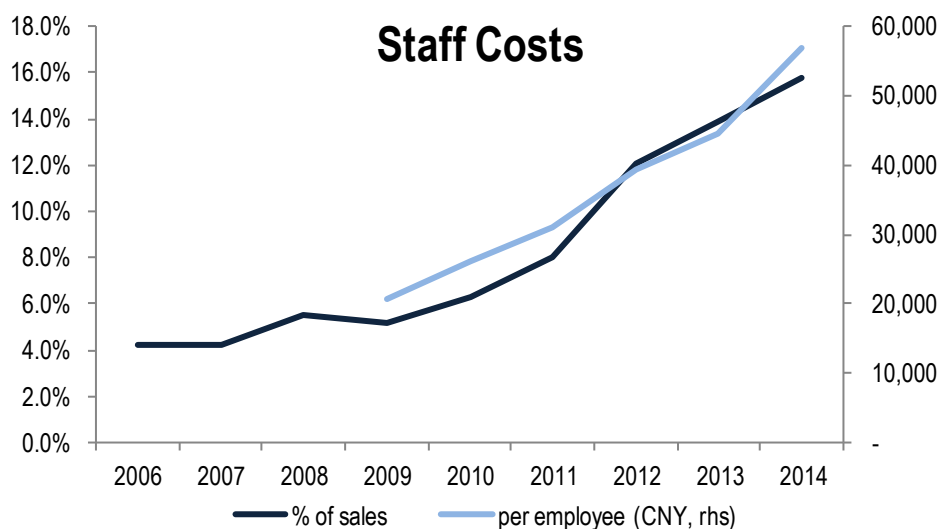
Margins

Gross Margin by Product	2006	2007	2008	2009	2010	2011	2012	2013	2014
Footwear	28.3%	30.3%	32.1%	37.8%	38.0%	38.9%	36.0%	35.2%	36.5%
Apparel	28.5%	30.0%	33.0%	37.2%	38.1%	40.0%	37.1%	35.6%	39.0%
Other	25.0%	30.0%	38.2%	36.6%	36.3%	37.5%	31.9%	37.4%	37.0%
Total Gross Profit	28.4%	30.2%	32.7%	37.5%	38.0%	39.4%	36.5%	35.5%	38.0%
Margins	2006	2007	2008	2009	2010	2011	2012	2013	2014
Gross Margin	28.4%	30.2%	32.7%	37.5%	38.0%	39.4%	36.5%	35.5%	38.0%
Selling and Distribution % Sales	9.7%	11.5%	8.9%	12.3%	11.9%	15.3%	15.9%	12.8%	12.6%
Administrative % Sales	1.1%	1.4%	4.1%	2.5%	3.0%	4.6%	7.9%	9.6%	10.3%
Operating Margin	17.6%	17.2%	19.7%	22.7%	23.2%	19.5%	12.7%	13.1%	15.1%

Source: Company data

Despite a slight decline during the recent industry downturn, when there was heavy discounting to clear inventory from the channel, Peak has been able to increase gross margins, with an average annual expansion of 1.2% per year from 2006 to 2014. Operating margins reached a maximum of 23.2% in 2010 and declined to 12.7% in 2012. It has since recovered to 15.1% in 2014.

Peak's biggest cost pressure is staff costs, which have increased from 4.2% of sales to 15.8% of sales in 2014. The cost per employee increased from CNY20,726 to CNY56,828 or 22.35% per year.



Source: Company data

Peak's staff costs as a percentage of sales are running well above the peer group average with Xtep the only peer within 4.5 percentage points.



Staff Costs % Sales	2006	2007	2008	2009	2010	2011	2012	2013	2014
Peak	4.2%	4.2%	5.5%	5.2%	6.3%	8.0%	12.1%	13.9%	15.8%
ANTA	8.3%	12.4%	13.8%	12.7%	13.6%	13.7%	10.5%	11.1%	11.0%
Li Ning	8.1%	7.7%	7.1%	7.5%	7.5%	8.7%	10.9%	11.5%	
Xtep	8.6%	5.6%	9.1%	11.8%	11.7%	11.3%	11.4%	11.2%	13.1%
361	12.4%	8.3%	4.3%	3.4%	5.2%	7.2%	7.2%	7.6%	8.4%
AVERAGE	8.3%	7.6%	8.0%	8.1%	8.9%	9.8%	10.4%	11.1%	12.1%

Source: Company data

Peak's staff costs per employee are near the bottom of its peer group, but the company's sales per employee is at the very bottom of the peer group. This is a function of Peak's strategy of pricing its products below peers giving up a bit on gross margin and spending less on differentiation.

