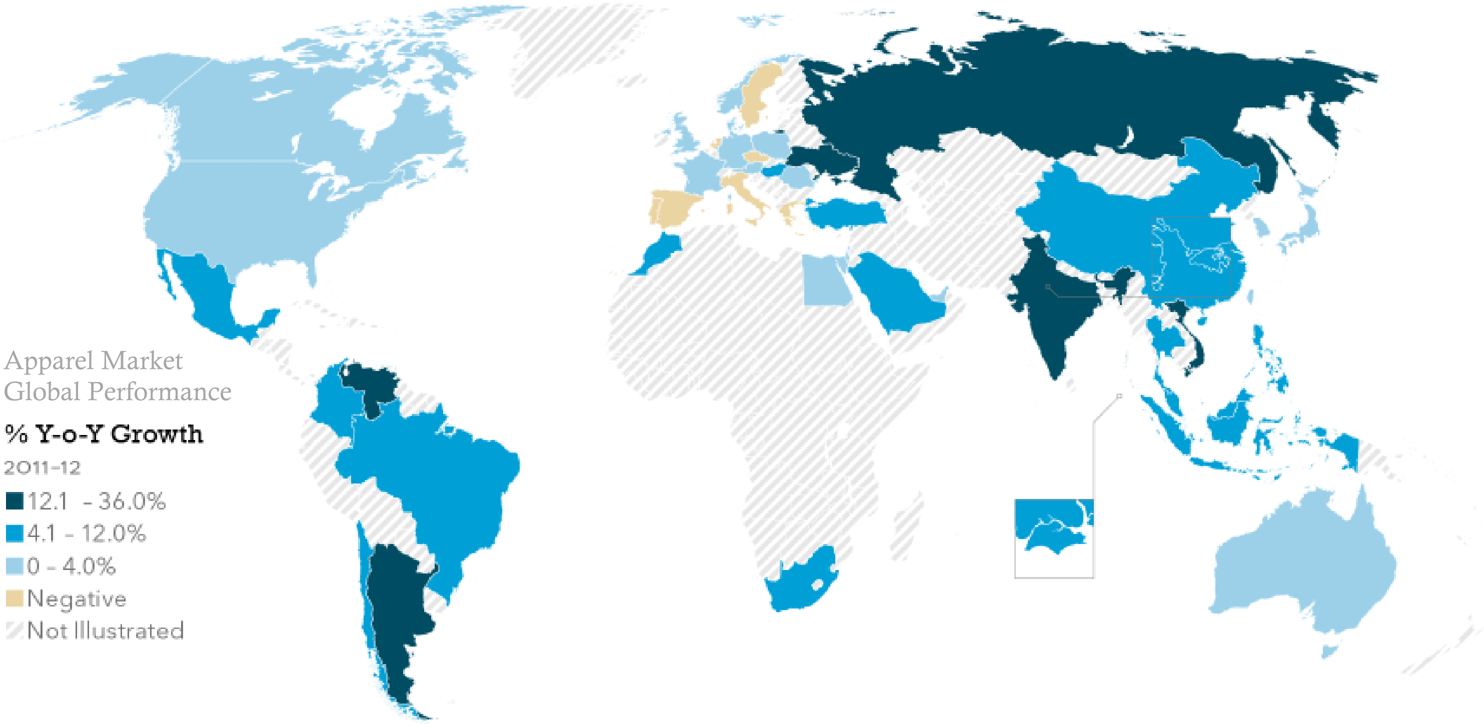
参考1

HKICPA
QP Case Analysis Competition 2013



High Fashion Nirvana

QP Case Analysis Competition 2013 Written Report

TABLE OF CONTENTS

I. EXECUTIVE SUMMARY

The purpose of this report is to achieve corporate value enhancement and sustainable growth for HFIC, by critically assessing its financial and operational practices, evaluating strategic options, providing a plausible long-term-oriented roadmap and solving its ethical conundrum.

Research for this report include i) analysis of global and regional apparel industry, ii) review of supply chain management and corporate governance literature, iii) comprehensive business data collection and data mining, and iv) interviews with experienced academics and industry players. We also selected 11 peer companies to create a proprietary comparison set for HFIC (**Appendix 1**). Furthermore, multiple theories, models and framework are applied in analysis, evaluation and planning.

The major findings indicate that HFIC has problems in its financial performance, operational practices and strategic moves. Potential future options are explored and assessed by evaluating the acceptability, profitability and feasibility of each project.

