Introduction

HLA Home(600398) is a domestic man apparel retailer, based in Wuxi, Jiangsu Province, China. It generates revenues mainly by selling clothes , both online and offline. It's not a cloth manufacturer, except for Sancano, but a retailer sourcing clothes from apparel manufacturers.

It's the **No.1 man clothing brand** in China, with a 5% **market share** in a market worth of 510.8 billion RMB. The major rivals are Adidas(2.4% market share) and Uniqlo(2.1% market share), which are foreign brands. Foreign brands may have disadvantages in the Chinese market compared to domestic brands, because of the nationalism agitated by Human Right Issues in Xinjiang's cotton claimed by western media.

HLA owns several brands:

- HLA: man apparel (target customer age: 25-45)
- Sancano: business costumes customization and manufacture for group purchase
- OVV: woman apparel
- HLA Jeans: man and woman apparel (target customer age: 18-35)
- Hey Lads: teenager apparel(target customer age: 0-16)
- YeeHoO: baby apparel(target customer age: 0-6)
- Heilan Home: like IKEA without selling furniture

According to HLA's 2020 annual report, its revenues are contributed by HLA(78%), Sancano(12%), and the rest(10%). The bulk part is HLA, the man apparel business.

The total revenues in 2020 is 17.95 billion RMB, with an -18% growth rate Y-O-Y. The Net Profit 1.785 billion RMB, 1.784 billion attributed to equity owner(1.731 billion RMB, with non-recurring gain or loss excluded). Cash Flow from Operating Activates is 2.83 billion RMB. The **profit quality is pleasing**：

- **Net Profit is pure**: not inflated by Non-recurring Gain or Loss
- **CFO/Net Profit is 1.65x**: more cash than profit confirmed, **a cash printing machine**

However, given the fact that the COVID hit the Chinese economy hard in year 2020, the **revenue growth** needs further discussion.

Business

Apparel Retailer

In a nutshell, the company sources clothes from Chinese manufacturers, keep the inventory in warehouse, and sell them at offline stores and online. This is the case for most of the brands, except for Sancano, which manufactures clothes itself. Sancano will be discussed in its own session.

HLA 2020 Revenues Breakdown Online and Offline

	2020			2019		
Revenues	Revenues	（%）	Gross Margin （%）	Revenues	（%）	Gross Margin （%）
Online	2,049,700,659.06	11.75	38.47	1,325,118,975.23	6.19	50.79
Offline	15,395,150,736.24	88.25	38.17	20,066,558,891.21	93.81	39.66
Total	17,444,851,395.30	100.00	38.20	21,391,677,866.44	100.00	40.35

In the case of HLA brand, the develop costs go to the suppliers while the brand only provides ideas, but, for other brands, they need to pay for R&D. This can be seen as a little advantage.

The value HLA provides in this business is warehousing and branding:

- warehousing: goods are collectively stored and allocated by the company; the company bears the inventory risk.
- branding: the company is in charge of brand promotion

The major revenues come from offline store, while online sales will become more and more important in the future. As we can see from the breakdown of HLA 2020 revenues, offline sales are the bulk part (88%). However, the online sales are gaining ground, with a percentage of 12% of total revenues resulting from a 6% increase. As the pandemic goes on, online shopping will become more and more popular to some extend, therefore, it's reasonable to expect that the online sales will play a more important role. Does the company has any advantage in this new battlefield?

Offline sales adopt direct, franchise and joint operation models. The channels are mainly distributed in pedestrian streets, department stores, shopping centers, etc. in core business districts of cities at the county level and above. Malaysia, Singapore, Thailand, Vietnam and other countries have opened stores; online sales are mainly achieved through e-commerce channels such as Tmall, JD.com, Vipshop, WeChat Mini Programs, and Tiktok and Kuaishou.

- Direct sales mode: The company is responsible for the management of stores and bears the costs of store operation. The company rents stores in commercial streets and shopping centers to provide consumers with products and services. After the products are sold, the company's income and income are confirmed by settlement. Related costs and expenses.
- Franchise mode: The company adopts a direct management approach to franchise stores. The franchisee has the ownership of the franchise store, and entrusts the internal management of the store to the company, and does not bear the risk of unsalable inventory; the company does not charge franchise fees and owns the ownership of the goods, and the sales settlement with the franchisee adopts the commissioned agency sales model. After the final sale of the goods, the company and the franchise store shall settle and confirm the company's operating income in accordance with the agreement.
- Joint operation mode: the company signs agreements with department stores and shopping centers, the company provides product and sales management, and department stores and shopping centers provide venues and collection services. After the merchandise is sold, department stores and shopping malls will be deducted according to the agreed proportion of sales, and settled with the company on a regular basis.

The merit of the offline business modes is:

1. HLA can avoid rents and salaries with franchise and joint operation mode
2. HLA can expand fast in any city
3. HLA has lighter assets
4. HLA has an economy of scale: the effects of branding can be enjoyed by stored of different modes

				¥ 10, 000
	Revenues/Store	**Costs/Store**	**Growth of Store Number**	**Revenue Growth**
Direct Store	¥ 2,339,895	¥ 1,025,817	22.2%	28.5%
Other Store	¥ 2,074,385	¥ 1,374,296	-0.3%	-23.6%

Unfortunately, operating an offline store is a bad business. A store can only expect RMB 2 million turnover every year, or 6,500 per day. It can only expect to earn 600 RMB per day. Considering the business modes mentioned above, HLA's partners may suffer, while HLA can quit more easily. HLA opens 179 direct stores and closes 182 franchise stores in 2020. Why does HLA keep opening new direct stores?

