AUSTRALIAN
RESEARCH
INDEPENDENT INVESTMENT RESEARCH

# Oneall International Limited (ASX: 1AL)

## Initiating Coverage

April 2017

INDEPENDENT
INVESTMENT RESEARCH

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| Investment Profile | |
|---|---|
| ASX Code: | 1AL |
| Share price ($) as at 30 March 2017 | 0.95 |
| **Target Price ($)** | **1.32** |
| Issued capital: | |
| Shares (M) | 129.0 |
| Options (M) | 0.0 |
| Fully Diluted (M) | 129.0 |
| Market capitalisation ($M) | 122.6 |
| 12-month Low/High ($) | 0.85/1.00 |

**Board and Management**

Douts Li: Executive Chairman/Joint CEO

Roger Cao: Managing Director/Joint CEO

Jimmy Chen: Executive Director

Peter Hogan: Independent Director

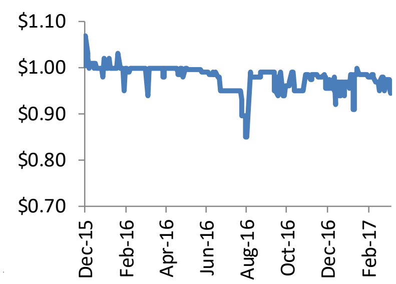
Phillip Au: Independent Director

Richard Yang: Chief Financial Officer

| Major Shareholders | % |
|---|---|
| Roger Cao & Related Party | 42.7 |
| Huatang Li | 38.2 |
| Lishan Yang | 4.5 |
| Jia Ying Chen | 4.5 |
| **Top 20 Shareholders** | **96.8** |

Source: IRESS

**Share Price**




## GLOBAL PLAYER IN THE OUTDOOR FURNITURE MARKET

Oneall International Limited (ASX: 1AL) designs, manufactures and distributes outdoor furniture, selling its products in 42 countries. The company was established in 2001 and listed on the ASX in December 2015 to provide it with access to capital markets and the opportunity to expand.

## KEY POINTS

**High Margin Manufacturer and Distributor of Outdoor Furniture**: 1AL designs, manufactures and distributes outdoor furniture around the world. The company owns and operates its manufacturing facility in Guangdong, China, where the company's key products are produced. The company has historically had a focus on the mid-tier and high-end markets. This combined with the company's distribution model of primarily selling direct to retail customers sees the company generate earnings margins that are significantly higher than its peers.

**Global Customer Base**: The company distributes its products to 42 countries. Europe is the largest market for the company, however the company is focusing on reducing the concentration of this market through growth in other regions. One area of focus is Australia, in which the company currently only has a small market share. The company is currently seeking to enter into distribution relationships with some local retail distributors to increase sales in Australia. Increasing the presence in Australia is important from a strategic viewpoint, with sales in this market offering the potential to smooth out the sales cycle, given the majority of revenue is generated from sales in the Northern Hemisphere during the warmer months. North America is also a market in which the company has indicated as a potential growth prospect.

**Moving to Original Brand Manufacturer Model**: The company is in the process of transitioning its business model from Original Design Manufacturer (ODM) to Original Brand Manufacturer (OBM). Under the OBM model, the company's products are identified with its own branding. 35% of revenue in FY16 was generated from OBM business. The OBM model gives the company more control over the distribution chain and greater brand recognition with customers.

**Vertical Integration of Distribution Chain**: The company is seeking to secure demand through the acquisition or joint venture with wholesalers. This will secure demand through ensuring the wholesaler will distribute 1AL's product range. Further to this, the company may potentially look to acquire retail chains in markets where the company is seeking to grow it's presence to secure demand.

**Capacity Expansion**: The company is currently at full capacity at its manufacturing facility in China. As such, in order to grow sales the company will need to expand its facilities, which management currently intend to do in 2017. Capacity is expected to be expanded by 20%-25%, which would increased in the manufacturing capacity at the company's China facility to 528,000 - 550,000 pieces of furniture per year.

**Protectionist Policies May Impact Growth**: The move towards protectionist policies in recent times may impact the growth prospects of the company in some markets. The company has indicated it's appetite to expand in North America, however, if President Trump delivers on his election promise to impose a 45% tariff on all Chinese produced products, this may make the company's products uncompetitive in this market.