This report recommends that HFIC to implement an expansion plan in PRC market through acquiring a new brand to gain a powerful top line driver, to continue the store-closure programme and invest in e-commerce in Europe, to conduct effective cost reduction activities and to refine supply chain management. A detailed roadmap is designed and presented using time boxing method with MoSCoW rules.

II. COMPANY PROFILE

1. Introduction

High Fashion International Company Limited (HFIC), the Hong Kong-based fashion clothing company, designs, manufactures and sells a wide range of products for women, men, teenagers and children. The company has a wholesale-dominating distribution structure with Europe (81%) and China (19%) as its major markets (**Appendix 2**). Throughout centennial development, HFIC has received worldwide recognition and reputation for its affordable, quality and stylish garments.

However, the recent two years has seen a struggling HFIC with a shrinking bottom line. To identify specific problems in liquidity, profitability and supply chain management, we conducted holistic analysis of HFIC's financial performance, operational practices and strategic moves.

2. Financial Analysis

Profitability and Liquidity (Figure 1): the bottom line decreased drastically by 56%. Also, the 9.4% drop in operating profit before depreciation and amortization (EBITDA) to sales (11.29%) was two times higher than peer average and failed to reach the 20% target. Other profitability indicators such as EBIT margin and gross margin fell below the industry average level.

From the perspective of liquidity, HFIC is still sufficient in current assets with above-average current ratio and quick ratio. However, working capital and cash flow analysis reveals potential liquidity hazards.

Working Capital Management: working capital and supply chain management have been deteriorating, as DIO, DSO, DPO and CCC have all increased (**Figure 2**) suggesting slower order response, bill collection and bill payment.

Figure 1. Profitability and Liquidity Ratios

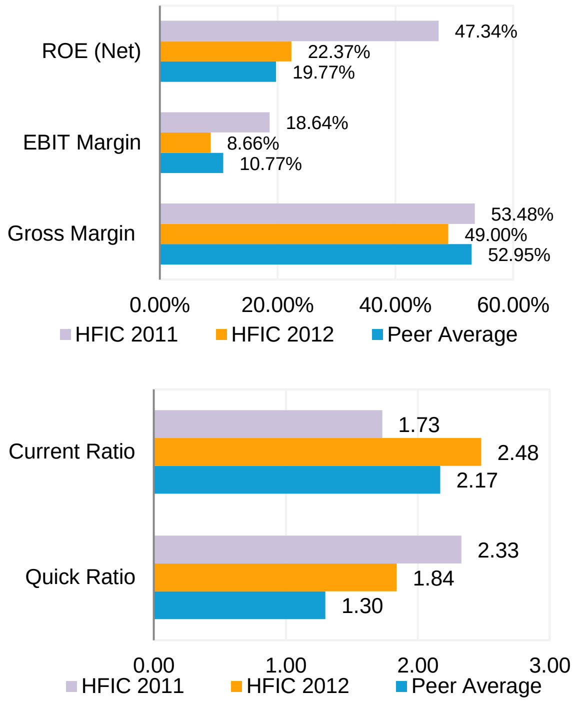
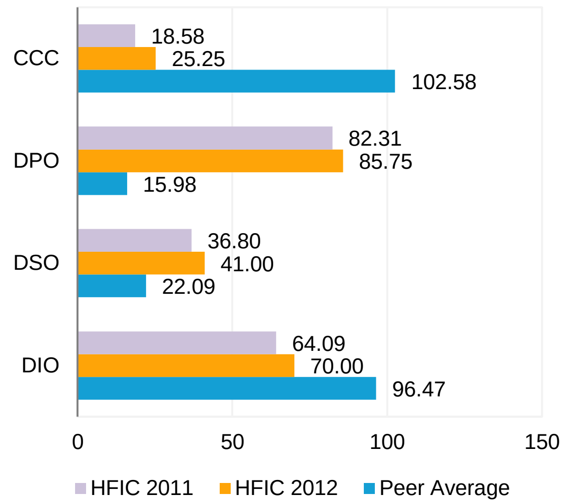


Figure 2. Working Capital Management



Notes:
CCC-Cash Conversion Cycle (days)
DPO-Days Payable Outstanding (days)
DSO-Days Sales Outstanding (days)
DIO-Days Inventory Outstanding (days)