BRAND	MODE	2019 NO. OF STORES	2020 NO. OF STORES	2020 STORES OPENED	2020 STORES CLOSED	CHANGE	%	AVG. NO. OF STORES
HLA	Direct	357	486	179	50	129	36.1%	421.5
	Franchise	5,241	5,057	182	366	-184	-3.5%	5149
Others	Direct	302	319	64	47	17	5.6%	310.5
	Franchise	1,354	1,519	442	277	165	12.2%	1436.5
Total	-	7,254	7,381	867	740	127	1.8%	7317.5

All in all, a sure thing is **offline stores struggle and online sales will be the key for the company to keep it position**. On average, online retail sales of clothing products increased by **5.8%** year-on-year in 2020, while this figure of HLA is **55%**.

Brands

HLA

This is the main brand, and it operates in the way we've discussed above.

Sancano

This brand is different from others. Sancano was founded in the 1990s and is positioned in the customization of professional wear. It adopts traditional independent production and business models to provide tailor-made business wear for finance, electric power, telecommunications, postal services, government agencies and other enterprises and institutions.

Heilan Home

Heilan Home is a brand-new lifestyle home furnishing brand under the company. It focuses on a one-stop home furnishing product collection store that focuses on the quality of life of the nation. It provides consumers with office supplies, cosmetics, table supplies, kitchen supplies, bedding, and nursing care. Products, travel goods, daily necessities, clothing, sports, food, and furniture products are the top twelve products in the preferred product series.

OVV

OVV brand was founded in 2017. It uses natural high-quality fabrics, sophisticated three-dimensional tailoring technology, and simple style design to provide modern urban women with effortless and cost-effective high-end garments.

HLA Jeans

HLA Jeans is a fast-fashion men's and women's clothing brand created by the company for young urban youths. It was founded in 2017.

Hey Lads

Hey Lads is the children's clothing brands that the company achieved through capital increase in 2018. The target group is children aged 0-16, positioning high-quality and cost-effective, advocating "affordable fashion, high-value products", and creating a one-stop shop A full-category brand of children's fashion and casual wear.

YeeHoO

YeeHoO is a children's wear brand that the company acquired in 2017 and achieved a controlling stake in 2019. Since its establishment in 1995, its own brand "YeeHoO" has always focused on the daily necessities of 0-3 years old infants and children, and extended it to the growth needs of 6 years old. Positioning high-end and high-quality, adhering to the product philosophy of "pure, soft, clean and beautiful", the product line mainly covers baby underwear, outing clothes, cribs, beddings, cars,chairs, shoes, hats and socks, washing and nursing, etc.

Strategy

1.Online Transformation

As we discuss above, the business has a new battlefield online. The company is paying more attention to online sales. **It competes against other brands online by lowering prices**, as we can see the profit margin goes down from 51% to 38%.

2.IPs and Co-brand

The company launch T-shirts authorized by known IPs(Intellectual Property), e.g.. Bruce Lee, World of Warcraft etc, aiming to attract younger customers and improve its brand image.

3.Multi-channel branding

Through celebrity endorsements, traffic placement, innovative marketing and other multi-dimensional promotion and publicity, it strengthens the image of the domestic brand.

4.Diversification Strategy

Apart from man garments, the company start to step foots in woman garments, children clothing, baby necessities, and home items. These are achieved through the brands we discuss above. Will this work? Will this be the next growth point?

- OVV: the brand's annual main business revenue increased by 65% year-on-year
- Heilan Home: achieved a year-on-year increase of 71% in main business revenue
- Other business: no growth

Porter Five Forces

(-) How are the products?

Are they necessary?

Yes, customers need them. There are few domestic brands selling business casual clothes for men. In addition, the Xinjiang cotton issue makes Chinese consumers prefer domestic brands than foreign brands in the short run.

Are they replaceable?

Yes, absolutely. There are other options.

Are their prices under control?

Yes, the company is a price-taker.

In a nutshell, the products are common and the market is competitive.

(+) Potential Entrants

The price of men's clothing at HLA is at a medium level, similar to Uniqlo

- Entrants need a lot of sales expenses for marketing
- Mass marketing at a medium price level is not cost-effective
- Need to accumulate reputation

- HLA is already a leader in menswear, and the domestic competition pattern has basically taken shape
- Foreign brands do not use domestic brands, and there are differences in the market

(+) Supplier Bargaining Power

Supplier Bargaining Power is WEAK:

- The top five suppliers only supply 14% of inventory
- 60% of the inventory items can be returned unconditionally, HLA will not bear the loss of price drop
- The supplier provides free proofing, HLA only provides design

(+) Buyer Bargaining Power

Buyer Bargaining Power is WEAK:

- In the retail industry, customers are all individual consumers
- The top five buyers account for less than 5% of revenue

(-) Threat of Substitutes

The market is competitive

- All substitutes, various brands

(-) Degree of Competition in the Industry

The market is competitive

- The industry has entered a mature period, and the concentration is increasing
- Clothing is a similar product and competition is fierce

- High sales cost

Industry

The man garment industry is entering a mature stage: From 2009 to 2019, the market size of my country's menswear industry increased from 308.1 billion yuan to 595.9 billion yuan, with an average annual compound growth rate of **6.82%(CAGR)**. Affected by the epidemic in 2020, the market size of China's menswear industry has dropped sharply to 510.8 billion yuan, a drop of 14.28%.