**Investment View**: We have assigned 1AL a target price of **$1.32** per share. This represents a 39.7% premium to the share price at 30 March 2017. The target price was determined using a DCF methodology over the next five financial periods. The target price is based on the assumption that the company will complete the expansion of its manufacturing facility in 2017 and will ramp up capacity usage to 95% in 2019. In the event this is not achieved the company will not achieve the expected future cashflows. The company has a tight shareholder register with the only a small portion of shares on issue as free float. As such there is low levels of liquidity in the stock. This will remain until further shares are issued or until the executive team releases a parcel of shares.

| PROFIT & LOSS (AUD$m) | | | | | |
|---|---|---|---|---|---|
| **Y/E June** | **2015A** | **2016A** | **2017F** | **2018F** | **2019F** |
| Revenue | 39.5 | 40.3 | 48.3 | 53.1 | 58.9 |
| Gross Profit | 16.0 | 17.0 | 20.8 | 22.3 | 24.1 |
| EBITDA | 12.1 | 11.1 | 12.1 | 12.8 | 13.5 |
| Interest Expense | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| PBT | 12.1 | 11.1 | 12.1 | 12.8 | 13.5 |
| Tax Expense | 0.9 | 1.9 | 2.4 | 2.6 | 2.7 |
| NPAT | 11.2 | 9.1 | 9.7 | 10.2 | 10.8 |

| BALANCE SHEET (AUD$m) | | | | | |
|---|---|---|---|---|---|
| **Y/E June** | **2015A** | **2016A** | **2017F** | **2018F** | **2019F** |
| Cash | 13.9 | 9.9 | 9.4 | 15.8 | 22.5 |
| Trade Receivables | 7.4 | 5.4 | 9.2 | 10.1 | 11.2 |
| Inventories | 7.4 | 9.2 | 9.2 | 10.1 | 11.2 |
| Other Current Assets | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| **Total Current Assets** | **29.1** | **24.8** | **28.0** | **36.3** | **45.2** |
| Property, plant and equipment | 4.8 | 4.5 | 18.4 | 16.5 | 14.9 |
| Intangible assets | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 |
| Prepaid Lease Assets | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 |
| Deferred tax assets | 0.0 | 0.6 | 0.6 | 0.6 | 0.6 |
| Other | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Total Non-Current Assets** | **5.6** | **6.0** | **19.8** | **17.9** | **16.3** |
| Total Assets | 34.7 | 30.8 | 47.8 | 54.2 | 61.5 |
| Trade and other payables | 6.2 | 4.4 | 7.7 | 8.5 | 9.4 |
| Borrowings | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Current tax liabilities | 0.8 | 2.1 | 2.4 | 2.6 | 2.7 |
| Provisions | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Other liabilities** | **2.5** | **1.8** | **1.8** | **1.8** | **1.8** |
| Dividends Payable | 14.4 | 0.0 | 0.0 | 0.0 | 0.0 |
| Current Liabilities | 24.0 | 8.4 | 12.0 | 12.9 | 14.0 |
| Trade and other payables | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Borrowings | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Deferred tax | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Provisions | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Non-Current Liabilities** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** |
| **Total Liabilities** | **24.0** | **8.4** | **12.0** | **12.9** | **14.0** |
| **Net Assets** | **10.7** | **22.4** | **35.8** | **41.3** | **47.5** |

| CASHFLOW (AUD$m) | | | | | |
|---|---|---|---|---|---|
| **Y/E June** | **2015A** | **2016A** | **2017F** | **2018F** | **2019F** |
| PAT | 11.2 | 9.1 | 12.1 | 12.8 | 13.5 |
| Profit After Adjustments | 11.5 | 9.3 | 12.1 | 12.8 | 13.5 |
| Change in Working Captial | 0.7 | -0.4 | -0.1 | -0.9 | -1.1 |
| **Operating Cashflow** | **11.3** | **8.2** | **11.9** | **11.8** | **12.4** |
| Payments for entities and businesses, net of cash acquired | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Payments for property, plant and equipment | -0.4 | -0.2 | -6.7 | 0.0 | 0.0 |
| Payments for intangible assets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Payments for other assets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Payments for acquisition of associates and other investments | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Proceeds on disposal of businesses and property, plant and equipment | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Loans to third party/franchisee | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Dividends from associates | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Others | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Cashflow from Investments** | **-0.4** | **-0.3** | **-6.7** | **0.0** | **0.0** |
| Proceeds from borrowings | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Repayments of borrowings | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Dividends paid to ordinary shareholders | -5.4 | -23.1 | -5.8 | -5.4 | -5.7 |
| Dividends paid to non-controlling interests | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Cashflow from Financing** | **-5.4** | **-12.3** | **-5.8** | **-5.4** | **-5.7** |
| Cash at beginning of period | 6.4 | 13.9 | 9.9 | 9.4 | 15.8 |
| Net change in cash | 5.5 | -4.4 | -0.6 | 6.4 | 6.7 |
| **Cash at end of period** | **13.8** | **9.9** | **9.4** | **15.8** | **22.5** |

