



Les Enphants Co., Ltd. (2911 TT)

BUY

Retail

Initiation

ML Research Team

Shuling Ho
886.2.2731 3888 ext. 635
shulingho@masterlink.com.tw
Non-Tech Analyst

Recommendation

BUY

Date: October 28, 2005
Share Price (NT\$): 19.00
Price Target (NT\$): 24.18
Percent Change: 27.3%
52-wk range (NT\$): 23.7-11.8
TWSE: 5632.97

Company Data

Capital Size (NT\$): 1.2bn
Market Cap (NT\$): 2.3bn
Market Cap (US\$): 67.0mn
Issuing Shrs: 118.5mn
Outstanding Shrs: 117.3mn
PER ('06E): 10.2x
PBR ('06E): 1.17x
Foreign Ownership: 15.9%
Major Shareholder: CEO Family (17.6%)

Performance	1-m	3-m	6-m
Absolute (%)	(7.77)	27.43	42.43
Relative to TAIEX	(2.88)	44.23	47.72

Key Changes	Current	Prev.
Recommendation	BUY	N/A
'06 Price Target (NT\$)	24.18	N/A
'06 Revenue (NT\$bn)	2.7	N/A
'06 Gross Margin (%)	48.7	N/A
'06 Oper. Margin (%)	7.5	N/A
'06 EPS (NT\$)	1.86	N/A

Price Catalysts (+,-)

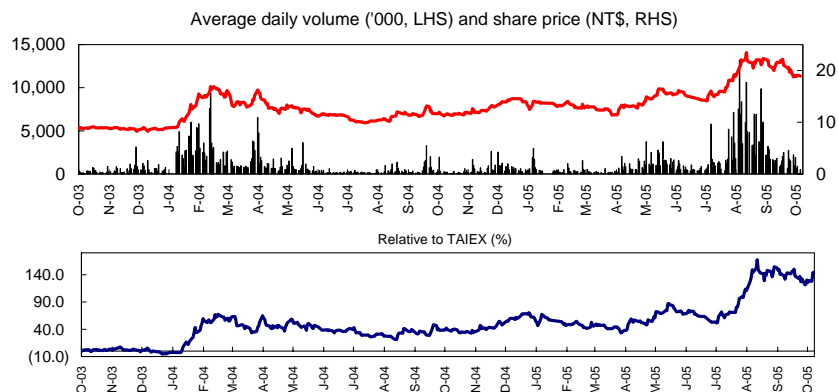
(+) Prosperous China sales growth
(+) Improving inventory turnover

Related Research

PCS (2912 TT) Oct 19, 05
FEDS (2903TT) Oct 17, 05

Initiate as a BUY

- **Discontinued slipping trend in Taiwan.** To cope with the curtailing birth rate in Taiwan, Les Enphants (L.E.) expanded into the youth sportswear market with the opening of a new store chain, Open Kids, currently with 53 locations. The new venture successfully discontinued L.E.'s sluggish sales volume since 2003. For the first 9 months of 2005, L.E. has recorded sales of NT\$1.7bn, up 11.7% YoY, with Open Kids making 12.6% contribution.
- **Reaping China operation.** As of August 2005, L.E. Shanghai's store number reached 442. Different from the Taiwan operation, the China subsidiary generates more than 70% of its sales through department stores. L.E. Shanghai has posted sales of NT\$790mn (or RMB190mn) in first three quarters of 2005, already exceeding 2004's total annual sales of NT\$737mn. The 2005 year-to-date accumulated net earnings was recorded at NT\$51mn. With the full deregulation of China's retail market, L.E. Shanghai is planning to expand more aggressively and we believe store number in China will increase by 200 stores every year.
- **High inventory level concern.** L.E.'s inventory turnover is apparently slower than its industry peers. Company indicated that an inventory control program has been implemented since 2000 in Taiwan and has successfully increased the inventory turnover and boosted up gross margin. In China, the inventory turnover period is even longer; however, for now, we believe that the high level of inventory can be justified by the up-coming expansion plan.
- **BUY with NT\$24.18 target.** The share is currently trading at 10.2x one-year forward PER, corrected from the 13.0x PER during the September rally. We, however, believe given the accelerating China sales outlook, the share deserves a premium pricing. Hence, we come to a valuation of 13.0x PER and conclude a target price of NT\$24.18 with 27.3% upside.