The overall profit level of the menswear market is relatively high: From 2018 to 2020, the gross profit margin of China's major menswear brands will remain stable. Among the four major brands, the gross profit margin of Jiumuwang and Baoxiniao is relatively high. Both Jiumuwang and Baoxiniao have maintained above 55% and close to the level of 60%, while Baoxiniao has continued to be higher than 60%. **HLA gross margin is 38%, lower than other brands**. **It might be due to its market positioning: targeting at clothes at medium prices.** As we can see from the table, the gross margin of HLA is around 40%

HLA's Gross Margin

	2015	2016	2017	2018	2019	2020
Gross Margin	40%	39%	39%	41%	39%	37%

The market concentration is not high. In 2020, China's menswear industry has a CR5 of 13.6% and CR10 of 20.4%. The market concentration is not high. However, the concentration of the menswear market has continued to increase since 2013. By 2020, CR5 has increased by 6 percentage points, and CR10 has increased by 7 points. Percentage points, the improvement of the top brand is more obvious, HLA contributed the most, an increase of 2.9%.

High inventory is a big trouble. Before 2012, China's apparel retail industry experienced a golden ten-year period. However, after 2012, the operating environment of the industry has become more and more complicated, and problems such as high inventory and weak single-store operation capabilities have been exposed. In addition to the decline in retail prosperity, **clothing retail companies can no longer sustain themselves by relying on price increases and expansion**. Men's clothing companies generally have a low inventory turnover rate. **There will be a blood bath for destocking. When smaller companies die, HLA has more room to grow.**

Future

So far, we can learn that the strengths of HLA are branding and light assets. The question now is: **Is the revenue growth sustainable?**

I tend to think yes, for following reasons:

1. The market concentration is not high, so there is still room for growth in this market
2. The industry CAGR is 6.8% before 2020, so there is still some growth in this market
3. HLA is good at branding, an important advantage in online transformation
4. Diversification may bring in new growth points. All the new businesses are not too far off from the main business, and can be operated with light assets. They can be promoted in the same way as promoting HLA

Do I Understand It?

The adjusted ROE of this company is **17.4%**(2021 TTM), which is larger than the industry average 4.33%. I ask myself these three questions:

- How does HLA make profits?
- Why customers choose HLA instead of others?
- Why don't other brands take HLA's market share by providing value for money product?

DuPont Analysis

This is based on the latest 2021 TTM ROE

ROE	NI/REVENUES	REVENUES/TA	TA/EQUITY
17.4%	12.1%	0.69	2.09
4.33%	7.73%	0.55	1.56

Profit Margin

The profit margin is high due to good expense control, even though the Gross Margin is lower than other competitors. The Gross Margin is 38%(the industry 38%) and Profit Margin 12%, meaning that roughly 26% of revenues are spent on expenses of all kind. Among them, 14% spent on Sales(the industry 16%), 7% on management(at par with the industry), and R&D 0.5%(the industry 1.7%).

Turnover

At the end of 2020, the inventory turnover rate was 1.87 for Seven Wolves, 0.81 for Saint Paul and respectively. Jiumuwang 1.33 times, HLA 1.37 times. These are the top 4 man's clothing brands in China. We can see HLA is better than others.

Leverage

The high leverage is an advantage, for most of the liabilities 78% are operational liabilities. Most of them are account payable, around 50%. The more the company owes, the more cash it has. A sign of negotiation power.

Only 18% are interest bearing liabilities, convertible bonds worth of 3 billion with a 5.3% interest rate(low in China for private enterprises).

We will discuss debt later.

How does HLA make profit?

It makes profits by selling medium priced clothes to individual customers at offline stores and online. The advantages it enjoys are:

1. Effective and Smart Marketing with less Sales Expense/Revenues Ratio
2. Economy of Scale in Collective Brand Promotion
3. Lowering Costs by Putting Pressure on Suppliers and Offline Store Partners

Effective and Smart Marketing with less Sales Expense/Revenues Ratio

HLA is good at marketing with all-round advertisement. The Sales Expense/Revenues Ratio is 13.4%(2020), compared to the industry 16.2%. It shows they are more effective, when it comes to marketing.

More importantly, HLA has the highest revenues. It has the largest marketing budget in the industry, if all spend 13.4% of their revenues on marketing. This big budget means better celebrity endorsement, more advertisements in better shows.

Economy of Scale in Collective Brand Promotion

It's wise to run brand promotion collectively, for all stores, be it online and offline, can enjoy the traffic brought in by marketing campaigns. One advertisement can benefit over 7000 physical stores.

Lowering Costs by Putting Pressure on Suppliers and Offline Store Partners

In the upstream, HLA has strong negotiation power against suppliers. That makes suppliers have to bear costs that should fall on HLA. For example, the costs of development. HLA only provides ideas, and suppliers have to pay for the development.

The more important thing is inventory risk. 60% of it is transferred to the suppliers.

In the middle, offline store partners have to pay salaries and rents. That saves a lot of money for HLA.

