

INITIATION REPORT

12 Apr 2011

Multi Sports Holdings Limited		<i>Market Price:</i>	RM0.495
		<i>Market Capitalisation:</i>	RM196.0m
		<i>Board:</i>	Main Market
<i>Recommendation:</i>	BUY	<i>Sector:</i>	Consumer Products
<i>Target Price:</i>	RM0.78	<i>Stock Code/Name:</i>	5150 / MSPORTS

Analyst: Research Team



Source: Multi Sports

BACKGROUND

Multi Sports Holdings Limited was incorporated in September 2008 in Bermuda under the Bermuda Companies Act as an exempted company limited by shares. Though the history of the group can be traced back to 1993, it was only until June 2009 that the company was registered in Malaysia as a foreign holding company. Subsequently it was listed on August 2009 as the second China-based shoe-sector manufacturer to list on Bursa Malaysia.

“Designer, developer & manufacturer of Sports-shoe Soles”

The core business activity of Multi Sports group is in design, development, and manufacture of sports shoe soles. The group’s principal place of operations is in Jinjiang City within Fujian province in China. Jinjiang City has the largest concentration of footwear manufacturing and supporting industries in China. Multi Sports is involved within the midstream segment of the shoe industry, namely sports shoe soles.

Multi Sport group is basically a one-stop specialist in serving the shoe-sole requirements of China’s sports-footwear industry. The group is vertically integrated and is able to product all the components required for its shoe-sole offering. The group is also able to develop and design shoe soles in-house, and is widely known in the industry as the providers of “**Houxing**” brand of shoe soles.

Multi Sports owns a 100% stake in Paksing Shoe Material (HK) Limited, which in turns owns a 100% stake in Jinjiang Baixing Shoe Material Co Ltd. The group’s emphasis on quality control had resulted in Baixing receiving the “Quality Reliable Products” award in 2008, from the China Light Industry Products Guarantee Centre.

Company	Incorporation	Description
Paksing	June 2003 / Hong Kong	Investment holding
Jinjiang Baixing	May 2004 / China	Design, development & manufacture of sports-shoe soles

“A Pioneer in shoe-sole production”

Mr Lin Huozhi, Multi Sports’ Executive Chairman, CEO and founder, is reputedly one of the pioneers involved in shoe-sole production in Jinjiang City. The group started off in 1993 when Mr Lin commenced the production of **rubber** (RB) shoe soles on a small scale.

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“Expansion of shoe-sole range”

TPR shoe soles

In 1995, Multi Sports commenced the manufacture of **thermoplastic-rubber** (TPR) shoe soles, which are lighter and have more cushioning abilities than RB soles. In 2000, the group began in-house production of TPR compound pellets to improve quality control, lower production costs and eliminate reliance on third party suppliers.

EVA MD I shoe soles

In 2003, the group started producing its “**EVA MD I**” shoe soles, which are even lighter, softer and provides better cushioning and shock absorbance than TPR shoe soles. Ethylene vinyl acetate (EVA) is a key component used in its shoe soles that provides elasticity, softness and flexibility.

EVA MD II shoe soles

In 2006, the group introduced its “**EVA MD II**” shoe soles, with improved features and is suitable for high impact sports such as tennis and basketball. In 2008, Multi Sports commenced the in-house production of EVA compound pellets to reduce costs, increase profit margins and eliminate reliance on third party suppliers.

Meanwhile, **thermoplastic polyurethane** (TPU) is used to produce components that are assembled onto shoe soles, to enhance the aesthetic qualities. TPU-based components can be dyed into various colours.

At the time of listing, Multi Sports had approximately 300 customers, including Guohui, 361 Degrees and Xdlong, which are manufacturers of well-known sports-shoe brands in China. Multi Sports is **reputedly one of the Top-5 sports-shoe-sole manufacturer in Jinjiang City** and has a long-standing business relationship with a substantial number of its corporate customers.

Multi Sports has successfully produced 300 product offerings that can be commercially mass-produced. Progressive investments over the years have allowed the group to achieve economies of scale, which enables it to provide a wide range of competitively-priced offerings. Substantial upfront costs are required for producing a complete set of customised moulds for each shoe-sole design. Thus, large-scale production is required to lower the costs per unit of shoe sole.

“Key location in Jinjiang City”

Operating in Jinjiang City allows Multi Sports to gain a few key advantages. The huge number of sports-shoe manufacturers in Jinjiang City provides the group with a large and established market to grow its business. Many of its customers’ products are targeted mainly at China’s domestic market.

