

Main Board Listing - Research

新宇亨得利控股有限公司

Xinyu Hengdeli Holdings Limited [Stock Code: 3389]

Global Coordinator, Sole Bookrunner & Lead Manager : Guotai Junan Securities (Hong Kong) Limited
Sponsor : Guotai Junan Capital Limited
Sponsor & Co-lead Manager : Partners Capital International Limited

Sector : Consumer Discretionary

Business : Wholesale and retail of imported watches in the PRC

Total share offer: <u>250,000,000</u> shares (25% of the enlarged share capital) Public Offer: 25,000,000 shares (10%) Placing: 225,000,000 shares (90%) Greenshoe: 37,500,000 shares (15%)	<u>Business of Xinyu Hengdeli ("The Group")</u> The Group is a wholesaler and retailer of watches in the PRC that focuses on international brands that target consumers of middle and high income. At the latest practicable date, the Group held the right to distribute watches of about 30 international brands such as Audemars Piguet, Jaeger- LeCoultre and Vacheron Constantin, etc. It has entered into five written distribution agreements with brand-owners or distributors for distributing certain brands in the PRC. The terms of the agreements range from three to five years and the expiry period of which are within the period from 2006 to 2010. The Group operates a distribution network that comprises about 300 wholesale customers located in over 40 cities in the PRC and 51 retail outlets located in 16 cities in the PRC. Apart from distributing watches of international brands, the Group has also started distributing watches under its proprietary brand, NIVADA since January 2005. These watches are designed and manufactured by third party manufacturers with whom the Group enters into sub-contracting agreements.
Price: HK\$1.10 – HK\$1.38 per share Market Cap.: HK\$1,100 million – HK\$1,380 million Pro Forma FY 2004 P/E: 11.70 – 14.68x Adjusted NTA per share: HK\$0.45 – HK\$0.52 Staffing: 1,141	
HK Public Offer period: 13 th September 2005 – 20 th September 2005 Receiving bank: BOC (Hong Kong) Limited Share registrar: Computershare Hong Kong Investor Services Limited Listing date: 26 th June 2005	

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

Family of Mr. Zhang Yuping, the Chairman [interest via Best Growth (BVI)]	72.63%
Mr. Song Jianwen, Executive Director [interest via Artnew Developments (BVI)]	1.185%
Mr. Zhang Xingen, Vice President of Shanghai Xinyu* [interest via Business Up (BVI)]	0.7875%
Ms. Li Ting, Vice President of Shanghai Xinyu* [interest via Spring Day (BVI)]	0.3975%
	<u>75.0%</u>

*Shanghai Xinyu is the Group's 95% owned subsidiary

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.

Use of Proceeds

Net proceeds from the offer are estimated to be HK\$289 million.

(Assuming the over-allotment option is not exercised, and at an issue price of HK\$1.24 each, which is the mid-point of the indicative price range)

	HK\$ million
Opening of approximately 20 of its own new retail outlets in the PRC	101
Acquisition of retail outlets from or co-operate with third parties in the PRC or overseas	101
Development of the Group's own brand, NIVADA	43
Development and acquisition of new potential brands	15
General working capital	29

Financial Highlights

	Year ended 31 st December		
	2002	2003	2004
	RMB'000	RMB'000	RMB'000
Turnover	1,375,420	1,496,401	1,518,582
Gross profit	112,352	224,318	308,134
Operating profit	43,999	113,355	176,378
Net profit	23,359	67,196	105,883
Basic EPS (RMB)	0.03	0.07	0.13

Strengths/Opportunities

- ✓ Demand for watches in the PRC is huge and the market penetration rate is low. According to the report of the PRC's Ministry of Information Industry, it is estimated that the demand for watches reached about RMB16 billion in 2004. In the PRC, an average of about 5 watches were purchased by every 100 consumers per annum. This is far below the average of about 27 watches in the developed countries and 18 watches in the developing countries.
- ✓ The Group has extensive retail network of 51 outlets that reach the cities that have the highest consumer spending, i.e. Hangzhou, Shanghai, Beijing, Shenyang and Harbin.
- ✓ The Group's effort in developing its own brand, NIVADA, might help to improve its profitability due to higher margin of proprietary brands in general.

Weaknesses/Threats

- × The global luxury watch market is dominated by industry giants like the Swatch Group, Richemont and LVMH, etc. As they control most of the luxury brands in the world, bargaining power of regional retailers like Xinyu Hengdeli should be quite limited. In order to recoup the vast sum of money they spent through years of consolidation, new agreements concluded with distributors are expected to be tougher than before. For instance, Swatch Group has taken over Xinyu's wholesale rights for Omega and Rado that accounted for 39.8% of its turnover in 2004.
- × All leases of the Group's stand-alone shops are for relatively short-term, typically ranging from one to five years. Hence, the Group is exposed to possible rent increases or non-renewal of leases.
- × Priced at 11.70x – 14.68x pro forma FY2004 PER, valuation of Xinyu Hengdeli is not very attractive when compared with close comparable such as Oriental Watch (0398) that only trades at 5.69x FY2004 PER with stable yields of some 4% per annum for the past few years. We see the latter to be equally accessible to the opportunities of China's fast growing retail market given its initiative to open outlets on the Mainland and the Frequent Individual Travellers Scheme to Hong Kong.
- × The Group does not provide guidance for its FY2005 earnings.

Recommendation: Unexciting