By having all these, the profits finally go to HLA, instead of suppliers or partners.

Why customers choose HLA instead of others?

- Price: clothes sold at medium prices
- Market: not many strong competitors in this medium price men clothing market
- IP&Co-brand
- **Brand Recognition**: almost everyone in China know HLA's famous slogan "Men's closet"; other brands are lesser known
- Nationalism(short-term): consumers undervalue national brands like Uniqlo, H&M, Adidas, after what happened about Xinjiang Cotton Human Rights Issue.

Why don't other brands take HLA's market share by providing value for money product?

First, HLA has **low costs** and **low gross margin**. It makes competition for a market which is **unprofitable**. Even they want, can they have enough bargaining power to have better deals in terms of costs and inventory? They need to receive 10-20 billion RMB a year to have such maneuver.

Second, **it takes years and billions to build brand recognition**. In addition, buying traffic becomes more and more expensive in China. Who wants to spend billions to enter a market that is not profitable?

Third, it takes time to expand offline stores. But who wants to open an offline store now, with a daily gross profit of 600? Those HLA owners are "hijacked" by HLA, due to the sunk costs. Otherwise, compete online, but like we just said, that costs a lot.

Forth, foreign brands have lost there advantages:

1. Patriotism stimulated by the Xinjiang Cotton Issues
2. Man usually have a terrible taste in terms of clothing, so better designs won't count

Is it good?

First, there isn't any "moat" in HLA in this competitive market.

The strengths of the company are:

- promotion and banding skills： Sales Expense/Revenues is lower than the industry average
- high negotiation power against suppliers
- some barriers against new entrants: branding, warehousing, offline stores, etc.
- controllable inventory risk

Therefore, this is a company having at least some advantages in the industry. Considering that the industry has low concentration rate and is still growing steadily in a sense. I expect that HLA's revenue growth is sustainable: either by winning market shares from others or growing with the market (6.8% CAGR).

In addition, HLA is entering new markets. There might be surprises there. Even if these minor brands fail, it won't hurt the company badly. After all, they contribute only 10% to the total revenue. The upside seems to outweigh the downside.

In a word, it is a good company with some advantages and opportunities in new markets.

Valuation

First and foremost, I consider the **revenue growth is sustainable**. This is the most important premise for perpetual free cash flows.

The assumption are as following:

1. Discount Rate: 5%(5-year bond risk free rate)
2. Required Rate of Return: 10%(2 x 5-year bond risk free rate)
3. Discount Rate: 5%(5-year bond risk free rate)
4. Eternal Growth Rate: 3%(inflation rate)
5. 2021 Free Cash Flow grows to the level of 2019, a 20% growth rate
6. 2022 has a growth rate of 6.8%(industry CAGR)

Before calculation, I shall discuss why these assumptions.

Why do I use risk free rate to discount? If the underlying business is sustainable, we can always expect free cash flows of certain amount in the future. **The certainty allows us to use the risk free rate to discount cash flows. 5% that's it**.

However, **this "certainty" - assuming that the free cash flows are known is worrying**. So, we we need a **Margin of Safety** to compensate for this "assumed certainty". I set it to be a 40% - 50% discount of the **reasonable price(the price we calculated).**

Why do I choose 10% as the required rate of return? Stock shares in essence are perpetuity with unfixed payments (free cash flows in this case). I want it to pay better than bonds to compensate for the risk coming along. So, I double the risk free rate. I get 10%.

If the underlying business is sustainable, we can always expect free cash flows of certain amount in the future. The certainty allows us to use the risk free rate to discount cash flows. But what is the "risk free rate", since we see all cash flows are certain to come. So I double the 5-year bond risk free rate to compensate for this "certainty".

It's reasonable and conservative to use 3% as the eternal growth rate. First, if the business is sustainable, we can expect revenues and cash flows from operation to grow at the same pace. Second, 3% is an underestimate of the inflation in China, which can be 4%(CPI version) or 7%(M2 - GDP version).

2021 Free Cash Flow grows to the level of 2019 is reasonable. And the 6.8% growth rate is the average estimate for the industry.

I use the classic: `Free Cash Flow = CFO - CFI`. It's also and underestimate, for Cash Flow from Investment includes new investments other than necessary CAPEX for maintaining the current business.

	YEAR 2020
CFO	¥ 2,830,253,816.73
CFI	¥ -440,462,890.14
FCF	¥ 2,389,790,926.59

With all these conservative assumptions, the valuation is as follow:

	0	1	2	ETERNAL
Free Cash Flow	¥2,389,790,926.6	¥2,867,749,111.9	¥3,062,756,051.5	¥45,066,267,615.2
Discount Multiple	1.00	0.95	0.91	0.86
Current Value	¥2,389,790,926.6	¥2,731,189,630.4	¥2,778,010,024.1	¥38,929,936,391.5
Value	¥46,828,926,973			
Share Outstanding	4,319,592,192			

	0	1	2	ETERNAL
Reasonable Price	**¥10.84**			

The current price is ¥6.51(2021/11/14), a 40% Margin of Safety.

An important fact is that **in 2019 HLA buys back shares at ¥9.16**, spending RMB 667 million on 72 million shares. Is that the target price in their mind? **A 40% upside**.

Should I buy?

Now we learn that:

- The business is OKay.
- The business has some advantages.
- Current price gives a good 40% margin of safety.