Figure 3. Sources of Cash

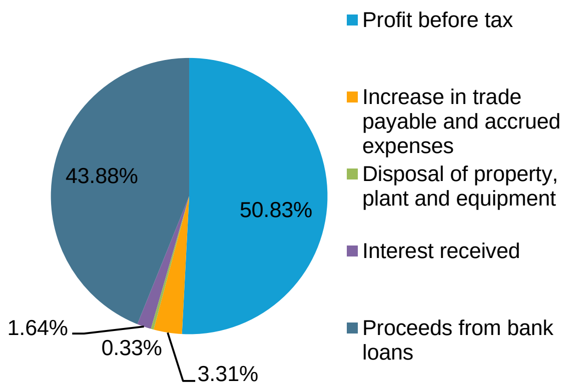
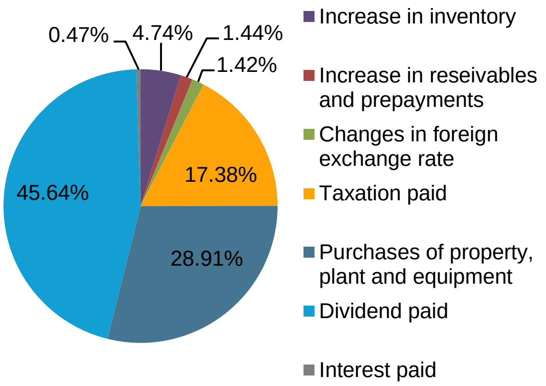


Figure 4. Uses of Cash



Sources of Cash for HFIC: Cash inflow from operating activities ("OCF") and proceeds from bank loans are the major sources of cash for HFIC 2012 (**Figure 3**). With shrinking operating profits, 60% dividend-payout ratio and the aggressive expansion plans, HFIC experienced more severe operating cash flow squeeze than its peers. To maintain its liquidity and strong cash position, HFIC borrowed 2.38-billion bank loan and increased current liabilities by 5.1% (e.g. trade payable and accrued expenses) but these sources are not sustainable in the long-run as credits would eventually be limited.

Uses of Cash for HFIC: Uses of cash for HFIC mainly consist of cash dividend payout and purchasing activities of property, plant and equipment (**Figure 4**). The cash flow adequacy ratio for HFIC was 0.83 (<1), indicating potential liquidity problems including future cash shortages, impaired financial flexibility and declining trade credit, as the investment and expansion activities could not be adequately supported by its own operations.

3. Operational Practices and Strategic Moves

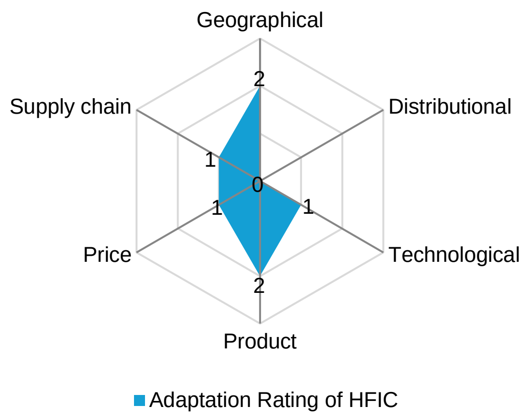
Based on industry research, review of peer companies' business performance from 2007 to 2012 and SWOT analysis of HFIC (**Figure 5**), we summarized 6 apparel market trends and rated HFIC on its adaptation to these trends (**Figure 6**). The incomplete blue "shuttle" against the complete hexagon indicates that it has not promptly adapted to the evolving apparel market landscape.

To rebound to the 20% level of EBITDA to sales ratio and achieve sustainable strategic growth, we evaluated the following four strategies proposed by the board.

Figure 5. SWOT Analysis

Strengths	Weakness
• Well-recognized brand name in Europe • Strong cash support • Corporate social responsibility as to produce environmental friendly clothing	• Declining, low profit margin • Seasonality of the sales • Large inventories & deteriorating WCM • High manufacturing cost
Opportunities	**Threats**
• Prevalence of online and retail store shopping • China-a growing market for expansion • European customers' rising concerns about environment protection	• Low recovery of the European Market • Euro depreciation again Hong Kong Dollars • Competitor in China- Glamour

Figure 6. Compliance Rating of Apparel Market Trends for HFIC



Scaling 0~3, HFIC is rated regarding the extent to which it has adapted to each market trend by incorporating pertinent strategies into its operations.