The group’s proximity to numerous raw-material suppliers provides it with timely & steady supplies at competitive prices. Besides, the group is able to save on transporting costs, with its proximity to customers and suppliers.

The large numbers of skilled employees with shoe-manufacturing experience in Jinjiang City, serves as a ready reservoir for Multi Sports’ human resource needs. The abundance of employment opportunities in Jinjiang City also attracts a large influx of labour from throughout China.

As at end-2008, Multi Sport produced about 22 million pairs of shoe soles, with its workforce of 1900 people. At the point of listing, the group’s production facilities have a built-up space of 15,200 sq metres.

Multi Sports’s new production facilities have a production capacity of approximately 84.4 million pairs per annum for its FY2011. Currently, the group has 25 production lines for RB shoe soles, 20 lines for EVA MD II shoe soles, 6 lines for EVA MD I shoe soles and 5 lines for TPR shoe soles.

**PERFORMANCE – FY10**

4Q/ 31 Dec	4Q10	4Q09	yoy %	3Q10	qoq%
Rev (RMm)	79.8	74.5	7.1	70.3	13.6
EBIT (RMm)	20.0	22.4	(10.8)	19.3	3.5
NPAT (RMm)	15.9	19.4	(18.1)	16.5	(3.3)
EPS (sen)	4.0	4.9	(18.1)	4.2	(3.3)

*EPS based on 396 million shares

12M/ 31 Dec	FY10	FY09	yoy %
Rev (RMm)	285.7	220.8	29.4
EBIT (RMm)	77.7	61.7	26.0
NPAT (RMm)	65.7	53.1	23.8
EPS (sen)	16.6	16.4	1.3

*EPS based on 396 mil shares (FY10) and 324 mil shares (FY09)

For FY10 ended 31st December 2010, the group recorded revenue of RMB613.5 (RM285.7) million and net profit after tax (NPAT) of RMB 141.0 (RM65.7) million. The group's growth in revenue by 29.4% compared to FY09 was mainly due to the increased demand for EVA MD products from its customers.

“Strong demand for EVA MD products”

Multi Sports' group gross profit margin for its FY10 ended 31st December 2010 has decreased to 32.2% from 33.9% in FY09. This was mainly due to the higher production costs arising from wage increments in January 2010 and also the rises in raw material costs.

The group's net profit margin had declined by 1.0% from 24.0% in its FY09 compared to 23.0% in its FY10. Additionally, if the listing expenses of RMB9.8 million were to be excluded from its FY09 ended 31st December 2009, the net profit margin in FY10 would have been reduced by 3.1% rather than a decrease of 1.0%. This is in line with the drop in gross profit margin, and the additional administrative expenses and withholding tax provisions.

During 4Q/FY10, the group had recorded revenue of RMB171.4 (RM79.8) million and net profit after tax (NPAT) of RMB34.2 (RM15.9) million. As compared to 3Q/FY10, the group's revenue for 4Q/FY10 had increased by 13.6%.

The group's 4Q/FY10 net profit margin had dropped to 19.9% as compared to 23.4% in the

preceding 3Q/FY10. This was mainly attributed to the expenses of approximately RMB4 million infrastructure costs incurred for the new production facility and also the increase in the provision for withholding tax on dividend expense.

OUTLOOK/CORP. UPDATES

Currently, Multi Sport's prospects for the current year appear promising, due to the strong demand for consumer goods in China's domestic market. Recently, the country's leadership has targeted a future economic growth rate of at least 7% per annum. China's economy grew at a pace of 9.8% (4Q/2010) and 10.3% (full year 2010). During 1Q/2011, China's Business Climate Index was 133.8 while its Entrepreneur Confidence Index was 137.4.

“Burgeoning consumer demand in China”

For the first 9 months up to 30th September 2010, according to the National Bureau of Statistics of China, the total retail sales of consumer goods had reached an astounding figure of RMB11,102.9 billion, representing a y-o-y growth of 18.3%. In February 2011, retail sales in China had grown by 11.6% y-o-y.

China's middle class segment had increased by 22.1% to 80 million people in January 2007, up from just 65.5 million people in January 2005 and this segment is expected to increase to the huge number of 700 million people by the year 2020. With purchasing power increasing among Chinese consumers, especially among the emerging middle class, private consumption is seen as a major driver for the growth of the Chinese economy in the future.