The question is, should I buy? Let's not jump to the conclusion before time, we need to evaluate:

- Asset Structure: Light or Heavy
- Financial Robustness: Debt
- Revenues: Structure & Growth?
- Profitability
- Profit Quality: Profit vs. Cash
- Demining: Trash Items (Account Receivable, Other XXX Receivable)
- Are the Financial Reports Reliable?

Revenues

Perform Poorer than Industry & Difficult to Clear Inventory

HLA 2020 Revenues Breakdown by Brand

	REVENUES	COSTS	GROSS MARGIN （%）	REVENUE GROWTH （%）	COST GROWTH （%）	MARGIN CHANGE （%）
HLA	13,767,591,374.85	8,813,238,818.37	35.99	-20.97	-15.21	-4.35
Sancano	2,071,189,171.75	979,419,296.48	52.71	-4.47	-9.84	2.81
Others	1,606,070,848.70	988,083,703.69	38.48	45.54	42.13	1.48

In 2020, the man apparel retail industry in China(the industry for short) goes down by -14.28%, from 595.9 billion RMB to 510.8 billion RMB, while HLA down by 20.97%. It seems HLA is losing ground in the industry, but that is not exactly the case. Revenues go down in three cases:

1. Lower the price to boost sales
2. Sell less quantity
3. Lower the price X Sell less quantity

In the case of HLA, a -15.21% cost growth suggests the quantity sold goes down by -15.21%, not too far off from the industry growth -14.28%. It seems **HLA lower prices to boost sales**, as we can see that the profit margin is down by -4.35%, as we can see that the profit margin for different items go down. However, it still can not rescue its sales.

HLA 2020 Item Sold

	ITEM SOLD(%)	GROSS MARGIN(%)	STOCK(%)
T-shirt	-1.99	-6.61	-20.66
Pant	-9.12	-5.00	-0.11
Shirt	-15.87	-2.32	-29.4
Knit	-3.72	-7.74	9.52
Down Jacket	-7.79	-8.86	-10.16
Jacket	-19.52	-5.02	-18.18
Suit	-21.37	-2.59	-22.98
Others	13.53	12.5	-17.39

The side effect is destocking. The company's ending inventory is RMB 7.42 billion, a decrease of RMB 1.63 billion or 18.00% from the end of the previous year of RMB 9.04 billion. The inventory turnover days were 263 days, an increase of 13 days from last year. Of the RMB 1.63 billion decrease, 850 million is impairment, 9.4% 2019's inventory of, so the actual decrease of inventory is 780 million, 8.6% of 2019's inventory. The revenues decrease by 4320 million to clear 780 million. **It seems the inventory is hard to clear**.

Inventory

Is Inventory a Trouble? No

HLA has its own advantage in terms of inventory: **it can sell 60% of the inventory back to the supplier**, if it can not be sold. The risk of inventory is transferred to the suppliers. But it need to be stated that only 60% of the inventory can be returned to the supplier and get refunded, while the rest 40% can not be returned and refunded. The inventory total is 7.42 billion: clothes(6.93 billion) and materials and customs(0.479 billion).

PURCHASE	BOOK VALUE (RMB 10,000)	IMPAIRMENT
Return to Supplier	¥421,588	No
Can	¥272,162	Yes
Total	¥693,750	-

The impairment policy for apparel inventory is as following:

BRAND	< 1 YEAR	1-2 YEARS	2-3 YEARS	3 YEARS
HLA	0%	0%	70%	100%
Others	Test according to recognizable value	Test according to recognizable value	Test according to recognizable value	Test according to recognizable value

How much worth of inventory is in danger?

	2020			2019		
	History Value	Impairment	Book Value	History Value	Impairment	Book Value
< 1 Year	¥131,839.95	¥ -	¥131,839.95	¥235,422.55	¥ -	¥235,422.55
1-2 Years	¥127,516.40	¥8,662.86	¥118,853.54	¥133,544.25	¥6,639.28	¥126,904.97
> 2 Year	¥ 98,060.70	¥76,592.09	¥21,468.60	¥56,308.66	¥45,338.76	¥10,969.91
Total	¥357,417.05	¥85,254.95	¥272,162.10	¥425,275.47	¥51,978.04	¥373,297.43

1.7 billion in the extreme case, roughly earnings in 1 year: 1318 X 0.40 X 0.70 + (1189 + 2147) X 0.40 X 1 = 1716 million(40% of inventory are not refundable).

Inventory is not a big trouble, given the fact that:

1. 60% of inventory can be returned to the suppliers, no inventory risk in there
2. HLA is capable to clear 8.6% of inventory each year from the rest 40%
3. 1.7 billion inventory is in danger, not too big compared to Net Profits
4. Growing Online sales can help release the inventory pressure

HLA 2020 Revenues Breakdown Online and Offline

	2020			2019		
Revenues	Revenues	（%）	Profit Margin （%）	Revenues	（%）	Profit Margin （%）
Online	2,049,700,659.06	11.75	38.47	1,325,118,975.23	6.19	50.79
Offline	15,395,150,736.24	88.25	38.17	20,066,558,891.21	93.81	39.66
Total	17,444,851,395.30	100.00	38.20	21,391,677,866.44	100.00	40.35

Debt

The debt consists of 79% current liabilities, 10.8 billions, 21% non-current liabilities, 2.9 billion. I break them down into three category:

- Operation Liabilities: liabilities come with daily operation, e.g.. account payable.
- Distribution Liabilities: liabilities owed in income distribution, e.g.. tax payable, dividend payable
- Financing Liabilities: liabilities owed due to necessity for cash, usually interest bearing

	LIABILITIES	%
Current Liabilities	¥ 10,835,223,262	79%
Non-current liabilities	¥ 2,939,230,787	21%
Total	¥ 13,774,454,049	100%

These are the break down:

LIABILITIES STRUCTURE	YEAR 1	YEAR 2
Operation Liabilities	$10,775,444,293.80	78%
Distribution Liabilities	$508,701,131.71	4%
Financing Liabilities	$2,490,308,623.55	18%
Total Liabilities	$13,774,454,049.06	100%

Most Debt are Operational Liabilities

78% are Operation Liabilities. It's a good thing. Among them, 50% are account payable.

OPERATION LIABILITIES	YEAR 2020	ITEM/TL
Bills Payable	¥ 1,584,830,000	11.51%
Accounts Payable	¥ 5,447,565,645	39.55%
Prepaid	¥ 5,241,800	0.04%
Contract Liabilities	¥ 716,058,590	5.20%
Employee Compensation Payable	¥ 531,772,742	3.86%
Other Payables	¥ 1,589,645,389	11.54%

OPERATION LIABILITIES	**YEAR 2020**	**ITEM/TL**
Non-current Liabilities Due within One Year	¥ 358,320,348	2.60%
Other Current Liabilities	¥ 93,087,617	0.68%
Long-term Payables	¥ 214,844,296	1.56%
Deferred Income Tax Liabilities	¥ 234,077,867	1.70%
Total Operation Liabilities	¥10,775,444,294	78.23%

Contract Liabilities

- This is money received but without providing services or goods
- Next year 716 million revenues

Other Payables

- The details not revealed
- Probably: Mainly due to the **payment of rent for franchisees(can be seen as a non-interest bearing loan)** during the period. **It seems franchisees are operating pretty bad or the willingness is low.**

Financing Debt: 3 Billion Convertibles

- 3 billion worth of convertibles are planed in September 2017 to invest in **industrial chain information upgrading projects, logistics park construction projects and EICHITOO(**爱居兔**) R&D office building construction project**.
- On 2017/09/30, HLA has only 6 billion currency before the convertibles launch (launch in 2018), so it seems reasonable to raise 3 billion.
- **Estimated Real Interest Rate: 5.3%**: low for private companies in China.
- Good interest payment terms: little at the beginning and increases along time (from 0.3% to 1.8%)

Convertible Bond

The company launched the convertible corporate bond project in September 2017, and plans to raise no more than **3 billion yuan** (including 3 billion yuan) of project funds to invest in **industrial chain information upgrading projects, logistics park construction projects and EICHITOO(爱居兔) R&D office building construction project**. On June 13, 2018, the company received the Reply to the Public Issuance of Convertible Corporate Bonds by Limited Companies” (China Securities Regulatory Commission [2018] No. 836). On July 13, the company officially issued Convertible corporate bonds; on July 31, the company’s convertible corporate bonds were listed on the Shanghai Stock Exchange (bond code: 110045, Bond abbreviation: Hailan Convertible Bond). Tianheng Certified Public Accountants (special general partnership) inspected the availability of raised funds and issued A capital verification report of Tianheng Yanzi (2018) 00061 was issued. On January 21, 2019, the company's convertible corporate bonds entered the conversion period.

- 200 million spent on the warehouse
- **Estimated Real Interest Rate: 5.3%**
    - （0.1亿票息 + 1.17亿摊余成本）/ 23.7亿期初摊余成本余额
- In 2019, EICHITOO was sold for 380 million, with a profit of 52 million.

The term of the convertible bond issued this time is six years from the date of issuance. The coupon rate of the convertible bond is 0.3% in the first year, 0.5% in the second year, and 0.8% in three years, 1.0% in the fourth year, 1.3% in the fifth year, and 1.8% in the sixth year. The convertible corporate bonds issued this time adopt annual interest payment.

A one-time interest payment method, the principal and the last year's interest will be returned at maturity.
With the approval of the Shanghai Stock Exchange’s “〔2018〕No.108” document, the company’s RMB 3 billion convertible corporate bonds will be issued on July 31, 2018. Listed on the Shanghai Stock Exchange, the bond is referred to as "Hailan Convertible Bond" and the bond code is "110045".

Other Non-Current Assets

2020	2019

	2020		2019		
Book Value	Provision for impairment	Book Value	Book Value	Provision for impairment	Book Value
Advance land deposit	2,611,848.00	2,611,848.00	2,611,848.00		2,611,848.00
Prepay for other non-current asset purchases	12,033,023.65	12,033,023.65	210,944,324.36		210,944,324.36
Total	14,644,871.65	14,644,871.65	213,556,172.36		213,556,172.36

Cash Coverage Ratio(√)

- Cash: 8.8 billion
- Convertible: 2.5 billion
- Ratio: 1.7x
- This company is financially robust

Demining: Payables(√)

Liabilities Sentinel	2015	2016	2017	2018	2019	2020
Bills Payable/Revenue	0.11	0.11	0.47	0.42	0.08	0.09
Accounts Payable/Revenue	0.50	0.44	0.00	0.00	0.27	0.30
Other Payable/Revenue	0.00	0.00	0.01	0.08	0.09	0.09

Does the company lack money?