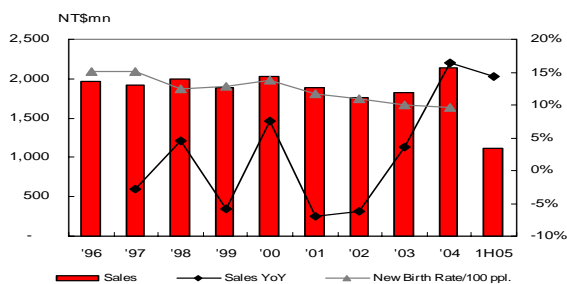
Investment Keynotes

Discontinued slipping trend in Taiwan

Les Enphants (L.E.) is the number-one domestic children wear and accessories designer/retailer targeting the bourgeoisie class. Besides self-branded products, the Les Enphants lines, the company also distributes children apparel of several international brands including Disney, Winnie the Pooh and Barbie via franchise contracts. To concentrate on sales and marketing, the production has been mostly outsourced to outside mills. The company currently sells through 187 Stores Island wide, including 91 direct-operated stores, 43 department-store counters, and 53 franchised stores. To cope with Taiwan's curtailing birth rate, the company expanded into the youth sportswear market with the opening a new store chain, Open Kids, currently with 53 locations. The new venture has successfully discontinued L.E.'s sluggish sales volume since 2003.

For the first nine months in 2005, L.E. has recorded sales of NT\$1.7bn, up 11.7% YoY, and net earnings of NT\$110mn, up by 28.8% from the NT\$85.4mn recorded in the same period in 2004. As of 3Q05, Open Kids has contributed 12.6% business turnover, or NT\$210mn of sales.

Figure 1: L.E. Sales Trend v.s. Taiwan Birth Rate

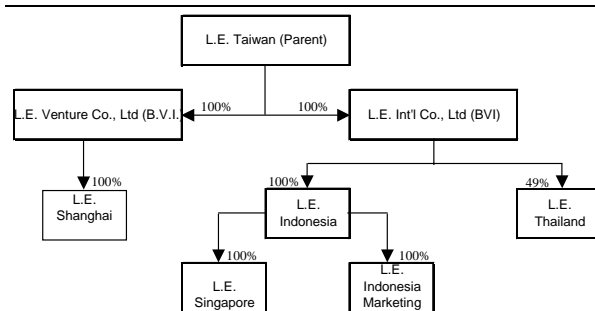


Source: Company data; MasterLink Securities

Offshore expansion

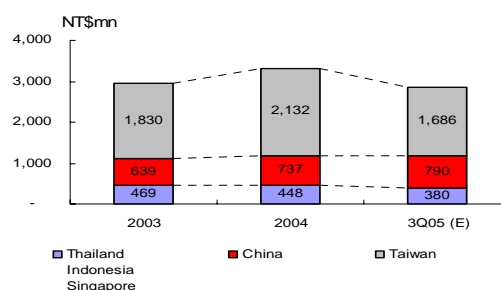
L.E. expanded into S.E. Asia during early 90's and currently with operations in Thailand, Indonesia, and Singapore. L.E. is one of the first few listed company setting up counterpart operation in China with the establishment of L.E. Shanghai in 1993. We estimate total 2005 consolidated revenue up until 3Q05 should record at NT\$2.9bn, 70.1% of company's yearly target with contribution mix of 59:28:13, individually from Taiwan, China, and S.E. Asia.

Figure 2: L.E. Global Deployment



Source: Company Data; MasterLink Securities

Figure 3: L.E. Consolidated Revenue Mix



Source: Company data; MasterLink Securities

L.E. Shanghai, the China operation

As of August 2005 L.E. Shanghai's store number reached 442 with 43% concentrated in the Yangzi River Delta area. Different from the Taiwan operation, the China subsidiary generates about 70% of its sales through department store (D.P.) counters, rather than from direct-operated stores. As D.P. sales is booked net of commission (28%~30%), we estimate the actual sales figure is 27%~30% higher than the accounting figures. Thanks for the booming China economy, during first nine months of operation in 2005, L.E. Shanghai posted sales of NT\$790mn (or RMB190mn), already exceeding 2004 total annual sales of NT\$737mn, before entering into the peak season of the 4Q05. The 2005 year-to-date accumulated net earnings was recorded at NT\$51mn, compare with 2004's total net earnings of NT\$43mn. We forecast the subsidiary's net earnings to be at NT\$68mn for 2005.