## SWOT ANALYSIS

### Strengths

- The company enjoys high margins as a result of its business model, with a NPAT margin of 22.7% in FY16.
- The company largely deals directly with retailers enabling it to enjoy higher margins by cutting out the intermediary and also allowing it to foster relationships with retailers to maintain products in stores.
- The company has low cost manufacturing operations which contribute to its strong margins.
- The company is in a strong financial position, with the company generating positive operating cashflow and currently has no debt.
- For the outsourced manufacturing operations, the company has exclusive agreements with the manufacture of the company's products, which allows them to maintain a significant amount of control over the process.
- The company is currently at capacity at the manufacturing facility in China and is looking to expand the capacity by 20%-25% in 2017. The additional capacity will make way for sales growth.
- In 2016, the company fulfilled a large scale, lower margin trial order for a European outdoor wholesaler. Expanding the product range into lower margin products will improve the company's overall market share and improve volumes.
- Management have proven to be thoughtful and diligent with product growth and have a strong focus on developing strong relationships for both the supply and distribution chain. The management team will be seeking to secure demand before the expansion plans are fulfilled to ensure spare capacity is kept at a minimum.

### Weaknesses

- There is limited liquidity in the company given that over 80% of shares on issue are held by Board members. This may make it difficult for buyers and sellers to acquire or off-load shares and may result in high levels of volatility.

### Opportunities

- 1AL has the opportunity to increase its market share in those countries in which it currently has a small market share. One of these markets is Australia. The ability to grow in Australia will also reduce the impact of seasonal revenues from the markets in the Northern Hemisphere.
- The ability of the company to transition to a primarily OBM model will provide the company with greater control over its distribution and provide greater customer awareness to the company's brands, improving customer loyalty.
- The company currently has no online presence. The company has the opportunity to expand its sales through the development of an online store.

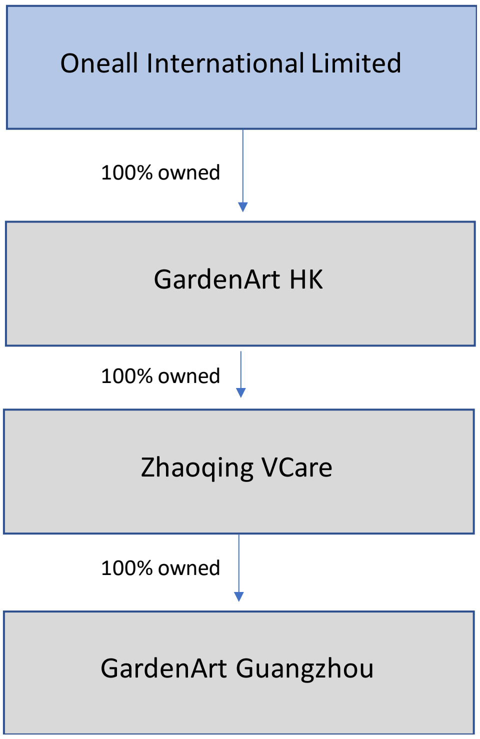
### Threats

- Raw material costs account for the majority of manufacturing costs. Increases in these costs may eat into earnings margins in the event the cost increases can't be passed onto customers. We note that to date,the company has been able to successfully manage the input costs with the gross profit margin improving over time.
- The economic climate drives consumer demand, therefore during difficult economic environments sales may decline.
- The company is exposed to foreign exchange risk given it manufactures and distributes from China. Any variances in the RMB may have either a positive or negative impact in earnings.
- The trend towards protectionist policies throughout the globe may have a negative impact on the ability of the company to expand in some countries. For example, the Turkish government has imposed a 50% import tariff on furniture from China and President Trump has indicated that the US will potentially be imposing a 45% tariff on Chinese goods.

## COMPANY OVERVIEW

- 1AL designs, manufactures and distributes outdoor furniture around the world. The company listed on the ASX in December 2015 after raising $13m through the issue of 13m ordinary shares at $1 per share.
- The company manufactures and distributes its furniture in China. The company has a facility in Guangdong, China, where the majority of the products are manufactured. The remaining manufacturing requirements are outsourced to factories with which the company has exclusive arrangements for the production of their goods. As such, the company maintains control over the quality of goods produced.
- The company was co-founded in 2001 by the Roger Cao (Managing Director and Joint CEO) and Douts Li (Chairman and Joint CEO) with the company commencing production in 2006.
- The company has a focus on the mid-tier and high-end market with design and quality at the forefront of the company's products. The company is seeking to expand its product range to the low-to-mid-tier markets to grow its market share. This market offers higher volume potential, however will result in lower margins.
- The company currently distributes its products to 42 countries with the company seeking to expand this. The largest market for the company is Europe, with 67% of FY16 revenue generated from this region.
- The company operates under the GardenArt brand name.