“Completion of new Production Centre”

As Multi Sports group had fast-tracked its expansion plans, the construction of all factories and dormitories for its new 70,034.9 sq metre production centre at Xibin Town, Jinjiang City have been completed in November 2010. With the completion of this new production centre,

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the group's annualised production capacity is expected to increase up to approximately 84.4 million pairs in FY11 from approximately 32.5 million pairs in FY10. As such, the commencement of operations at the new production centre is anticipated to contribute positively to the group's growth in its FY11.

“Ongoing efforts for the future”

Multi Sports plans to enhance its product design and development capabilities. This is in order to extend its product range and also to improve the quality of its products. The group plans to increase its R&D capabilities to 50 designs annually and to eventually manufacture 70% of these designs.

Going forward, the group plans to strengthen its sales, marketing & branding initiatives. This would be done by the establishment of new sales and marketing offices. The group would also strengthen its branding and company profile by increasing its advertising activities, trade fair participation and media outreach efforts.

The group is also willing to explore synergistic acquisitions, investments or joint ventures. Other than organic growth, expansion of business could also be achieved through acquisitions, investments and or joint ventures. Via such ventures, the group may be able to strengthen its market position, expand its customer base and enhance its economies of scale.

“Rights issue”

In August 2010, Multi Sports had listed 90 million new shares of US\$0.05 each from a renounceable rights issue. The rights had an issue price of RM0.38 per rights share and were allocated on the basis of one rights share for every four existing shares of US\$0.05 each held in Multi Sports at the cut-off date.

“TDR plan”

Multi Sports plans to sponsor a Taiwan Depository Receipt programme (TDR) that

would represent up to 67.5 million new shares of 5 US cents each or 15% of its current paid-up share capital. The new shares will be issued at a price to be determined later, which would be the underlying shares for the TDR programme. The issue ratio would be two TDR for every one underlying share. The issue size would be up to 135 million units of TDRs represented by up to 67.5 million underlying shares.

Funds raised from the TDR programme would be used mainly for the group's working capital. The proposed TDR listing is envisaged to enhance the appeal and visibility of the group to investors, especially those in Taiwan. The TDR is expected to be listed during 2H/2011.

“Concerns & Risk Factors”

Meanwhile, Multi Sports' businesses also face possible risks such as slower economic growth, higher labour costs, fluctuating raw materials prices (in tandem with rubber and crude oil prices), volatile foreign exchange fluctuations, future changes in PRC-government policies and also stiff competition with other rival companies.

VALUATION / CONCLUSION

“Dividends proposed”

Multi Sports' Board of Directors had declared a tax exempt final dividend of 2.5 sen per share for its FY10 ended 31st December 2010. This would be the group's first post-listing dividends, as no dividends were declared for its FY09.

The group's future dividends would be determined by the performance of the group. During the IPO, the group's management had stated their desire to endeavour to pay out around 20% of its annual net earnings as dividends. As such, we expect that the group would be able to maintain a reasonable dividend payout ratio of close to 15-20 % of its annual net earnings for its FY11.

With a close adjusted beta (correlation factor) of 1.02 to the KLCI, Multi Sports (-1.98% YTD) has slightly underperformed the KLCI (+0.90% YTD) this year. Market conditions have also been volatile lately, impacted by the recent political uprisings in the Middle East/North Africa and major earthquake in Japan. As Multi Sports is not a particularly large market-cap stock, this may put a dampener on its market visibility and trading volume.

“Buy Call”

Based on our forecast of Multi Sports’ FY11 EPS and a prudent estimated P/E of 4 times (near its historical range), we set a FY11-end **Target Price (TP) of RM0.78**. This TP offers a 58.5% upside from its current market price. Our TP for Multi Sports reflects a P/BV of 1.0 time over its FY11F BV/share. Meanwhile, the Regional Footwear sector’s average P/E and P/BV is 16.5 times and 2.2 times, respectively.

“Hugely undemanding valuations”

We find that Multi Sports’ FY11F P/E and P/BV valuations are not pricey at all, while it has reasonably high dividend yields and ROEs. The group is also in a net cash position. Multi Sports’ financial performance and outlook appears promising to us. The group has already started paying dividends post-IPO, its new production facilities are ready while its P/E and P/BV valuations are hugely undemanding. We nevertheless note that its share price has not appreciated in tandem with its earnings performance.

“Public perception needs to be improved”

Upon further examination, we find that the investing public’s perception of PRC (People’s Republic of China) i.e. China-based companies listed in both Malaysia and Singapore are not entirely favourable. Such PRC companies listed in Malaysia and Singapore are normally not particularly large-cap, and as such may not be very liquid.