Figure 4: L.E.'s China Store Type & Sales Contribution

Store Type	Number of Stores	As of Jun. 05	
		Number of Stores	Sales Contribution
Direct Operated	71	Directed Operated and Franchised combine for	
Franchised	129	20%	
D.S. Counters	238	70%	
Distributors	-	10%	
Total	438	100%	

Source: Company data; MasterLink Securities

Backed by full deregulation of China's retail market in late 2004, upward-looking macro-economy, and consumer spending power, L.E. Shanghai is planning to expand more aggressively, pushing up store numbers in China's first-tier cities. Owing to the expensive 28% commission paid to department stores, L.E. Shanghai will concentrate on developing street franchised stores. Moreover, with franchise operations, L.E. will be able to save costs on extra hiring and store rental that will otherwise incurred when opening direct-operated stores.

We estimate the major capital expenditure of the expansion plan will be the initial store decoration costs of RMB0.3mn for each franchise store to setup. We think the store number will grow with at the speed of 200 stores each year, meaning RMB60mn of CAPEX every year for L.E. Shanghai.

High inventory level concern

We've noticed L.E.'s high inventory levels, compared with its industry peers. Company management indicated an inventory control program has been in place since 2000 in Taiwan and has successfully improved the inventory turnover and boosted up gross margin. Currently the off-season stocking is down from 35% to 20% of total inventory.

Figure 5: Inventory T/O Comparison & Gross Margin Trend

		Unit: Days			
		2001	2002	2003	2004
Esprit	0330 HK	64	64	51	45
Giordano	0709 HK	30	26	24	30
L.E. Taiwan	2911 TT	215	213	194	199
L.E. Taiwan	Gross Margin	36.0%	40.4%	44.3%	48.7%

Source: Company data; MasterLink Securities

In China, the inventory turnover period is even longer. As of July 2005, the inventory turnover period is 381 days, longer than a full-calendar year. Although we are still worried for the potential inventory write-off expenses, we believe that for now, the high level of inventory can be justified for the upcoming expansion plan.

Figure 6: L.E. SWOT Analysis

Strengths	Weakness
<ul style="list-style-type: none"> ▪ Steady growing Taiwan operation ▪ 13-year operation experience in China, which has helped to establish good level of brand recognition ▪ Built-up warehouse and logistics system which cover six major Chinese cities, including Shen Yang, Beijing, Nanjing, Shanghai, Guang Zhou, and Cheng Du 	<ul style="list-style-type: none"> ▪ Continuing high inventory level, although has been improving ▪ More than 50% products are subject to loyalty fees
Opportunities	Threats
<ul style="list-style-type: none"> ▪ Booming China economy, which should accelerate the development of strong bourgeoisie society ▪ Full-deregulated China retail market ▪ Chinese currency appreciation benefited 	<ul style="list-style-type: none"> ▪ Dropping birth rate in Taiwan ▪ Children wear is easy to copy, especially in China ▪ As franchise operation is still a new concept, franchisees in China may take more time to train and create mutual trust

Source: MasterLink Securities

Financial Forecast

With the rolling out of new Open Kids stores, we estimate L.E.'s parent operation in Taiwan to grow at the steady rates of 11.7% for 2005 and 12% for 2006. China will grow at a faster tempo with 42% for 2005 and 73% for 2006. However, the net margin will be trimmed down for the increasing depreciation expenses of the new store facilities.

Figure 7: L.E.'s Key Financial Forecasts

	Unit: NT\$m			
	2003	2004	2005	2006
Taiwan Sales	1,830	2,132	2,380	2,666
China Sales	639	737	1,079	1,862
China Net Earning	47	43	68	78
L.E. EPS NT\$	0.51	0.87	1.66	1.86
China EPS Contribution NT\$	0.42	0.39	0.57	0.66

Source: Company data; MasterLink Securities

Valuations and Recommendation

L.E.'s valuation recently jumped up sharply due to exciting sales growth in China. Compare with Far Eastern Department Store (2903 TT, NT\$16.50, HOLD), we prefer L.E. more for the "China Harvest Theme". We think under China's increasing competition in retail industry, we think small-to-medium operations, like L.E.'s, have greater flexibilities, lower risks, and shorter time required to reach breakeven.

The share is currently trading at 10.2x one-year forward PER, corrected from 13.0x PER during the September rally. We; however, believe given the accelerating China sales outlook, the share deserves premium pricing. Hence, we come to a valuation of 13.0x PER and conclude a target price of 24.18 based on our 2006 EPS estimate of NT\$1.86.