**Company Structure**




## FINANCIAL POSITION

- The company is in a strong position from a financial point of view. 1AL is generating free cashflow, has high earnings margins and no debt.
- At 31 December 2016, the company had $8.2m cash on hand, a net asset position of $21.3m and a current ratio of 2.37x.
- The company is well placed in the event it wanted to take on funding to pursue growth opportunities.
- In January 2017, the company announced it had received approval to change its financial year-end from 30 June to 31 December.

## BUSINESS MODEL

- The company designs, manufactures and distributes outdoor furniture. The company focuses on the mid-tier and high-end market, priding itself on its quality and design.
- 1AL currently has primarily an Original Design Manufacturer (ODM) business model, which involves customers purchasing the company's products but putting their own branding on the products. This compares to the large majority of manufacturers which operate an Original Equipment Manufacturer (OEM) model, in which the company manufactures a product designed and sold by the customer.
- 1AL is in the process of moving to an Original Brand Manufacturer (OBM) model, whereby the company's products are identified with its own branding. 35% of revenue in FY16 was generated from OBM business. The goal for the company is for the OBM model to be 100% of the business.

**Design**

- The company has an in-house design team and as a result, 95% of the design work is done in-house.
- The company has over 200 design patents registered in Australia, Europe and China. Patents are an important measure for the company to mitigate against counterfeit products.

**Manufacturing**

- The company uses a combination of in-house and outsourced manufacturing. The company owns and operates its manufacturing facility in Guangdong, China where the majority of goods are produced, with the remainder of production outsourced. While the company outsources a portion of its orders, the key products are produced at the company's facility.
- The company's facility consists of three factories for a total of 23,600m$^2$, with the capacity to produce 40,000 pieces of furniture a month (440,000 pieces of furniture a year). There are 275 permanent employees working at the facility, which operates for 11 months of the year.
- Given the company has a greater number of orders than the capacity of its manufacturing facility, the company outsources a portion of its orders.
- 1AL has advised that it has exclusive arrangements with these manufacturers, with the manufacturers only producing 1AL products. This allows for 1AL to maintain strong management over quality control.
- Quality control is important for the company given its target market. The quality of products is tested and monitored throughout the three phases of production:
  - **(1) Development Phase:** in the product development phase testing and design samples are produced. If these samples meet internal standards, the company carries out a small scale pilot production for further monitoring and quality checks. If the design passes the quality control evaluation the design can move into the mass production phase. 1AL adopts EN-581 as its base quality control standard.
  - **(2) Production Phase:** quality control tests are conducted on all materials and accessories used in the production phase. Any material or accessory that fails testing will be returned to suppliers for replacement. Throughout the production phase, the company has in-process quality control tests at each stage of the manufacturing process aimed at identifying quality faults.
  - **(3) Sale/After-Market Phase:** products must pass a final quality control test upon assembly of the products. Unsatisfactory products are returned to the relevant department to be fixed before being accepted for packaging and sale. Feedback from customers is collected after the products are delivered and analysed by the Quality Control department to improve the production process and customer experience.

**Distribution Agreements**

- The company primarily deals directly with retailers. Dealing directly with the retailers provides the company with the ability to foster a relationship with the retailers which will hopefully result in the retailer being a long-term distributor of 1AL's products.
- In addition to the ability of the company to build relationships, the company is also able to improve the margins by dealing directly with the retailers.
- The company currently deals with 120 customers, globally.
- One of the main marketing strategies for the company is to attend the major fairs, of which there are two every year: (1) the SPOGA fair in Germany; and (2) the China International Furniture fair. Attending these fairs gives the company a chance to showcase their products to retailers from around the world.

### Strategic Measures Being Implemented

The company will be implementing the following five strategic measures to counter the depressed economic conditions being experienced in some markets in combination with increasing competition:

**1) Strengthen production cost control:** the company is seeking to synchronise the sales forecast with production planning processes to increase productivity and reduce wastage. The company's goal is to achieve the highest quality production at the lowest possible cost.

**2) Position the company as a design champion and enhance product variety:** the company prides itself on its design and believes it differentiates them from competitors. The company is establishing collaborative relationships with independent designers who can bring a variety of styles and diversity to creativity to the products. This is in addition to continuing to work with designers across a number of regions to improve design.

