

**Analyst: Sabina Cheng**

## **Main Board Listing – Research**

中國利郎有限公司

**China Lilang Limited [Stock Code: 01234]**

<b>Sole Global Coordinator</b>	:	Merrill Lynch International
<b>Sole Sponsor</b>	:	Merrill Lynch Far East Limited
<b>Joint Bookrunners</b>	:	Merrill Lynch International and HSBC
<b>Joint Lead Managers</b>	:	Merrill Lynch Far East Limited and HSBC for the “Public Offering”
<b>PRC Domestic Financial Adviser</b>	:	Industrial Bank

**Sector** : Menswear

**Business** : The leading PRC menswear brands

<b>Total share offer:</b> <u>300,000,000</u> shares (25.0% of the enlarged share capital) <b>Public Offer:</b> 30,000,000 shares (10%) <b>Placing:</b> 270,000,000 shares (90%)	<b><u>Business of China Lilang (“The Group”)</u></b>  The Group is an integrated fashion enterprise in China which designs, sources, manufactures and sells business and casual apparel for men under its LILANZ brand. Among those brands that are focused on the second and lower tier cities in China, LILANZ ranked first in terms of retail sales in 2007 and 2008.  The Group’s target customers are between the ages of 28 and 45 and its products include suits, jackets, shirts, trousers, sweaters and accessories which can be broadly divided into business formal, business casual, fashion casual and sports.  The Group manufactures its apparel at its own production facilities in Jinjiang, Fujian and outsources partially to some OEM contractors. Its products are sold across an extensive distribution network, covering 31 provinces, autonomous regions and municipalities in the PRC. As at 30 <sup>th</sup> June 2009, the Group had 53 distributors operated or subcontracted the operation of 2,456 retail outlets. In terms of outlet number, Lilang is the third largest in China, with K-boxing being the largest with 3,200 outlets.
<b>Price:</b> HK\$3.20 – HK\$4.00 per share <b>Market Cap:</b> HK\$3.84 billion – HK\$4.80 billion <b>Pro forma fully diluted FY08 P/E:</b> 24.9x – 31.1x <b>Pro forma fully diluted FY09 P/E:</b> 13.7x – 17.1x <b>Adjusted NTA per share:</b> RMB1.08 – RMB1.25 <b>Staffing:</b> 3,251 (as of 4 <sup>th</sup> September 2009)	
<b>HK Public Offer period:</b> 11 <sup>th</sup> Sep 2009 – 16 <sup>th</sup> Sep 2009 noon <b>Receiving bank:</b> Hang Seng Bank Limited The Bank of East Asia, Limited <b>Hong Kong Share registrar:</b> Computershare Hong Kong Investor Services <b>Listing date:</b> 25 <sup>th</sup> September 2009	

*This report has been prepared solely for information purposes and we are not soliciting any action based upon it. Neither this document nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information, which we consider reliable, but accuracy or completeness is not guaranteed. Opinions expressed herein are subject to change without notice. At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein, while its group companies may from time to time have interests in securities of the company or companies mentioned herein.*

**Shareholders after Listing** (Assuming the over-allotment option is not exercised)

Wang Brothers –Mr. Wang Dong Xing (chairman of the Group), Mr. Wang Liang Xing (vice chairman of the Group) and Mr. Wang Cong Xing (vice chairman of the Group).	5.70%
Xiao Sheng International – a company owned by the Wang Brothers (76.5%), and the executive directors of the Group, Mr. Cai Rong Hua (8%), Mr. Hu Cheng Chu (5%), Mr. Wang Ru Ping (3%), Mr. Pan Rong Bin (3%) and others (4.5%).	55.13%
Ming Lang Investments – a company owned by the Wang Brothers (76.5%), and the executive directors, Mr. Cai Rong Hua (8%), Mr. Hu Cheng Chu (5%), Mr. Wang Ru Ping (3%) and Mr. Pan Rong Bin (3%) and others (4.5%).	12.38%
Management of the Group and their relatives as well as employees of the Group.	1.79%
Public shareholders	25.00%
	<b>100.00%</b>

**Use of Proceeds**

Net proceeds from the offer are estimated to be HK\$979.9 million (based on an offer price of HK\$3.60, being the mid-point of the indicative price range and assuming the over-allotment option is not exercised)

	% of total
To further expand the Group's product development studio in Shanghai and develop facilities in Xiamen	147.0
To develop a sub-brand of the Group's targeting customers aged 20 to 30	147.0
To lease and renovate flagship stores for the distributors to operate	147.0
To participate in promotional and brand building activities	195.9
To expand the Group's production facilities at the Wuli Industrial Park in Jinjiang	49.0
For establishing an enterprise resource planning system, developing the required information technology network and obtaining the necessary consulting services and system software	98.0
To partially repay the Group's bank loans	98.0
To provide funding for working capital and other general corporate purpose	98.0