Staff Costs per Employee (CNY)	2009	2010	2011	2012	2013	2014	2009-2014 CAGR
Peak	20,726	26,047	30,979	39,466	44,580	56,828	22.4%
ANTA	56,096	85,384	106,083	67,260	63,640	68,636	4.1%
Li Ning	141,927	168,657	185,833	211,120	186,462		9.4%
Xtep	53,459	66,272	79,311	80,449	59,465	78,233	7.9%
361	21,231	29,454	41,753	38,454	35,383	35,113	10.6%
AVERAGE	58,688	75,163	88,792	87,350	77,906	59,703	0.3%

Sales per Employee (CNY)	2009	2010	2011	2012	2013	2014	2009-2014 CAGR
Peak	398,583	413,407	387,250	326,180	320,732	345,696	-2.8%
ANTA	441,729	627,797	774,348	640,588	573,307	562,028	4.9%
Li Ning	1,892,374	2,248,873	2,136,124	1,955,033	1,621,381		-0.6%
Xtep	482,182	599,623	723,426	705,658	530,929	547,500	2.6%
361	643,382	554,346	575,144	557,029	491,800	409,751	-8.6%
AVERAGE	771,650	888,809	919,259	836,898	707,630	466,244	-9.6%

Source: Company data

Investment Requirements

Investment Requirements	2006	2007	2008	2009	2010	2011	2012	2013	2014
Working Capital Inv % Sales	-1%	6%	-6%	-13%	6%	-10%	-5%	6%	2%
Fixed Capital Inv % Sales	-1%	-7%	-7%	-4%	-3%	-4%	-6%	-3%	-1%
Total Inv % Sales	-2%	-1%	-13%	-17%	3%	-14%	-12%	4%	1%
Inv in NOA % Sales		-16%	-12%	-17%	5%	-13%	-8%	9%	1%
Inv in IC % Sales		-17%	-13%	-17%	4%	-15%	-11%	8%	2%

Source: Company data, Reperio Capital Research estimates

Peak's investment requirements are relatively modest. On an absolute basis, from 2007 to 2014, the average working capital investment was 1.7% of sales, fixed capital investment was 4.4% of sales, and change in net operating assets was 11.5% of sales. On an incremental basis from 2007 to 2014, working capital investment was 32.8% of incremental sales, fixed capital investment was 51.2% of incremental sales, and change in net operating assets was 127.4% of incremental sales.



The working capital requirements from 2007 to 2013 for Peak and its peers within the Chinese Sportswear industry are illustrated below.

2007-2013 Incr. Inv. Req.	Δ Sales	Δ WC Inv	Δ FC Inv	WC Inv	FC Inv	Total Inv Req
Peak	1,598	814	442	51.0%	27.6%	78.6%
ANTA	4,099	374	542	9.1%	13.2%	22.4%
Li Ning	1,475	450	424	30.5%	28.7%	59.3%
Xtep	2,978	666	415	22.4%	13.9%	36.3%
361	2,266	1,192	1,022	52.6%	45.1%	97.7%
Dongxiang	(297)	98	22			

Source: Company data, Reperio Capital Estimates

Peak has the second highest working capital investment requirements and the third highest fixed capital investment requirements in the industry. It is clearly underperforming on working capital investment. While fixed capital is affected by levels of internal production, working capital points directly to the company's operating efficiency.

Cash Conversion Cycle (days)	2006	2007	2008	2009	2010	2011	2012	2013	2014
Peak	42	31	38	64	55	67	159	171	148
ANTA	-	7	19	19	19	27	38	32	39
Li Ning	58	54	40	30	33	55	75	89	
Xtep	168	94	53	32	27	64	90	95	77
361	(37)	5	14	4	11	45	90	115	93
Dongxiang		(2)	3	7	17	135	326	359	

Source: Company data

Peak's working capital management deteriorated significantly in 2009 to be the worst in the industry. The recent industry downturn weakened Peak's working capital position. Despite the weak working capital position, Peak continues to generate positive cash flow. At current levels of sales, if cash conversion cycle reverts to pre-downturn levels of 70 days, HKD752 million in working capital requirements would be released roughly 44% of the company's current enterprise value. Working capital investment requirements should be minimal going forward as the cash conversion cycle reverts to normal.