**3) Expand product lines:** the company is considering expanding its product lines to the lower-end of the middle market. In this market, the demand is higher however margins are lower.

**4) Improve geographic sales distribution:** At present, the largest market is Europe. The company is looking to increase the contribution from other regions to reduce the concentration risk. In the FY16 Annual Report, the company stated that it was looking to expand in North America. However, President Trumps intentions to impose tariffs on Chinese products may make 1AL uncompetitive in this market.

**5) Expand production capacity:** The company would like to expand its production and warehousing capacity. The company is currently assessing its options with respect to expansion.

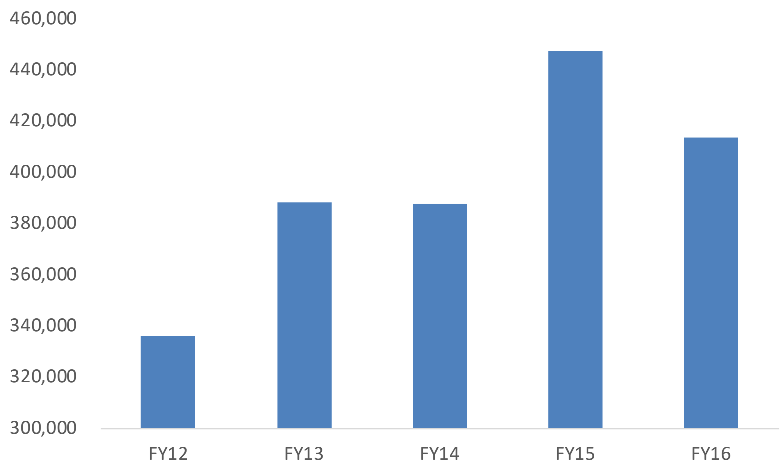
## HISTORICAL FINANCIAL PERFORMANCE

- FY16 was 1AL's first reporting period as a listed company. As part of the listing, the company provided audited reports for FY12, FY13 and FY14 which is where we have sourced the below financials from.
- Revenue has grown at an average rate of 17.3% from 2012 to 2016. Revenue increased at it's slowest pace in FY16, increasing 1.9% for the year. Sales were impacted by a decline in demand in the company's largest market, Europe.
- Despite the fall in sales volume in FY16, increased unit prices compensated resulting in the improved revenue.
- The company generates strong margins with an EBITDA margin of 27.6% in FY16. EBITDA and the EBITDA margin declined on FY15 largely as a result of the listing in late December 2015. The listing has resulted in increased office and administrative costs.
- The strong margins are driven by a combination of the company targeting the mid-to-high end markets which results in the company selling its products at a premium and the direct distribution to retailers.
- The gross margin has improved year on year as a result of the company being able to manage its input costs, with input costs growing at a slower rate than revenue in all years.

| Profit & Loss Growth | | | | | |
|---|---|---|---|---|---|
| **AUD$m** | **FY12** | **FY13** | **FY14** | **FY15** | **FY16** |
| Revenue | 21.7 | 28.6 | 36.4 | 39.5 | 40.3 |
| *Revenue Growth (%)* | *na* | *31.4%* | *27.4%* | *8.7%* | *1.9%* |
| Gross Profit Margin | 33.5% | 36.5% | 39.3% | 40.3% | 42.2% |
| EBITDA | 5.7 | 7.9 | 11.4 | 12.1 | 11.1 |
| EBITDA Margin | 26.2% | 27.8% | 31.2% | 30.7% | 27.6% |
| *EBITDA Growth (%)* | *na* | *39.4%* | *43.0%* | *7.0%* | *-8.6%* |
| PBT | 5.4 | 7.6 | 11.0 | 12.1 | 11.1 |
| PBT Margin | 24.7% | 26.8% | 30.4% | 30.7% | 27.6% |
| *PBT Growth (%)* | *na* | *42.2%* | *44.4%* | *10.0%* | *-8.6%* |
| NPAT | 5.3 | 7.4 | 10.7 | 11.2 | 9.2 |
| NPAT Margin | 24.3% | 26.0% | 29.4% | 28.4% | 22.7% |
| *NPAT Growth (%)* | *na* | *40.6%* | *43.9%* | *5.2%* | *-18.6%* |

- Annual sales volumes have improved 23.2% from 2012 to 2016. Volumes dropped in FY16 largely as a result of a decline in demand from it's largest market, Europe. Volumes were impacted by the weak economic conditions in Europe.