Rating	Description
0	No sign of this market trend has been observed
1	The trend has been publicly discussed by the management and incorporated into the company's overall corporate strategies
2	The trend has been further incorporated into the company's segmented business strategies
3	The trend has been integrated in the company's detailed implementation strategies and operations

Six Apparel Market Trends

Market Trends	Description	HFIC Rating
Geographical	Asia market gains power as the new growth point	**2**
Distributional	Retail stores outweigh department stores in percentage of sales	**0**
Technological	Electronic/Social Media/Mobile-commerce is re-shaping retailing landscape	**1**
Product	Product diversification balances risk profile in a volatile market	**2**
Price	Mid-market is squeezed as consumers increasingly elastic to unit price changes	**1**
Supply Chain	Vertical integration gives retailers an edge in fiercer global competition	**1**

III. STRATEGIES

1. Rapid Expansion in the PRC

Expansion in the PRC can be a new growth point for HFIC as Chinese apparel market has outperformed Europe and the U.S. for five years (**Figure 7**). Gap analysis is used to assess the 25% PRC market share target in HFIC’s 5-year plan (**Appendix 3**). To close the gap between projected momentum line and the ultimate target, HFIC is suggested to develop a low-priced product line to cater to Chinese consumers’ needs. Merger and acquisition, strategic alliance and internal organic growth are evaluated as three implementation options.

Based on our analysis, internal organic growth is not viable because a large amount of capital will be locked up during the brand development process, which will lead to a prolonged payback cycle. To better utilize HFIC's large holding of cash, we recommend the company to acquire a well-established product line to achieve rapid expansion in the PRC. Gap analysis indicates that in order to obtain a 25% market share in 5 years, HFIC should consider acquiring a brand with a turnover around HK$2,508 million (**Appendix 4**). The acquiring price is estimated to be HK$1,416 million, which accounts for 27.38% of HFIC's cash and cash equivalents at June 30th, 2012. This acquisition transaction can therefore be fully funded by HFIC's cash holdings without further need of financing.

Three target companies are shortlisted after careful screening, including the new brand developed by Glamour, ONLY by Bestseller and E•Land. Among them, Glamour ranks top on the list with its well-established brand and sophisticated distribution network. We expect this acquisition will help increase HFIC's capital efficiency and achieve its market share target in the PRC. However, downside risks should not be neglected, such as regulatory complications and blurred brand positioning.

2. Expansion in European with Existing Products

Compared with fast-growing Asian market, European apparel market has been stumbling under the shadow of Eurozone crisis and hampered consumption (**Figure 7**). Problems in mature market, such as saturation and resistance to price increase, are also eroding the profit margin. The weakening euro further deteriorates sales performance, as there is a mismatch between functional currency (euro) and presentation currency (Hong Kong dollar), which calls for systematic hedging measures. HFIC's turnover in Europe has dropped by 12.22%, contributing a smaller fraction to sales performance of HFIC. (**Figure 8**) Similar trend has been observed in other major European market players as well.

参考1

Figure 7. Emerging Markets, Eurozone & US: Apparel Market Growth 2007-2012

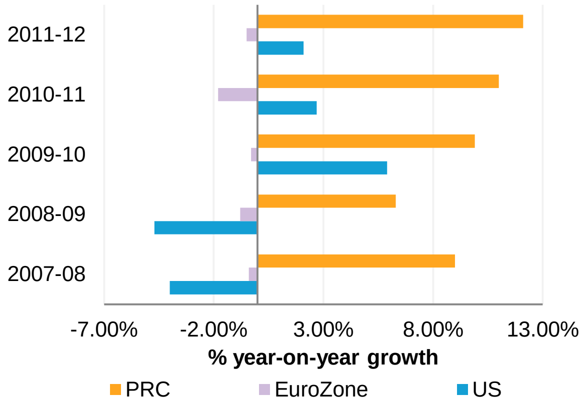
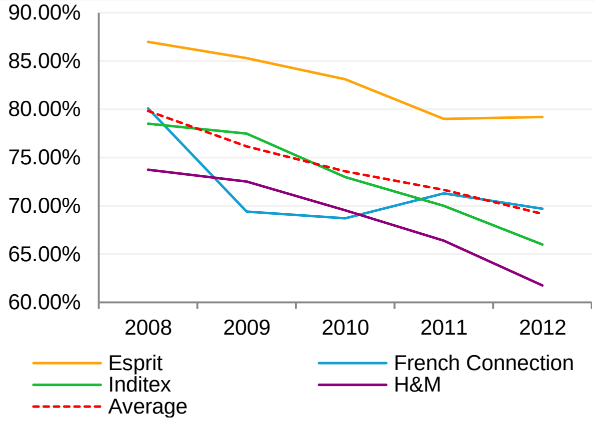


