

MITA No. 010/06/2008

19 November 2008

# Cacola Furniture Int'l Ltd

## Our concerns reaffirmed; downgrade to HOLD

Downgrade to

# HOLD

Previous Rating: BUY

## S\$0.075

## Fair Value: S\$0.095

Stock Code:

Reuters:

ISIN Code

Bloomberg:

CACF.SI

D2U

CCFSP

Event:

Results

### General Data

Issued Capital (m)	345
Mkt Cap (S\$m/US\$m)	26/17
Major Shareholder	Rainbow Champion (27.72%)
Free Float (%)	34.5
NAV per share (RMB cents)	116.2
Daily Vol 3-mth ('000)	1,643
52Wk High (S\$)	0.485
52Wk Low (S\$)	0.060

**Environment remains challenging.** Cacola Furniture International Ltd (Cacola) hosted a post-3Q08 results teleconference this week. Key concerns included (i) lacklustre sales performance (-11.9% QoQ) along with weak property markets, (ii) declining gross profit margin due to intense price competition in the PRC, and (iii) stagnating retail penetration. This is in line with the 30% contraction we are projecting for FY09 earnings.

**Expect more shops to fold.** 13 Cacola distributors, which together account for approximately 5% of the group's turnover, succumbed to the harsh operating environment and ceased operating in 3Q08. We expect another 10 stores to fold in 4Q08, offsetting management's target of opening 10 new stores. This signals deteriorating demand, and could put the group at risk of having to slash its prices further in order to dispose of its inventory, leading to further gross margin erosion. The group also faces numerous obstacles including indefinite delays with regard to its upcoming mega stores, marring earnings visibility and raising execution risk.

**Lack of clarity over Chairman's sale.** Recently, the Chairman sold 22.9% of his stake in the company. No details, other than "personal reasons", were provided. His deemed interest in the company now stands at 27.72% (vs. 50.63% previously). Buyers of his stake consisted of around 5 institutional and retail investors. While this move is not a clear "red flag" at this point, it could dampen investors' confidence especially under present weak market sentiment.

**Net cash position.** Recognising that weak demand could persist in the near term, the group plans to cut back on A&P expenses. As of 30 Sep 08, Cacola has maintained a cash position of S\$0.14/share with no debt on its balance sheet. We estimate that it will be left with S\$0.093/share after it fully deploys its IPO proceeds. This still places the group in a net cash position, which should buffer it from the ongoing credit crunch.

**Downgrade to HOLD.** We do not see near term price drivers given the subdued macro outlook. Nevertheless, from a valuation perspective, Cacola's shares should receive some support from its cash valuations. We are leaving our earnings estimates unchanged as we had recently cut our numbers. However, with the lack of earnings drivers, the risk of more store closures, declining margins and lower demand, the outlook is very challenging. We are downgrading the stock to a **HOLD** with fair value estimate of S\$0.095 or 0.4x FY08F NAV

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Year to 31 Dec	Turnover (RMB m)	Gross Profit (RMB m)	Net Profit (RMB m)	EPS (RMB cents)	EPS Growth (%)	PER (x)	Div Yield (%)
FY 06	455.6	145.7	75.2	29.5	33.7	1.3	75.3
FY 07	564.2	190.6	123.3	35.7	21.2	1.1	19.0
FY 08F	665.3	212.9	131.2	38.0	6.4	1.0	20.2
FY 09F	614.4	184.3	91.9	26.6	-29.9	1.4	14.2

Please refer to the important disclosures at the back of this document.