**Annual Sales Volume**




## Geographic Revenue

- As mentioned previously, the company distributes its products to 42 countries. It's largest market is Europe with 67.1% of revenue in FY16 from the European region.
- Revenue increased across all regions in FY16 with the exception of the 'others' category, which declined 29.6%.

| AUD $M | FY15 | % Revenue | FY16 | % Revenue |
|---|---|---|---|---|
| Europe | 24.87 | 62.9% | 27.02 | 67.1% |
| Asia | 3.48 | 8.8% | 3.83 | 9.5% |
| North America | 2.77 | 7.0% | 3.50 | 8.7% |
| Others | 8.42 | 21.3% | 5.93 | 14.7% |
| | **39.54** | | **40.28** | |

## Market Share

- Frost & Sullivan estimated the market share of 1AL in four particular markets, tabled below.

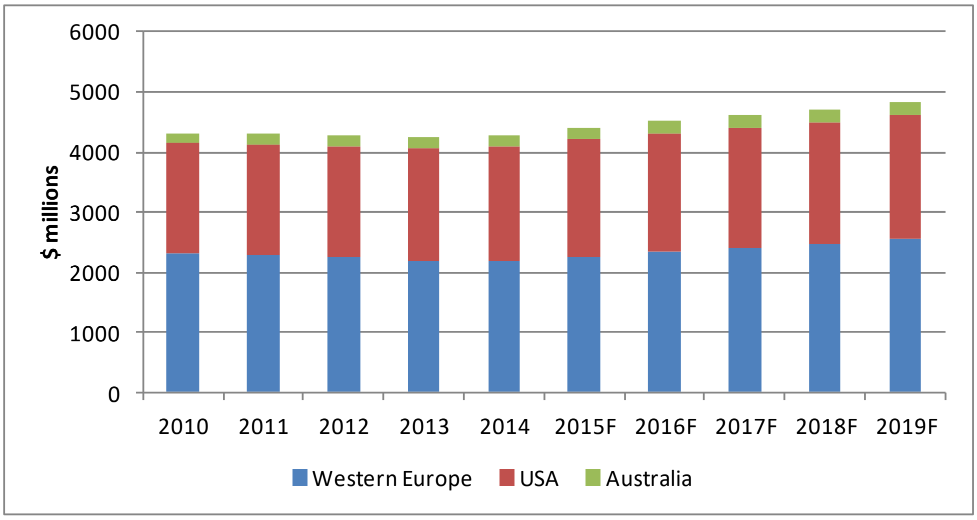
- In some European countries, the company has a significant market share, however in other countries such as Australia, the company has only a small market share. It is within these countries, the company has an opportunity to grow its market position.
- We note the company is currently restructuring it its distribution channels in Australia in 2016. The company is currently seeking to develop relationships with other distributors in the local market.

| Region | Market Share (%) |
|---|---|
| Belgium | 18% |
| Spain | 7% |
| France | 1% |
| Australia | 1% |

## OUTDOOR FURNITURE MARKET

- As part of the IPO, the company commissioned Frost & Sullivan to complete an industry report on the outdoor furniture market. Frost & Sullivan estimated the total market size of outdoor furniture in 1AL's key target markets of Western Europe, Australia and North America, to be US$4.28bn in 2014, based on ex-factory prices.
- Frost & Sullivan forecast the market in these regions to grow to close to US$5bn in 2019, tabled below.
- The market is estimated to still be below pre-GFC levels. Improving economic conditions and recovering housing markets will be key to growth in the outdoor furniture market.

**Outdoor Furniture Market by Region (2010 - 2019)**




Source: Frost & Sullivan

- In 1AL's key target markets, outdoor furniture is increasingly imported. In Western Europe and North America it is estimated that ~50% of outdoor furniture is imported and ~70% in Australia. We do not envisage this to situation to change in Australia, however protectionist policies in Western Europe and North America could see a reversal of this trend.
- The outdoor furniture market can be segmented by price: (1) Low end; (2) Mid-tier; and (3) High-end. Manufacturer margins are typically higher in the mid-tier and high-end markets in which 1AL currently competes. In this market, the design and quality of the product is very important to customers.
- Frost & Sullivan estimates that the high-end segment accounts for 5%-10% of the market, while the mid-tier segment accounts for 40%-50% of the market. Based on these figures, in 2019 Frost & Sullivan forecast the market size of the segments with which 1AL operates in to be US$2.2- $2.9bn. 1AL currently only has a small portion of this market, providing large upside potential.

- According to Frost & Sullivan, the manufacturing of outdoor furniture industry is fragmented, largely comprised of small-to-medium sized privately owned companies, with the exception of a few larger companies. Given this, 1AL is one of the larger manufacturers from a revenue standpoint. In the event some of the smaller companies fall out of the market, this will provide 1AL an opportunity to improve its market share.