Pre-2012 Average	Gross Margin	Opex % Sales	Operating Margin	WC Turnover	FC Turnover	IC Turnover	ROIC
Peak	36%	15%	20%	5.15	12.30	3.42	70%
ANTA	40%	18%	23%	7.57	10.60	4.35	98%
Li Ning	47%	34%	13%	7.04	13.17	4.54	59%
Xtep	38%	20%	18%	5.13	22.85	4.04	74%
361	34%	15%	19%	2.43	10.14	1.86	36%
Dongxiang	61%	29%	32%	6.37	24.92	5.00	161%
Average	43%	22%	21%	5.62	15.66	3.87	83%
Post-2011 Average	Gross Margin	Opex % Sales	Operating Margin	WC Turnover	FC Turnover	IC Turnover	ROIC
Peak	37%	23%	14%	2.27	5.38	1.58	21%
ANTA	42%	21%	20%	6.97	8.42	3.72	75%
Li Ning	41%	57%	-16%	3.51	7.57	2.40	-38%
Xtep	41%	24%	17%	3.64	10.76	2.70	45%
361	40%	27%	13%	2.02	3.96	1.27	17%
Dongxiang	54%	73%	-19%	1.78	10.74	1.52	-29%
Average	42%	38%	5%	3.37	7.80	2.20	15%

Source: Company data, Reperio Capital Estimates

Overall, the industry's profitability was very high pre-2012 as demand outpaced supply. Post 2011, Peak and all peers saw a very small contraction in gross margin and a larger contraction in both operating margin and IC turnover. Peak maintains a lower gross margin than peers as it competes more on price than Marketing and R&D. Despite the significant increase in operating expenses and lower efficiency of working capital and fixed capital, Peak remains very profitable and maintains a ROIC well above its cost of capital.

MANAGEMENT

The Xu family are the primary owners and managers of Peak Sport Products. The family collectively owns 68.81% of Peak's shares.

Strategy

The company's strategy of focusing on functional products over fashionable products while maintaining a strong focus on basketball has worked well and allowed the company to insulate itself from competition. More fashion focused sportswear companies such as Xtep, 361 Degrees and Dongxiang are facing intense competition not only from sportswear competitors but also from fast fashion players in China. By focusing on functionality, the number of competitors with the capabilities to compete with Peak decreases significantly.

In addition, Peak's focus on high quality at a mass market price point has allowed the company to remain as the number one domestic basketball sportswear company for six straight years.

Rather than branching out into other sports or into fashion, Peak grew its operations with overseas distribution of its basketball products. The company partners with national basketball federations and other associations, providing a very strong value for money on marketing spend as it plays on nationalism. These partnerships, a high quality product and low price point allow Peak to have a competitive offering in any market.

Relative to Chinese Sportswear peers, Peak's pricing is only higher than 361 Degrees. By a wide margin, Peak's ASP's has been the most consistent of all Chinese Sportswear companies. This illustrates the insulation of Peak from the overall competitive environment.



Volume (mn units)	2006	2007	2008	2009	2010	2011	2012	2013
Peak	9	14	30	47	63	65	40	36
ANTA	21	42	61	74	89	-	-	-
Li Ning	-	-	-	-	-	-	-	-
Xtep	-	19	40	48	56	66	67	57
361	6	14	39	60	69	65	62	52
Dongxiang	6	10	16	20	22	12	8	6
ASP	2006	2007	2008	2009	2010	2011	2012	2013
Peak	71	71	68	66	68	72	73	72
ANTA	61	71	76	79	83	-	-	-
Li Ning	-	-	-	-	-	-	-	-
Xtep	-	71	65	70	76	81	82	74
361	50	55	60	60	64	65	62	52
Dongxiang	137	169	174	170	168	171	138	141
COGS per unit	2006	2007	2008	2009	2010	2011	2012	2013
Peak	51	50	46	42	42	44	46	46
ANTA	46	47	46	46	48	-	-	-
Li Ning	-	-	-	-	-	-	-	-
Xtep	-	48	41	43	45	48	48	44
361	46	46	42	40	42	49	48	42
Dongxiang	52	68	65	63	63	70	67	61
GP per unit	2006	2007	2008	2009	2010	2011	2012	2013
Peak	20	21	22	25	26	28	27	26
ANTA	15	24	30	33	36	-	-	-
Li Ning	-	-	-	-	-	-	-	-
Xtep	-	23	24	27	31	33	33	30
361	9	14	18	24	29	36	32	27
Dongxiang	86	101	109	107	105	101	71	81