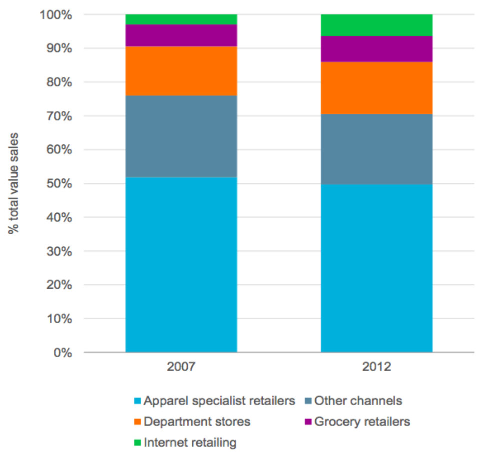
Figure 8. European Sales as % of Company Total



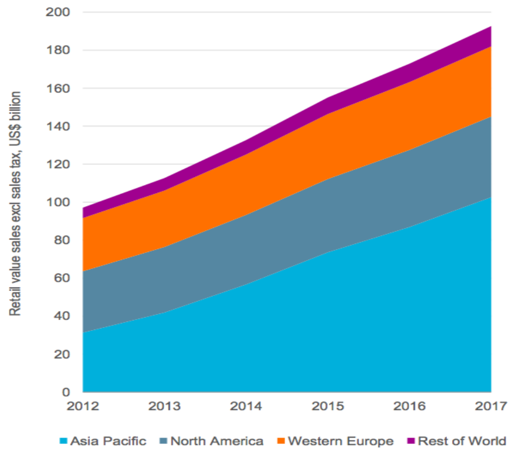
Although a refurbishment programme has been undertaken in Europe together with a closure programme of 25 underperforming stores, same store sales (SSS) is still estimated to have dropped by 9.18% (**Appendix 5**). Under current circumstances, further expansion and refurbishment investment in Europe would involve risks such as lower-than-target in-store traffic and inferior project ROI. HFIC is recommended to continue with its current store closure program as an effective stop-loss measure. In addition, to retain existing customers, stimulate sales and survive in the economic quagmire, financial resources should be reallocated from in-store refurbishment plan to re-engineering and upgrading HFIC's e-shopping platform (**Figure 9**).

Figure 9.

Apparel Distribution: % Value Share by Channel 2007/2012



Apparel Internet Retailing Sales 2012-2017



E-commerce has the advantage of lower distribution cost, higher level of customization, diversified online catalog, and convenient search engine optimization. However, one major risk is the cannibalization of existing sales due to its expansion in digital territory.

3. New Products in Existing Markets

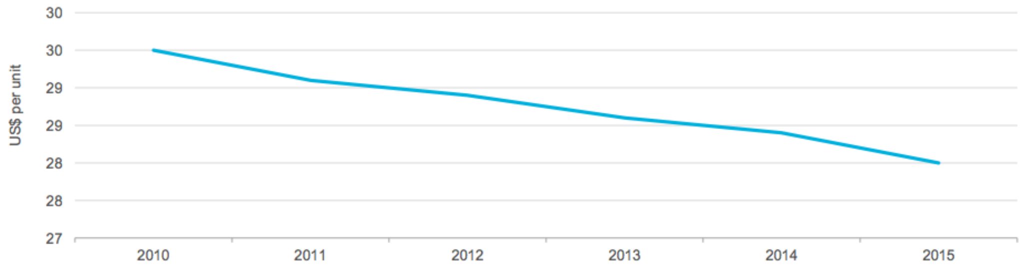
We evaluate the strategy of developing new product lines for existing markets to improve HFIC's sales performance and regain its 2011 profit margin level. Product diversification strategy enables HFIC to leverage its existing marketing methods and distribution channels. But on the other hand, there could be considerable initial investments in product development process with uncertain project ROI. Therefore the strategy can only be adopted with compensation from significant high return. Several new product ranges are proposed: i) Sustainable fashion; ii) denim; iii) sunglasses and swimwear.

(1) Sustainable Fashion: Research suggests a growing awareness of environmental protection in both manufacturing process and consumption behavior, especially in European apparel market. However, low conversion rate indicates that the benefits could be largely intangible. This strategy will help uphold HFIC's corporate social responsibility and ethical standards, rather than generating substantial revenue growth.

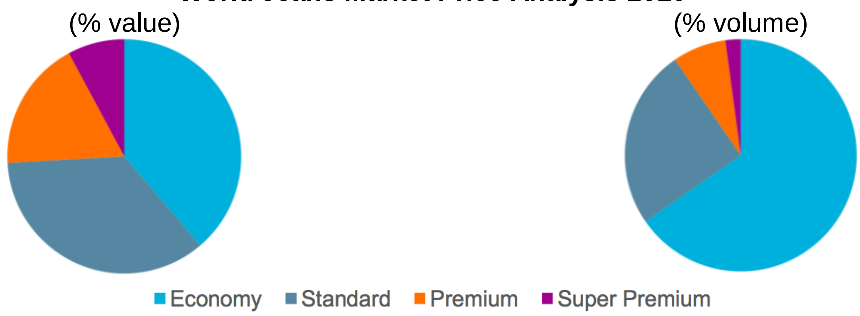
(2) Denim: Despite the slow-down during global economic recession around 2008, denim market has experienced a healthy bounce-back to steady growth (**Appendix 6**). Two major issues might be HFIC's concerns throughout strategy implementation.