## VALUATION

- We have assigned 1AL a target price of **$1.32** per share. The target price is determined by a discounted cash flow (DCF) methodology over a five year period. We have applied a discount rate of 13% to future cashflows.
- The company is currently at full capacity at its manufacturing facility in China and therefore we do not expect significant growth in sales volumes in FY17. The company is expected to complete an expansion at its manufacturing facility in China, which is expected to increase capacity by 20%-25%. We have assumed the additional capacity will be available from FY18. The company has sufficient cash to fund the expansion.
- Revenue is based on 95% of the capacity being in use (90% in FY18) and the ability of the company to continue to steadily increase the average unit price. Over the long-term, demand growth to fuel further capacity expansion will be required to continue revenue growth. We believe management will continue to be diligent and only expand to satisfy guaranteed demand.
- The company is seeking to expand its product line to include products for the lower-to-mid tier markets. While this is expected to be generate greater demand expand into this market will result in lower margins.
- The company has stated that it will be paying out 60%-80% of NPAT in dividends. We have assumed a dividend payout ratio of 70%. We note that the declared dividend payout ratio was above this rate, at 84.9% for FY16. This does not include the special post-IPO dividend of 4 cents per share paid in February 2016.

| Valuation Assumptions | | | | | |
|---|---|---|---|---|---|
| **December Year-end** | **FY17** | **FY18** | **FY19** | **FY20** | **FY21** |
| Revenue Growth | 20.0% | 9.9% | 10.8% | 5.0% | 5.0% |
| Capacity (pieces of furniture per year) | 440,000 | 550,000 | 550,000 | 550,000 | 550,000 |
| Capacity Use | 95% | 85% | 90% | 95% | 95% |
| EBITDA Margin | 25.0% | 24.0% | 23.0% | 23.0% | 22.0% |
| Dividend Payout Ratio | 70% | 70% | 70% | 70% | 70% |
| Dividend per Share (cents) | 5.2 | 5.5 | 5.9 | 6.2 | 6.2 |
| EPS | 7.5 | 7.9 | 8.4 | 8.8 | 8.9 |
| EPS Growth | 6.1% | 5.5% | 6.2% | 5.0% | 0.4% |

## CAPITAL STRUCTURE

- The company has 129m ordinary shares on issue, no options and no debt.
- The co-founders own the large majority of shares on issue with 80.9% of the shares on issue. The Board members own 85% of the shares on issue.
- Board members are not expected to sell their position and as such the number of free float shares will only increase through the issue of new equity. The tight shareholder register will result in low liquidity for the stock which could result in heightened volatility.

| Executive Shareholdings | | |
|---|---|---|
| **Shareholder** | **Number of Shares (M)** | **% of Shares on Issue** |
| Roger Cao | 55.1 | 42.7% |
| Douts Li | 49.3 | 38.2% |
| Jiaying Chen | 5.9 | 4.5% |
| Peter Hogan | 0.03 | 0.0% |
| **Total** | **110.3** | **85.4%** |

## ASX PEERS

- There are four other companies listed on the ASX that fall within the Home Furnishings sector. These companies are detailed below.
- NCK is the largest company by market cap in the peer group and is trading at the highest PE ratio.
- 1AL generates superior margins to its peers with an EBITDA margin of 28.5% in FY16.
- NCK and 1AL both distribute furniture. NCK sells indoor furniture while 1AL sells outdoor furniture. Unlike NCK, 1AL also designs and manufactures its furniture. NCK is the only company in the peer group that has established stores through which it sells its products. All the other companies distribute their products through retail outlets or wholesalers. The NCK model provides the company to control the distribution of its products. While 1AL is seeking to vertically integrate its distribution chain, at this stage the company is looking to retain distribution through retail outlets and not open GardenArt specific stores.
- 1AL and GAP both offer products for outdoor furnishing with 1AL manufacturing and distributing outdoor furniture and GAP manufacturing and marketing screening and shading products for domestic, commercial and industrial applications. These two companies have a similar market cap and are trading at a similar PE ratio, however 1AL delivers much better earnings margins.

| ASX Home Furnishings Sector | | | | |
|---|---|---|---|---|
| **Company** | **ASX Code** | **Market Cap*** | **FY16 EBITDA Margin** | **PE Ratio*** |
| Gale Pacific Limited | GAP | 127.9m | 12.8% | 12.29 |
| Kresta Holdings | KRS | 24.0m | 1.1% | -16.16 |
| Shenhua Ltd | SHU | 22.7m | 12.8% | 3.66 |
| Nick Scali Limited | NCK | 582.4m | 19.8% | 17.93 |
| **Oneall International Limited** | **1AL** | **125.8m** | **28.5%** | **11.07** |