Source: Company data, all figures in CNY except volume



Volume (mn units)	2006	2007	2008	2009	2010	2011	2012	2013
Peak	9	14	30	47	63	65	40	36
ANTA	21	42	61	74	89	-	-	-
Li Ning	-	-	-	-	-	-	-	-
Xtep	-	19	40	48	56	66	67	57
361	6	14	39	60	69	65	62	52
Dongxiang	6	10	16	20	22	12	8	6
ASP	2006	2007	2008	2009	2010	2011	2012	2013
Peak	71	71	68	66	68	72	73	72
ANTA	61	71	76	79	83	-	-	-
Li Ning	-	-	-	-	-	-	-	-
Xtep	-	71	65	70	76	81	82	74
361	50	55	60	60	64	65	62	52
Dongxiang	137	169	174	170	168	171	138	141
COGS per unit	2006	2007	2008	2009	2010	2011	2012	2013
Peak	51	50	46	42	42	44	46	46
ANTA	46	47	46	46	48	-	-	-
Li Ning	-	-	-	-	-	-	-	-
Xtep	-	48	41	43	45	48	48	44
361	46	46	42	40	42	49	48	42
Dongxiang	52	68	65	63	63	70	67	61
GP per unit	2006	2007	2008	2009	2010	2011	2012	2013
Peak	20	21	22	25	26	28	27	26
ANTA	15	24	30	33	36	-	-	-
Li Ning	-	-	-	-	-	-	-	-
Xtep	-	23	24	27	31	33	33	30
361	9	14	18	24	29	36	32	27
Dongxiang	86	101	109	107	105	101	71	81

Source: Company data, all figures in CNY except volume

Peak has accepted a lower but much more consistent gross margin than peers. This lower gross profit per unit and ASP below peers may point to under pricing by Peak and potential for future price hikes.

Profitability	2006	2007	2008	2009	2010	2011	2012	2013	2014
Return on Assets	31%	17%	26%	18%	20%	16%	6%	4%	5%
Return on Tangible Equity	73%	39%	49%	21%	24%	19%	8%	6%	8%
Return on Tangible Invested Capital	154%	76%	80%	68%	116%	58%	20%	21%	27%
Return on Net Tangible Operating Assets	190%	83%	88%	71%	128%	67%	23%	25%	33%
FCF Return on Tangible Invested Capital	131%	-7%	19%	9%	116%	3%	-2%	24%	19%
FCF Return on Net Tangible Operating Assets	0%	-5%	26%	10%	133%	12%	2%	33%	22%
Gross Profit to Total Assets	54%	35%	47%	34%	38%	38%	21%	17%	18%

Source: Company data, Reperio Capital Research estimates

The best measure of a good strategy is the ability to generate consistent Returns on Net Operating Assets (RONOA) above its cost of capital. Although its current RONOA is well below its maximum RONOA, Peak has consistently generated RONOA above its cost of capital.



Capital Allocation

Peak's allocation to internal production is poor. As illustrated, the cost of internal production is higher than external production by roughly CNY1.4 per unit. CNY1.4 per unit on 2014 production equals CNY31.2 million or 1.12% of revenue. This decrease in profitability is exacerbated by the additional capital and administrative costs associated with production facilities. Additional evidence of the poor capital allocation to production is there is very little differential among peers on COGS per unit illustrating many other organizations can do this activity equally well eliminating any value add by Peak. It would be much better to focus on R&D and marketing where there is significant potential for differential among peers.

Management's other poor capital allocation decision is the amount of cash held on the balance sheet. Given management's wealth is tied to the performance of the company, it is understandable for Peak to be conservatively financed, which is appreciated. Management either could buy back shares or increase the dividend payout. Peak has net cash per share of CNY1.27 or 46% of overall assets.