We nevertheless opine that with concerted efforts from various parties, the investing

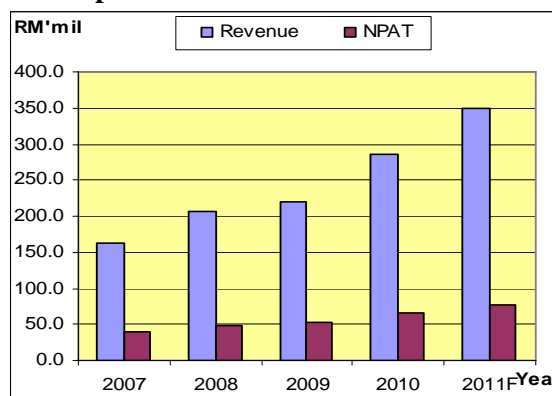
public’s perception on PRC companies listed here can be improved. This would include efforts such as – addressing corporate governance issues, appointing global auditing firms, hiring top PR/IR agencies, arranging site visits and conducting road-shows.

Multi Sports: Share Price



Source: NextView

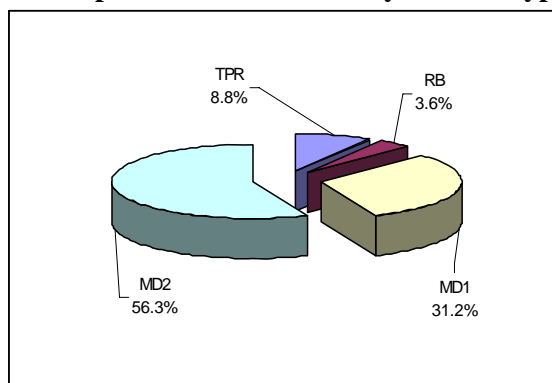
Multi Sports: Revenue and NPAT trend



Source: Multi Sports

*2011F figures are our estimates

Multi Sports: FY10 Revenue by Product type



Source: Multi Sports

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**KEY FINANCIALS**

Key Stock Statistics	2011F
Earnings/Share (sen)	19.6
P/E Ratio (x)	2.5
Dividend/Share (sen)	3.3
NTA/Share (RM)	0.75
Book Value/Share (RM)	0.78
Issued Capital (mil shares)#	396.0
52-weeks Share Price (RM)	0.38 – 0.63
Major Shareholders:	%
.Power Wide Holdings Ltd / Lin Huozhi	51.8

*USD0.05 par value

including recent rights issue

Ratios Analysis	2008	2009^	2010^	2011F
Book Value/Share (RM)	n.a.	0.44	0.61	0.78
Earnings/Share (sen)	n.a.	16.4	16.6	19.6
Dividend/Share (sen)	n.a.	0.0	3.3	3.3
Div. Payout Ratio (%)	n.a.	0.0	15.1	12.7
P/E Ratio (x)	n.a.	3.0	3.0	2.5
P/Book Value (x)	n.a.	1.1	0.8	0.6
Dividend Yield (%)	n.a.	0.0	6.7	6.7
ROE (%)	n.a.	37.1	27.1	25.0
Net Gearing (or Cash) (x)	n.a.	(0.46)	(0.39)	(0.48)

*2008 figures not available as company was listed in 2009

*2011F figures are our estimates

^based on share base of 324 mil (FY09) and 396 mil (FY10)

P&L Analysis (RM'mil)	2008	2009	2010	2011F
Year end: Dec 31				
Revenue	205.6	220.8	285.7	350.5
Operating Profit	56.1	62.0	78.4	94.2
Depreciation	n.a.	(4.0)	(5.2)	(6.3)
Interest Expenses	0.0	(0.5)	(0.8)	(1.1)
Pre-tax Profit	56.1	61.5	77.6	93.1
Effective Tax Rate (%)	12.4	13.8	15.3	16.6
Net Profit	49.2	53.1	65.7	77.7
Operating Margin (%)	27.3	28.1	27.4	26.9
Pre-tax Margin (%)	27.3	27.9	27.2	26.6
Net Margin (%)	23.9	24.0	23.0	22.2

*2008 figures are pro-forma as company was listed in 2009

*2011F figures are our estimates

*RM at time of past reporting

#1RMB=0.46RM

SAMPLES OF SHOE SOLES:**EVA MD 1****EVA MD II****TPR****RB**

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