

**BEA securities**

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**HONG KONG RESEARCH****25<sup>th</sup> September 2007**

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**Main Board Listing – Research****China Dongxiang (Group) Limited [Stock Code: 3818]** 中國動向（集團）有限公司

**Joint global coordinators, joint bookrunners, joint lead managers and joint sponsors** : Deutsche Bank Merrill Lynch

**Sector** : Consumer Durables & Apparel**Business** : Design and manufacture of sportswear

<p><b>Total share offer:</b> <u>1,375,000,000</u> shares (25% of the enlarged share capital)</p> <p><b>Placing:</b> *1,237,500,000 shares (90%)</p> <p><b>Public Offer:</b> 137,500,000 shares (10%)</p> <p><b>Greenshoe:</b> ^206,250,000 shares</p> <p><i>*Comprising 1,043,500,000 New Shares and 194,000,000 Sale Shares</i></p> <p><i>^Comprising 177,150,000 New Shares and 29,100,000 Sale Shares</i></p>	<p><b><u>Business of China Dongxiang (Dongxiang)</u></b></p> <p>Dongxiang is a leading sportswear and brand enterprise in the PRC. Dongxiang's Kappa Brand is among the top three international sportswear brands in the PRC in terms of market share by sales revenue. Dongxiang primarily engages in the design, development, marketing and wholesale of branded sportswear in the PRC.</p> <p>Since 30 May 2006, Dongxiang owned all rights to the internationally recognized Kappa Brand in the PRC and Macau. Dongxiang also has a licensed Rukka Brand offering performance-focused sportswear and accessories. Dongxiang does not operate any retail outlets but wholesale products to distributors and Kappa licensees. Consignment sales are made for Rukka Brand products. Dongxiang outsources retail and manufacturing functions but focus more on brand management, design and development capabilities.</p> <p>Dongxiang provided FY07E consolidated attributable profit forecast to be no less than RMB611 million, equivalent to a pro forma fully diluted EPS of RMB0.11.</p>
<p><b>Price:</b> HK\$3.60– HK\$3.98 per share</p> <p><b>Market Cap:</b> HK\$19.80 billion – HK\$21.89 billion</p> <p><b>Pro-forma fully diluted FY07 PER:</b> 32.7X – 36.2X</p> <p><b>Adjusted NTA per share:</b> HK\$0.84 – HK\$0.91</p> <p><b>Staffing:</b> 278</p>	
<p><b>HK Public Offer period:</b> 25<sup>th</sup> September 07 – 2<sup>nd</sup> October 07 noon</p> <p><b>Receiving bank:</b> HSBC, ICBC</p> <p><b>Share registrar:</b> Computershare Hong Kong Investor Services Limited</p> <p><b>Listing date:</b> 10<sup>th</sup> October 2007</p>	

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

Mr. Chen Yihong – the founder, chairman, executive director (through Poseidon Sports Ltd.)	47.0%
Ms. Liu Peiying – the wife of Mr. Chen (through Colour Billion Ltd.)	6.3 %
Mr. Chen Yiliang – the brother of Mr. Chen Yihong (through Forever Step Investment Ltd., Talent Hill Group Ltd. & Ease Luck Group Ltd.)	5.1 %
Mr. Qin Dazhong – the CEO and executive director (through Wise Finance Ltd.)	4.4%
Morgan Stanley Apparel Ltd. & Morgan Stanley Apparel II Ltd. – selling shareholders	12.2%
Public shareholders*	25.0%
	<u>100.0%</u>

Remarks: \* Dongxiang and the joint global coordinators have entered into placing agreements with each of the following cornerstone investors:

- **China Life Insurance Co. Ltd.** will subscribe for HK\$275.1 million worth of shares. (some 72.585 million shares at the mid-point offer price)
- **Tiger Global funds** will subscribe for HK\$275.1 million worth of shares. (some 72.585 million shares at the mid-point offer price)

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- **Intime Department Store (Group) Co. Ltd.** will subscribe for an aggregate of HK\$78.6 million worth of shares. (some 20.738 million shares at the mid-point offer price)

### Use of Proceeds

Net proceeds from the offer are estimated to be HK\$4,292.6 million. (Assuming an offer price of HK\$3.79, being the mid-point of the indicative offer price range, and the over-allotment option is not exercised)

	HK\$ million
To develop existing brands and expand brand portfolio	2,275.1
To expand and improve distribution network which may include directly investing in distributors, setting up retail joint ventures and/or purchases of premises for retail stores	1,073.2
To establish new operating headquarters through construction of new buildings or purchases of new office buildings	214.6
To enhance design and development capabilities and facilities	214.6
To pay special dividends of RMB230.0 million declared in respect of the 5 months ended 31 May 2007	238.3
For working capital purposes and other general purposes	balance

### Financial Highlights

	Year ended 31 <sup>st</sup> December		
RMB million	2004	2005	2006
Revenue	0.1	147.7	858.9
Gross profit	0.1	66.6	535.6
Operating profit / (loss)	(0.0)	40.5	388.3
Net profit	0.6	37.8	306.5
Gross margin	94.0%	45.1%	62.4%
Operating margin	NA	27.4%	45.2%
Net margin	628.0%	25.6%	35.7%

### Breakdown of turnover by activities

RMB million	2004	%	2005	%	2006	%
Kappa brand products	0.0	0.0%	144.6	97.9%	839.3	97.7%
International sourcing	0.0	0.0%	3.1	2.1%	19.6	2.3%
Rukka brand products and others	0.1	100.0%	0.0	0.0%	0.0	0.0%
Total	0.1	100.0%	147.7	100.0%	858.9	100.0%

### Strengths/Opportunities

- ✓ **Asset-light model** Dongxiang outsources manufacturing and retail distribution. It currently has about 70 suppliers and 39 distributors who directly or indirectly operate 1,548 retail outlets selling Kappa brand products. Dongxiang then focuses on brand management as well as design and development activities.
- ✓ Dongxiang owns all rights to the Kappa brand in the PRC and Macau. Kappa is a well-known brand in China trailing behind Nike (16.7%), Adidas (15.6%), Li Ning (10.5%) and ANTA (4.0%) with a market share of 2.8% according market research report dated August 2007.
- ✓ The IPO price range of Dongxiang is at a FY07E pro-forma fully diluted PER range of 32.7X – 36.2X. HK-listed peers, Li Ning (2331.HK) and ANTA (2020.HK), trade at FY07E PER of 48X and 45X respectively. Dongxiang is priced at about 22%-30% discount to the peers, which we think is reasonable given Dongxiang's lower market share and fewer retail outlets.

### Weaknesses/Threats

- ✗ Dongxiang practically operates on a **single brand** – Kappa. Although Dongxiang now has Rukka brand, Kappa will still account for over 95% of total turnover in the coming 2-3 years.
- ✗ **Tax rate increase** Dongxiang's effective tax rate varied from 5% to 18% over the past 3 years and for FY07E, it is expected to be 7% due to tax credit. The long-term tax rate will increase to 25% in 5 years effective from 1 Jan 2008.

**Recommendation: Trading buy**



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