Strategic Balance Sheet	2006	2007	2008	2009	2010	2011	2012	2013	2014
Net Tangible Operating Assets per Share	0.03	0.13	0.27	0.47	0.37	0.64	0.76	0.64	0.62
Net Financial Assets per Share	0.05	0.11	0.18	0.96	1.29	1.27	1.18	1.31	1.39

Source: Company data, Reperio Capital Research estimates

The company has net financial assets per share of CNY1.39 compared to CNY0.62 in net tangible operating assets. In 2014, the company generated return on net tangible operating assets of 33%, while return on net financial assets was -0.67%. Given the extreme undervaluation of the company, the best use of the net financial assets would be to buy back shares. If the company is concerned about the size of the company's float, the next best thing would be to pay cash to shareholders.

Salaries

5 Highest Paid % Gross Profit	2009	2010	2011	2012	2013	2014	Average
Peak	0.3%	0.5%	0.4%	0.6%	0.7%	0.7%	0.5%
ANTA	0.3%	0.4%	0.4%	0.5%	0.4%	0.3%	0.4%
Li Ning	1.0%	0.7%	0.7%	0.6%	1.0%		0.8%
Xtep	0.3%	0.4%	0.6%	0.6%	0.6%	0.4%	0.5%
361	0.6%	0.4%	0.5%	0.5%	0.6%	0.6%	0.5%
Dongxiang	0.6%	0.5%	1.2%	2.0%	1.8%		1.2%
5 Highest Paid % Operating Profit	2009	2010	2011	2012	2013	2014	Average
Peak	0.5%	0.8%	0.7%	1.8%	2.0%	1.9%	1.3%
ANTA	0.6%	0.7%	0.8%	1.0%	0.8%	0.7%	0.8%
Li Ning	3.4%	1.8%	3.7%	-0.8%	-8.6%		-0.1%
Xtep	0.7%	0.8%	1.2%	1.3%	1.4%	1.2%	1.1%
361	1.0%	0.7%	0.8%	1.4%	3.0%	1.5%	1.4%
Dongxiang	1.0%	0.9%	8.9%	-5.6%	-5.5%		0.0%

Source: Company data

The pay of Peak's five highest paid employees are roughly in-line with the peer group. At 1.9% of 2014 operating profit, the highest paid employees are not extracting an unreasonable amount.

The Xu family salaries averaged CNY4.37 million per year. The Xu family collectively hold 68.81% of Peak's shares. With the company's market cap at HKD4,811 million on a diluted basis, the Xu family share in Peak is worth roughly CNY2,673 million. The family's collective annual salary is only 0.18% of the value of the family's shares meaning they are highly incentivized to increase the company's share price.

Accounting

Accounting Assumptions	Peak	ANTA	Li Ning	Xtep	361	Dongxiang
Buildings	20 years	20 years	20-40 years	Shorter of lease term or 20 years	Shorter of lease term or 50 years	20-35 years
Leasehold improvement		2 years	shorter of 2 years or the remaining lease terms	Shorter of lease term or 5 years		shorter of lease term or 2-15 years
Machinery	5-10 years	10 years	2 years	3-10 years	5-10 years	NA
Motor vehicles	5 years	5 years	10-18 years	5 years	5 years	5 years
Office equipment	5 years	3-10 years	3-12 years	5 years	2-10 years	2-15 years
Patents and trademarks	Infinite	10-40 years	20-50 years	5 years	NA	40 years
Computer software	5 years	3-10 years	10-20 years	NA	NA	2-5 years
Club membership	NA	NA	3 years	NA	NA	NA
Depreciation method	Straight line	Straight line	2-10 years	Straight line	Straight line	Straight line

Source: Company data

With the exception of indefinite life of trademarks, Peak's accounting assumptions are in-line with industry standards. Earnings are not inflated relative to its peer group and financial statements give an accurate reflection of the company's profitability. Peak has not changed any accounting assumptions since listing in 2009.