Figure8: L.E.'s P/E Band



Source: TEJ; MasterLink Securities

Figure 9: L.E.'s P/B Band



Source: Company data; MasterLink Securities

Les Enphants Key Ratios					NT \$mn
Year to December	2002	2003	2004	2005E	2006E
Net Sales Growth	-6.24%	3.53%	16.51%	11.65%	12.00%
Gross Margin	40.78%	44.33%	48.73%	48.73%	48.73%
Operating Margin	-0.69%	4.11%	7.52%	7.52%	7.52%
EBT Margin	-9.12%	4.32%	5.09%	10.14%	10.16%
EBT Growth	-751.90%	-149.09%	37.11%	122.48%	12.18%
Net income Margin	-9.70%	3.09%	4.48%	8.26%	8.28%
Net income Growth	-822.80%	-133.02%	68.76%	105.74%	12.22%
RoAA	-5.96%	2.07%	3.37%	6.79%	7.23%
RoAE	-11.16%	3.91%	6.41%	11.93%	12.11%

Les Enphants P&L					NT \$mn
Year to December	2002	2003	2004	2005E	2006E
Net Sales	1,767	1,830	2,132	2,380	2,666
Cost Of Goods Sold	(1,053)	(1,019)	(1,093)	(1,220)	(1,367)
SG&A	(733)	(736)	(879)	(981)	(1,099)
Operating Income	(12)	75	160	179	200
Net Investment Income	(68)	18	51	68	78
Other Non-Operating Income (net)	(81)	(14)	(103)	(6)	(8)
Pre-Tax Income	(161)	79	108	241	271
Income Tax Expense	10	22	13	45	50
Extraordinary G/L	-	-	-	-	-
Net Income	(171)	57	96	197	221
EPS(NT\$)	(1.54)	0.51	0.87	1.66	1.86
DPS(NT\$)	0.00	0.00	0.20	0.00	0.00
Payout Ratio	0.00%	0.00%	22.99%	0.00%	0.00%
Common Stocks	1,140	1,140	1,140	1,185	1,185

Les Enphants Balance Sheet					NT \$mn
Year to December	2002	2003	2004	2005E	2006E
Cash & Equivalent	55	36	45	44	130
Receivable	126	147	201	135	151
Inventories	546	537	653	675	656
Long-term Investment	767	802	833	845	923
Total Fixed Assets	733	750	809	867	874
Other Assets	542	426	431	402	402
Total Assets	2,770	2,698	2,974	2,967	3,137
Current Liab.	761	670	1,317	767	716
L-T Liabilities	578	562	142	488	488
Total Liabilities	1,339	1,232	1,460	1,256	1,204
Common Stocks	1,140	1,140	1,140	1,185	1,185
Capital & Legal Reserve	441	441	352	371	393
Retained Earnings	(150)	(93)	96	204	403
Adjustment	-	(21)	(73)	(49)	(49)
Total Equity	1,431	1,466	1,514	1,712	1,932
Total Liab. & Equity	2,770	2,698	2,974	2,967	3,137
BV(NT\$)	12.56	12.87	13.28	14.44	16.30

Les Enphants Cashflow					NT \$mn
Year to December	2002	2003	2004	2005E	2006E
Net Income	(171)	57	96	197	221
Depreciation & Amortization	49	55	65	73	73
Net Working Capital Change	111	13	(77)	24	-52
Others	220	54	27	(182)	(74)
Operating Cashflow	209	178	111	111	167
Sale (Purchase) of L-T Inv.	(5)	(56)	3	38	-
Sale (Purchase) of F.A.	(25)	39	(108)	(127)	(80)
Others	(58)	(27)	(59)	36	-
Investment Cashflow	(88)	(44)	(164)	(53)	(80)
Dividend Paid	(22)	-	-	(23)	-
Debt Change	(100)	(138)	93	(67)	-
Others	(2)	(15)	(30)	30	-
Financing Cashflow	(124)	(153)	63	(60)	-
Total Cash Change	(3)	(18)	9	(2)	87

MasterLink Securities – Stock Rating System**BUY:** Total return expected to appreciate 10% or more over a 3-month period.**HOLD:** Total return expected to be between 10% to –10% over a 3-month period.**SELL:** Total return expected to depreciate 10% or more over a 3-month period.

Additional Information Available on Request

©2005 MasterLink Securities. All rights reserved.

This information has been compiled from sources we believe to be reliable, but we do not hold ourselves responsible for its completeness or accuracy. It is not an offer to sell or solicitation of an offer to buy any securities. MasterLink and its affiliates and their officers and employees may or may not have a position in or with respect to the securities mentioned herein. This firm (or one of its affiliates) may from time to time perform investment banking or other services or solicit investment banking or other business from, any company mentioned in this report. All opinions and estimates included in this report constitute our judgment as of this date and are subject to change without notice. MasterLink has produced this report for private circulation to professional and institutional clients only. All information and advice is given in good faith but without any warranty.