**Financial Highlights**

	Year ended 31 <sup>st</sup> Dec			Six months ended	
	2006	2007	2008	30 <sup>th</sup> June 2008	30 <sup>th</sup> June 2009
	RMB '000	RMB '000	RMB '000	RMB '000	RMB '000
Turnover	418,195	885,921	1,135,684	483,945	600,176
Gross profit	95,180	233,901	344,057	144,166	176,835
Operating profit	49,508	109,727	171,044	75,924	108,034
<b>Profit attributable to shareholders</b>	<b>32,581</b>	<b>96,506</b>	<b>154,132</b>	<b>69,314</b>	<b>89,964</b>
Gross profit margin	22.8%	26.4%	30.3%	29.8%	29.5%
Operating profit margin	11.8%	12.4%	15.1%	15.7%	18.0%
Net profit margin	7.8%	10.9%	13.6%	14.3%	15.0%

**Breakdown of turnover in terms of customer group**

	Year ended 31 <sup>st</sup> Dec						Six months ended	
	2006		2007		2008		2009	
	(RMB '000)	%	(RMB '000)	%	(RMB '000)	%	(RMB '000)	%
Apparel	416,139	99.5	872,382	98.5	1,096,289	96.5	571,008	95.1
Accessories	2,056	0.5	13,539	1.5	39,395	3.5	29,168	4.9
Total	418,195	100.0	885,921	100.0	1,135,684	100.0	600,176	100.0

**Strengths/Opportunities**

- × The mainstream brands accounted for 31% of the total market share in China's menswear market in 2008. Within the highly fragmented mainstream brands market itself, in 2008, the top ten brands held 29.41% of the market share. The LILANZ brand ranked the top among its competitors in the mainstream brands market in 2008 with market share of 3.4%.

**Market Share by Retail Sales in the Mainstream Brands Menswear Market in 2008**

Brand	Market share (%)
LILANZ	3.40%
Septwolves	3.37%
Seven brand	3.35%
Firs	3.28%
K-boxing	2.84%
Fordoo	2.80%
Romon	2.68%
Baoxiniao	2.65%
Taizilong	2.59%
Joe One	2.45%
Subtotal of top 10 brands	29.41%
Others	70.59%
Total	100.00%

- ✓ The Group registered an improvement in operating profit margin (from 15.7% in Jun08 to 18% in Jun09) and net profit margin (from 14.3% in Jun08 to 15% in Jun09), despite the difficult operating environment following the financial crisis, implying the company's products have gained much brand loyalty from its targeted customers between the age group of 28 and 45 years old.
- ✓ It is expected that after the Group has established an enterprise resource planning system, developed the required information technology network and obtained the necessary consulting services and system software, it is able to monitor the inventory levels at its distributors effectively.
- ✓ Shares of China Lilang will be traded between 13.7x and 17.1x 2009E P/E (assuming that the company's net profit will be not less than HK\$281 million in 2009), valuation looks attractive when compared with its closest peers like Li Ning (#02331), Anta (#02020), Daphne (#00210), Ports (#00589) and Esprit (#00330), which are trading between 16.5x and 24.9x 2009E P/E.

**Weaknesses/Threats**

- × There was a sharp rise the Group's cost of outsourced production as a percentage of its costs of sales, from 41.9% in 1H FY2008 and 61.2% in 1H FY2009, reflecting that the Group has been depending on its OEM contractors for production. Any near term material disruption in the supply of products from its OEM contractors may adversely affect its results of operations.
- × The Group will use 10% (around HK\$147 million) of this IPO proceeds for the development of a sub-brand for a younger age group between 20 and 30 years old. Recently, it has appointed David Wu (吳彥祖) to be the spokesperson for this new sub-brand. However, it is expected that this new business line may face more challenges as younger customers usually have lower brand loyalty.

**Recommendation: Trading buy**



## **Important Disclosure / Analyst Certification / Disclaimer**

This document is published by East Asia Securities Company Limited, a wholly-owned subsidiary of The Bank of East Asia, Limited (BEA).

The research analyst primarily responsible for the content of this report, in part or in whole certifies that the views on the companies and their securities mentioned in this report accurately reflect his/her personal views. The analyst also certifies that no part of his/her compensation was, is, or will be, directly, or indirectly, related to specific recommendations or views expressed in this report.

This report has been prepared solely for information purposes and has no intention whatsoever to solicit any action based upon it. Neither this report nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information, which East Asia Securities Company Limited considers reliable, but accuracy or completeness is not guaranteed. Information and opinions expressed herein reflect a judgment as of the date of this document and are subject to change without notice. Any recommendation contained in this report does not have regard to the specific investment objectives, financial situation and the particular needs of any specific addressee. This report is not to be taken in substitution for the exercise of judgment by respective readers of this report, who should obtain separate legal or financial advice. East Asia Securities Company Limited and / or The BEA Group accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or further communication given in relation to this report.

At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein the report, while BEA along with its affiliates and/or persons associated with any of them may from time to time have interests in the securities mentioned in this report. BEA and its associates, its directors, and/or employees may have positions in, and may effect transactions in securities mentioned herein and may also perform or seek to perform broking, investment banking and other banking services for these companies.

BEA and/or any of its affiliates may beneficially own a total of 1% or more of any class of common equity securities of the subject company or companies mentioned in this report and may, within the past 12 months, have received compensation and/or within the next 3 months seek to obtain compensation for investment banking services from the subject company or companies mentioned in the report.

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of, or located in, any locality, state, country or other jurisdiction, publication, availability or use would be contrary to law and regulation.