Financial Statements

FINANCIAL SUMMARY (CNY mn)	2006	2007	2008	2009	2010	2011	2012	2013	2014
Total Revenue	624	1,015	2,042	3,095	4,249	4,647	2,903	2,613	2,841
Gross Profit	177	306	668	1,160	1,616	1,832	1,058	927	1,079
Selling and Distribution Expense	(60)	(116)	(181)	(380)	(505)	(713)	(461)	(334)	(359)
Administrative Expenses	(7)	(15)	(85)	(78)	(126)	(213)	(228)	(252)	(291)
Operating Profit	110	175	402	702	985	907	369	341	428
Other Income	1	3	15	16	13	31	45	62	80
Financial Income (expense)	(1)	(2)	(7)	(15)	-	(2)	(8)	(13)	(20)
Profit before Tax	110	176	411	703	998	937	406	390	489
Income Tax	(10)	(24)	(35)	(75)	(176)	(159)	(95)	(146)	(168)
Profit after Tax	100	152	376	628	822	778	311	244	321



FINANCIAL SUMMARY (CNY mn)	2006	2007	2008	2009	2010	2011	2012	2013	2014
Cash	81	169	489	1,988	2,663	2,697	2,763	3,281	3,752
Accounts Receivables	110	448	507	864	744	1,089	1,093	978	987
Inventory	100	158	169	210	335	421	386	366	346
Other Current Assets	13	-	-	-	-	-	-	-	-
PP&E	9	72	232	306	396	482	543	533	506
Intangibles	-	9	10	10	14	16	20	23	25
Other Non-Current Assets	14	20	27	22	49	174	244	268	259
Total Assets	326	876	1,435	3,400	4,200	4,880	5,049	5,448	5,874
Accounts Payable	152	391	370	339	608	562	373	415	419
Other NIBCLs	22	76	66	27	63	55	30	65	68
ST Debt	15	11	132	-	-	161	496	530	702
LT Debt	-	-	70	-	-	-	-	237	350
Other Liabilities	-	0	23	31	47	59	67	78	87
Total Liabilities	188	478	661	398	718	836	965	1,325	1,628
Equity	137	398	774	3,002	3,482	4,044	4,083	4,124	4,247
Shares Outstanding, basic end	1,678	1,678	1,678	2,098	2,098	2,098	2,098	2,098	2,098
Shares Outstanding, diluted end	1,678	1,678	1,678	2,098	2,112	2,111	2,110	2,116	2,129
Total Debt	15	11	202	-	-	161	496	766	1,053
Net Debt	(66)	(159)	(286)	(1,988)	(2,663)	(2,536)	(2,266)	(2,514)	(2,699)
Invested Capital	71	240	510	1,045	866	1,567	1,883	1,687	1,635
Tangible Invested Capital	71	230	500	1,035	853	1,551	1,863	1,664	1,610
Net Operating Assets	58	219	468	998	782	1,369	1,611	1,368	1,334
Net Tangible Operating Assets	58	210	458	988	769	1,352	1,590	1,345	1,309
Net Financial Assets	80	179	306	2,004	2,699	2,675	2,472	2,756	2,913
FINANCIAL SUMMARY (CNY mn)	2006	2007	2008	2009	2010	2011	2012	2013	2014
Cash Flow from Operations	108	(50)	403	675	896	782	338	340	329
Working Capital Investment	(9)	63	(119)	(406)	270	(472)	(158)	167	55
Fixed Capital Investment	(6)	(76)	(143)	(111)	(142)	(183)	(183)	(75)	(25)
Free Cash Flow	93	(62)	141	158	1,025	128	(2)	432	359
Other Investing	(24)	(62)	8	(493)	484	(129)	(313)	(780)	(509)
Cash from/(to) Debtholders	28	129	169	(270)	-	160	328	256	266
Cash from/(to) Shareholders	(6)	46	-	1,601	(349)	(227)	(272)	(217)	(200)
Operating Income	110	175	402	702	985	907	369	341	428
Income Tax	(10)	(24)	(35)	(75)	(176)	(159)	(95)	(146)	(168)
NOPAT	100	151	367	627	809	748	274	195	260
Investment in Net Operating Assets		(162)	(249)	(530)	215	(586)	(242)	243	34
Investment in Invested Capital		(168)	(271)	(535)	179	(701)	(316)	196	53
Free Cash Flow		(10)	119	98	1,024	161	32	438	294
Residual Income	94	130	322	529	732	613	115	61	129

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