- If so the total of payables will shoot up, but it is decreasing.
- That implies that the **Currency Assets is real**

Assets

Likewise, I divide assets into four categories:

- Currency Assets
- Operational Assets
- Production Assets
- Investment Assets

We can see that over the years:

- Currency Assets increase: may due to Convertible Launch and Operation
- Operation Assets decrease: may due to inventory decreases(impairment and sales)
- Production Assets and Investment Assets decrease: may due to selling assets

	YEAR 2020	YEAR 2019	YEAR 2018	YEAR 2017	YEAR 2016	YEAR 2015
Asset Structure(%)						
Currency Assets	38.1%	34.7%	35.6%	31.2%	36.3%	33.9%
Operation Assets	37.4%	40.3%	40.3%	40.7%	42.4%	48.0%
Production Assets	16.3%	17.2%	16.0%	17.7%	17.1%	14.7%
Investment Assets	4.9%	4.6%	7.8%	10.4%	4.2%	3.4%
Good Will	3.3%	3.2%	0.4%	0.0%	0.0%	0.0%

	YEAR 2020	YEAR 2019	YEAR 2018	YEAR 2017	YEAR 2016	YEAR 2015
Total Assests	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

	YEAR 2020	YEAR 2019	YEAR 2018	YEAR 2017	YEAR 2016	YEAR 2015
Assest Structure	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Currency Assets	¥10,530,691,583	¥10,045,203,039	¥10,526,328,556	¥ 7,841,978,234	¥ 8,858,417,959	¥ 7,945,527,337
Operation Assets	¥10,335,371,860	¥11,645,890,758	¥11,912,050,817	¥10,204,112,854	¥10,324,080,633	¥11,240,756,011
Production Assets	¥ 4,520,794,426	¥ 4,966,648,992	¥ 4,735,635,296	¥ 4,442,798,873	¥ 4,177,347,792	¥ 3,457,209,481
Investment Assets	¥ 1,367,355,073	¥ 1,344,032,381	¥ 2,304,482,782	¥ 2,609,412,768	¥ 1,016,947,280	¥ 798,243,707
Good Will	¥ 913,949,145	¥ 913,949,145	¥ 112,948,552			
Total Assests	¥27,668,162,087	¥28,915,724,316	¥29,591,446,003	¥25,098,302,728	¥24,376,793,664	¥23,441,736,536

Light Assets

The **EBT/Production Assets** is: 50.85% >> 12% (2 times GDP), so this is **a light asset company**. It means more flexibility during hard times and less CAPAX to sustain the business.

Currency Assets

- Currency total: 10.6 billions
- Cash: 8,8 billions
- The rest 1.8 billions are restricted to provide guarantee for the issuance of bank acceptance drafts
    - Time Deposits: 1.6 billions
    - Bank Acceptance Draft Margin: 51 millions
    - Guarantee and Letter of Credit Margin:16 millions

Cash

	YEAR 2020	YEAR 2019
Cash in treasure	¥ 911,070	¥ 835,854
Bank savings	¥10,447,368,080	¥ 9,904,083,909
(-)：Pledge Deposit Receipt	¥ -1,595,000,000	¥ -1,756,000,000
Receivables financing: bank acceptance draft	¥ 14,203,487	¥ 22,831,126
Cash Available	¥ 8,867,482,636	¥ 8,171,750,889

Operational Assets

OPERATION ASSETS	2020	2019	2018	2017	2016	2015
Accounts receivable	¥ 972,434,153	¥ 773,366,692	¥ 685,107,791	¥ 594,868,459	¥ 645,933,622	¥ 609,211,358
bill receivable			¥ 2,793,534	¥ 16,590,952	¥ 14,734,910	¥ 24,054,814
Prepayments	¥ 332,910,366	¥ 449,622,457	¥ 489,512,556	¥ 519,056,020	¥ 505,806,215	¥ 626,717,750
Other receivables	¥ 616,664,576	¥ 370,009,986	¥ 429,737,288	¥ 69,305,912	¥ 57,251,497	¥ 40,919,640
Inventory	¥ 7,416,375,222	¥ 9,044,042,581	¥ 9,473,636,674	¥ 8,492,687,262	¥8,632,129,071	¥9,579,731,369
Other current assets	¥ 138,859,627	¥ 237,578,798	¥ 144,770,200	¥ 53,823,789	¥ 33,760,391	¥ 28,993,422
Long-term prepaid expenses	¥ 282,649,180	¥ 276,460,414	¥ 193,480,664	¥ 108,256,106	¥ 105,377,292	¥ 79,957,791
Deferred tax assets	¥ 575,478,737	¥ 494,809,830	¥ 493,012,111	¥ 349,524,353	¥ 329,087,636	¥ 251,169,867
Receivables financing: other	¥ 14,203,487	¥ 22,831,126				
Total Operation Assets	¥10,335,371,860	¥11,645,890,758	##############	#############	#############	#############

Deming: Accounts Receivable(√)