*As at 2 March 2017

## RISKS

- **Counterfeit Products:** Counterfeit products from China are a concern for the company as they pose a risk to brand image of the company's products. In an attempt to protect against this risk, the company has registered a number of design patents around the world and the company will actively fight against any infringements of the intellectual property rights.
- **Tariffs Imposed on Chinese Products:** Current political sentiment is moving towards a number of countries implementing protectionist policies and implementing tariffs on Chinese goods. Additional countries imposing tariffs could have a significant adverse impact on the company's sales volume, with the tariffs making the company's products uncompetitive.
- **Customer Concentration:** The company currently distributes its products through 120 customers globally. However, 38% of FY16 revenue was generated from two customers. As such, in the event one of the major customers ceases to stock 1AL's products, this would have a significant negative impact on revenues.

- **Increasing Costs:** The company's earnings will be adversely impacted by increasing input costs. Increases in raw material costs and rising wages may impact the earnings margins of the company.
- **Foreign Exchange Risk:** With the company manufacturing and distributing its products from China, the company is exposed to foreign exchange risk. An increase or decrease in the value of the Chinese Remimbi will have a positive or negative impact on earnings.
- **Delays to Capacity Expansion:** The company is looking to expand the manufacturing facility in China given the current facility is currently operating at capacity. In the event the expansion plans are delayed, this will impact the ability of the company to grow sales.

## BOARD AND MANAGEMENT

**Douts Li: Executive Chairman/Joint CEO/Co-founder -** Mr. Li has 23 years experience in international business, with more than 15 years in procurement in China. Mr. Li has worked in a high level role at two European furniture and houseware retailers, during which time he visited and evaluated more than 300 Chinese factories. Mr. Li also provided consultation and training for companies with regard to production, expansion and development. Mr. Li has long-term collaborative relationships with senior executives of a number of European furniture retailers.

**Roger Cao: Managing Director/Joint CEO/Co-founder -** Mr. Cao has over 23 years experience in international business, working in the furniture sector since he graduated. Mr. Cao has an in-depth knowledge of the design, manufacturing and marketing process of furniture. Mr. Cao has worked with European multinational corporations, with his duties including administration, procurement, product development and furniture design. Mr. Cao has a good understanding of the western furniture market and has worked with European designers to develop new product designs.

**Jimmy Chen: Executive Director -** Mr. Chen established a food logistics operating company in the US, China Wok, supplying products and providing management services to more than 1,000 Chinese restaurants during peak seasons. Mr. Chen also established Stone Monkey Company Limited, a marble trading business. Mr. Chen returned to China in 2008 at which point he joined 1AL, focusing on the execution and management of special projects.

**Peter Hogan: Independent Director -** Mr. Hogan is a Chartered Accountant currently working at Incitec Pivot Ltd (ASX: IPL). Mr. Hogan commenced a 16 year career with the Australian Tax Office (ATO) in 1969, where he worked in the Assessing, Investigations and Appeals branches, as well as holdings senior management positions throughout his time at the ATO. After leaving the ATO, Mr. Hogan became a tax partner at Coopers & Lybrand, a accounting firm which merged with PwC in 1998. Mr. Hogan spent 23 years at PwC before retiring. Mr. Hogan is currently a director at Carbon Energy Ltd (ASX: CNX) and is a director and deputy chairperson of Villa Maria Catholic Homes Ltd.

**Phillip Au: Independent Director -** Mr. Au is a principal consultant of Phillip Au & Associates, a firm specialising in accounting, tax, real estate and business management consulting services. Mr. Au has over 15 years experience in business consultancy with offices around the world. Mr. Au has held a number of roles throughout his career, including, being a member of the NSW Asia Council, where he advised the NSW government on effective strategies and actions to promote trade and investment opportunities in Asia. In 1986, Mr. Au was appointed a justice of the peace by the NSW government. Further to this, Mr. Au was the economic consultant to the government of the Republic of Nauru, where he advised cabinet ministers in issues of infrastructure and the economic development of the nation.

**Richard Yang: Chief Financial Officer -** Mr. Yang was joined the company as CFO in June 2016. Mr. Yang previously worked at the Canon Oceania Regional Headquarters in Sydney as the head of internal audit and advisory function for the Oceania region. My. Yang was also a Senior Accountant at PricewaterhouseCoopers Assurance Services in China where he provided IPO and statutory audit, Sarbanes-Oxley audit and international reporting services to a number of companies.

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