### Cacola's Key Financial Data

<b>Cacola Results</b> Year Ended 31 Dec (RMB m)	<b>3Q07</b> (RMB m)	<b>3Q08</b> (RMB m)	<b>% Chg</b> (YoY)	<b>2Q08</b> (RMB m)	<b>% Chg</b> (QoQ)
Revenue	143.0	158.5	10.9%	180.0	-11.9%
Cost of sales	-94.5	-108.6	14.9%	-118.3	-8.2%
Gross Profit	48.4	49.9	3.1%	61.7	-19.1%
Other income	0.1	0.5	233.6%	0.4	5.3%
Selling and distribution expenses	-6.5	-10.7	65.6%	-13.8	-22.3%
Administrative expenses	-7.7	-8.7	13.0%	-10.2	-15.0%
Profit from operating activities	34.4	30.9	-10.0%	38.1	-18.7%
Finance costs	0.0	0.0	N.M.	0.0	N.M.
Profit before tax	34.4	30.9	-10.0%	38.1	-18.7%
Tax	0.0	0.0	N.M.	2.5	-100.0%
Net profit	34.4	30.9	-10.0%	40.6	-23.7%

### EARNINGS FORECAST

<b>Year Ended 31 Dec (RMB m)</b>	<b>FY06</b>	<b>FY07</b>	<b>FY08F</b>	<b>FY09F</b>
Revenue	455.6	564.2	665.3	614.4
Cost of sales	-309.9	-373.6	-452.4	-430.1
Gross Profit	145.7	190.6	212.9	184.3
Other income	0.1	2.1	1.6	0.0
Selling and distribution expenses	-20.0	-23.8	-45.2	-43.0
Administrative expenses	-13.4	-35.5	-40.6	-36.9
Profit from operating activities	112.4	133.5	128.7	104.4
Finance costs	0.0	0.0	0.0	0.0
Profit before tax	112.4	133.5	128.7	104.4
Tax	-37.2	-10.2	2.5	-12.5
Net profit	75.2	123.3	131.2	91.9
Earnings per share (RMB cents)	29.5	35.7	38.0	26.6

### Profitability Ratios

Gross margin (%)	32.0	33.8	32.0	30.0
PBT margin (%)	24.7	23.7	19.3	17.0
Net profit margin (%)	16.5	21.9	19.7	15.0

**BALANCE SHEET**

<b>As at 31 Dec (RMB m)</b>	<b>FY06</b>	<b>FY07</b>	<b>FY08F</b>	<b>FY09F</b>
Cash and bank balances	1.5	214.2	230.9	287.7
Other current assets	86.7	140.0	153.0	141.3
Property, plant, and equipment	4.3	4.2	52.0	93.2
Total assets	92.5	358.4	436.0	522.2
Current liabilities	38.3	47.1	19.8	32.5
Advance from ultimate holding company	4.6	0.0	0.0	0.0
Total liabilities	42.9	47.1	19.8	32.5
Share capital	0.4	33.4	33.4	33.4
Reserves	49.3	277.9	382.8	456.4
Total equity	49.6	311.3	416.2	489.7
Total equity and liabilities	92.5	358.4	436.0	522.2
NAV per share (RMB cents)	19.5	90.2	120.6	142.0

**CASH FLOW**

<b>Year Ended 31 Dec (RMB m)</b>	<b>FY06</b>	<b>FY07</b>	<b>FY08F</b>	<b>FY09F</b>
Operating profit before working cap. changes	117.0	134.2	130.2	113.3
Working capital changes	-24.3	-46.9	-27.7	9.4
Income taxes paid	-28.1	-7.7	-10.2	2.5
Net cash from operations	64.6	79.6	92.3	125.2
Capex	-15.0	-1.1	-51.0	-50.0
Other investing flows	0.1	-39.6	1.6	0.0
Investing cash flow	-14.9	-40.7	-49.4	-50.0
Financing cash flow	-39.4	174.1	-26.2	-18.4
Net cash flow	10.3	213.1	16.7	56.8
Cash and cash equivalents retained by Dongguan Cacola	-20.9	-0.4	0.0	0.0
Cash at beginning of year	12.2	1.5	214.2	230.9
Cash at end of year	1.5	214.2	230.9	287.7

**Key Ratios**

PER (x)	1.3	1.1	1.0	1.4
Price/NTA (x)	1.9	0.4	0.3	0.3
Dividend yield (%)	75.3	19.0	20.2	14.2
ROE (%)	151.5	39.6	31.5	18.8
PE to growth (x)	0.0	0.0	0.2	0.0

Source: Company data, OIR estimates

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**SHAREHOLDING DECLARATION:**

The analyst/analysts who wrote this report holds NIL shares in the above security.

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