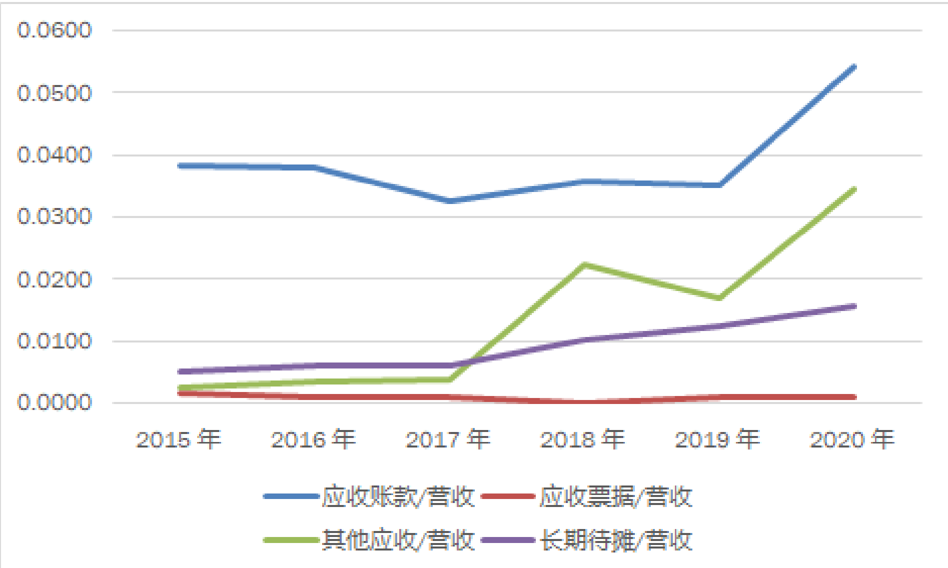
- Accounts Receivable increase but doesn't look suspicious

ADJUSTED ACCOUNT RECEIVABLE	2020	2019
Accounts receivable	¥ 972,434,153	¥ 773,366,692
Other receivable	¥ 616,664,576	¥ 370,009,986
(-)：Receivables financing: other	¥ -14,203,487	¥ -22,831,126
(-)：Bill receivable	¥ -	¥ -
Adjusted Account Payable	¥ 1,574,895,242	¥ 1,120,545,552

Does Accounts Receivable Increase Disproportionally?

- Yes, more radical sales credit policy

	2020	2019	2018	2017	2016	2015
AR/TA	5.69%	3.88%	3.76%	2.58%	2.82%	2.67%
AR/Monthly Revenues	1.05	0.61	0.70	0.43	0.49	0.47



Is Accounts Receivable Dubious?

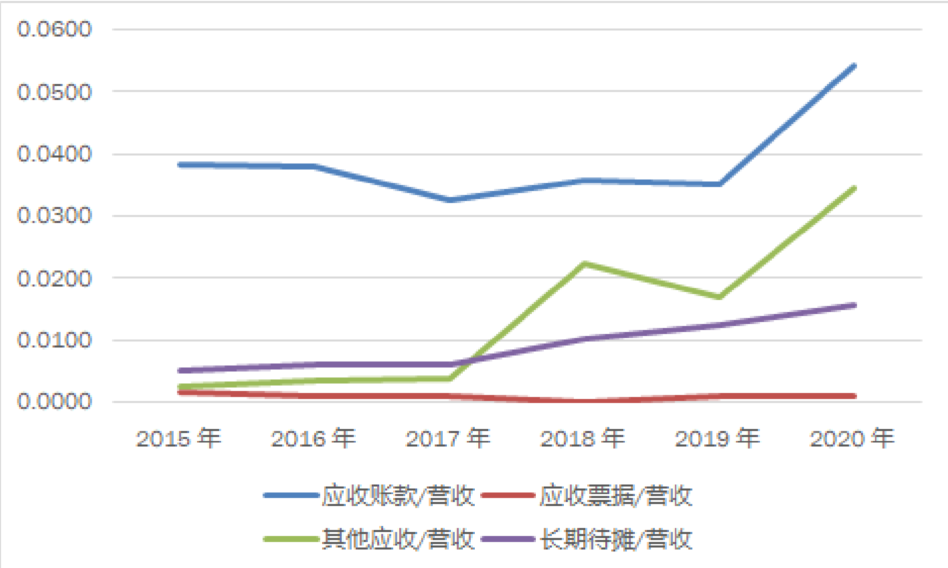
- Significantly impaired for a single item? No
- Are there affiliated companies owing a lot? No

The total amount of the top five accounts receivable at the end of the period collected by the owing party during the reporting period is 125,307,745.78 yuan, accounting for **12.21%** of the total closing balance of the accounts receivable, and the corresponding provision for bad debts The sum of the balance at the end of the period is 6,265,387.29 yuan.

Deming: Other Receivables(√)

Is the ratio of other receivables/operating income stable?

- No, look at the green line
- Reason given: pay for franchisees (like a free loan) - 200 million
- Is that a reasonable reason: probably, **it shows offline store partners are struggling.**



Deming: Long-term prepaid expenses(√)

Does the company hide current expenses to boost earnings?

- Probably, it is said that 24 millions more (24 millions more than 2019's 252milion) are spent on decoration and props, but why did it spend so much in a hard time during the pandemic.
- It can add 24 millions EBT. 18 million RMB after tax.
- No that won't make a significant impact on 170 million net profits.

Investment Assets

Does they company loose its focus on the main business?

- No, Investment Assets/Total Assets is 4.94%, not a big deal