A. Popularity of economy jeans. Economy jeans refer to denim product at the bottom end of the price range including private label and unbranded products. Examples include Primark (UK), Forever 21 (US), Kik (Germany) and Kiabi (France). In terms of market share, economy jeans have been dominating denim market in both value and volume, as the average unit price goes down year by year with the prevalence of "throw away" fashion culture (**Figure 10**).

Figure 10.
Global Jeans Average Unit Price Trend Forecast



World Jeans Market Price Analysis 2010



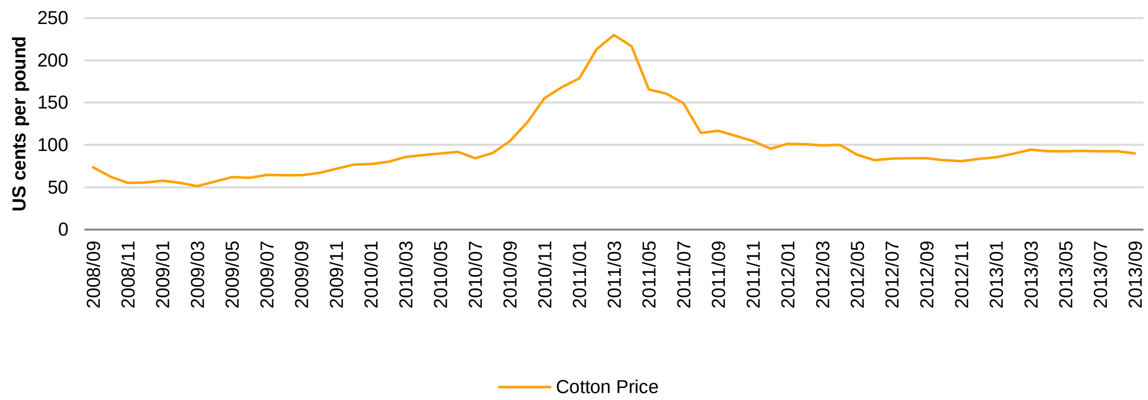
Denim product line will be a safe choice for HFIC to increase sales. However, as this growth model is based on low price and large volume, it is difficult for HFIC to increase operating margin by establishing premium product range. Although super premium jeans still lead developed markets like Western Europe, competition is fierce and saturated among high-end brands.

B. Fluctuations of raw material price. HFIC's denim product line has just started and the market prospect is positive on the demand side. However, fluctuations of cotton prices are the main risk the firm should deal with. (**Figure 11**)

(3) Other product range: HFIC has limited previous experience in producing accessories (sunglasses) and athletics clothing (swimwear). That being said, these

two product lines that are not related to its traditional business, would bear considerable risks. In face more urgent operational and financial issues, we recommend this idea should be considered as lower priority.

Figure 11. World Cotton Price Trend



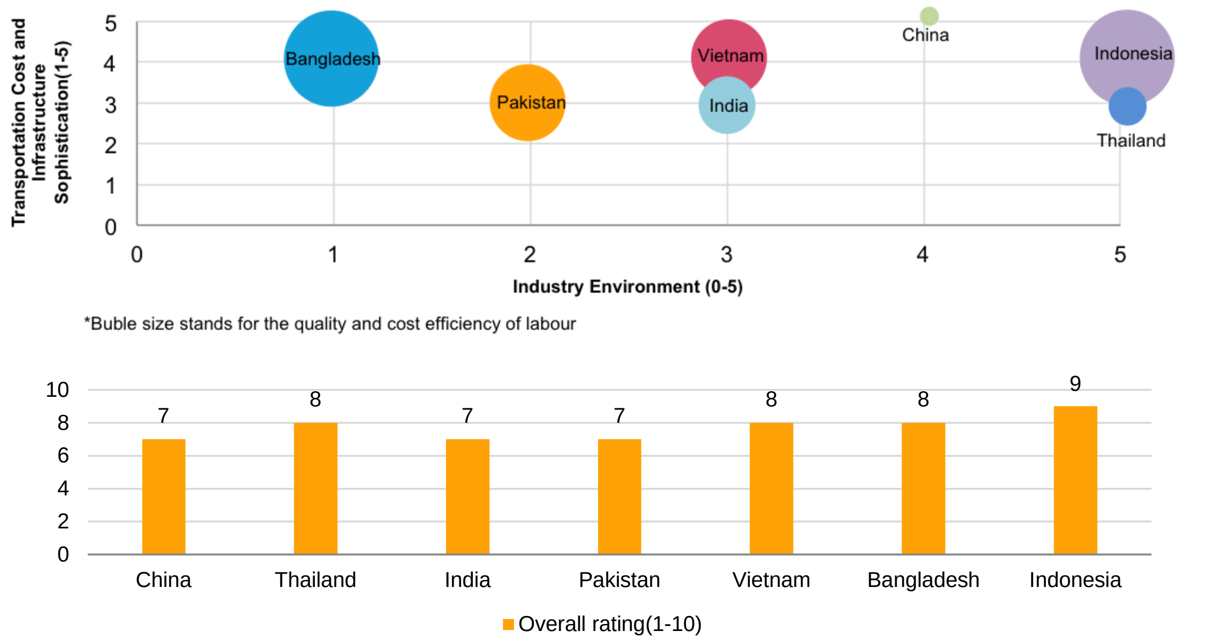
4. Consolidation Strategy to Improve Efficiency and Reduce Costs

The organization restructuring in 2009 has enabled HFIC to more accurately predict sales performance and decrease inventory turnover time, which as a result, increased the effectiveness of JIT. However, the insufficient level of supplier consolidation exposes HFIC to higher costs and slower market response. Current JIT system and management restructuring are not very successful, with an increase in COGS from 46.52% of total turnover to 51% (**Appendix 7**). More recent difficulties in negotiating prices also indicate the necessities of consolidating its suppliers and building up long-term trustworthy partnerships with each of them.

Careful screening of each existing supplier and other non-existing suppliers is essential to maintain HFIC's competitiveness in pricing and global reputation of affordability. Taking into consideration the physical locations of HFIC's major markets and its strategic plan of expanding in the PRC market, we recommend HFIC to size down the number of existing suppliers within the Asia pacific region to regain its profitability level of 21.39% in 2011.

Based on our analysis, six major criteria should be utilized in the screening process including four broader countrywide criteria and two supplier-specific criteria: (i) matureness of clothing manufacturing market, (ii) quality and cost of labour, (iii) transportation cost and infrastructure sophistication, (iv) law enforcement and consumer perception, (v) each supplier's ability and willingness to protect workers' rights, (vi) each supplier's ability and willingness to upgrade with advanced information management systems such as RFID.

Figure 12. Supplier Ratings



We rate 7 major clothing manufacturing countries in Asia in four indicators from 0-5 and generated an overall rating from 0-10 based on the weighted average. (**Figure 12**) Higher weights are allocated on (ii) and (iii), both of which have significant contribution to minimizing costs in the short-term. However, the importance of (i) and (iv) should not be downplayed in a longer-term to conduct better supply chain management and fulfill HFIC's commitment to sustainable business practices. We find that Vietnam and Bangladesh are rated 8 out of 10 while Indonesia is rated 9, the highest among 7 countries. The high overall rating of Indonesia comes with its advantageous physical location, low labour cost and better consumer perception. Bangladesh is downgraded to incorporate the impact of recent industrial disasters.

Therefore, we recommend HFIC to develop long-term partnership with targeted suppliers in Indonesia, Vietnam and PRC, either existing or non-existing, to achieve better information sharing and shortened lead times. Four major improvements are expected with the sizing-down of suppliers.

(a) A lower level of reliance on PRC suppliers will reduce HFIC's exposure to rapidly rising labour costs in China, cutting COGS by 4% of total turnover that help regain its profitability back to 21.39%, effective from FY2013.

(b) COGS is predicted to decrease by another 1.5% of total turnover with larger orders and therefore lowered unit price, effective from FY2013.

(c) Consolidation of suppliers will reduce distribution expenses by 1.5% of total turnover with economies of scale in distribution process.

(d) JIT will have more significant impact with accelerated inventory turnover and reduced warehouse expenses. Supply and demand synchronization is expected to reduce lead times by 60%, which enables the design team to better capture the fashion trend and consumer needs.

Operating margin of FY2013 is predicted based on the decrease of COGS and distribution expense, from 11.29% to 21.36% (**Appendix 8**).

RFID is also expected to improve supply chain efficiency and reduce costs, although successful implementation requires a higher initial investment and longer timeframe.

Uncertainty and risk are inherent in every supply chain therefore the downside of consolidating suppliers should not be ignored. A smaller number of suppliers will increase HFIC's vulnerability to various adverse scenarios such as the absence of surplus stock or labor, inaccurate forecast of customer demand, delayed distribution or machine breakdown. Thus, HFIC needs to strike a balance between minimizing costs and reducing risks.

IV. IMPLEMENTATION PLAN

We used time boxing planning with MoSCoW rules to prioritize feasible strategies (**Appendix 9**), and designed the following implementation plan (**Figure 13**):

Figure 13. Implementation Time Box

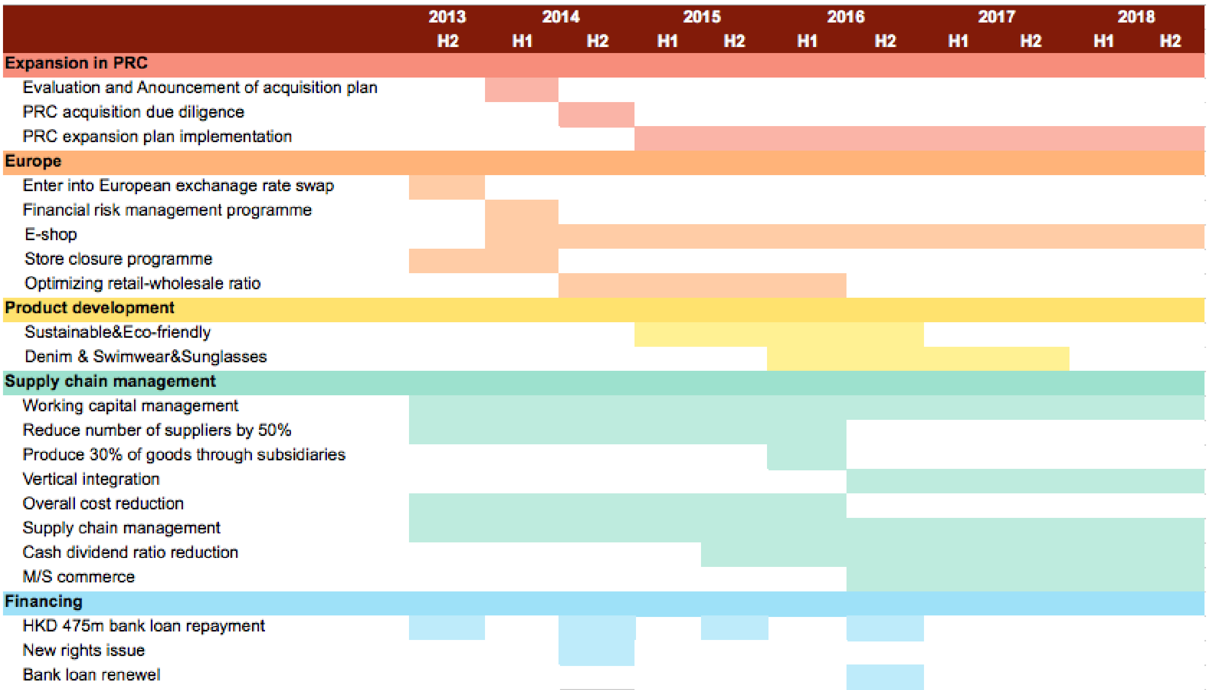
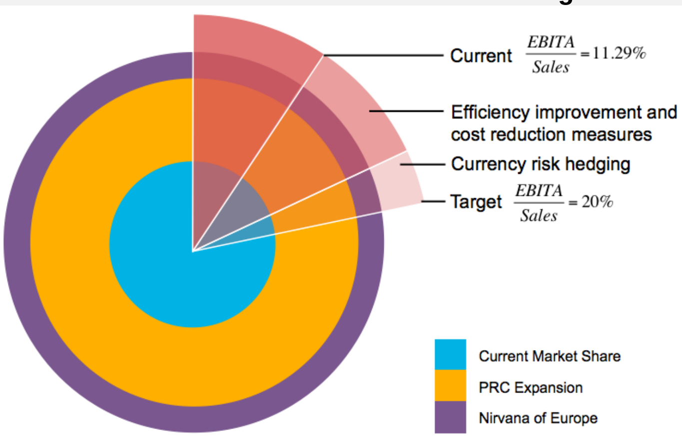


Figure 14



Notes:

1. Expanding circle size represents HFIC's growing global market share over the projected timeline, during which process, turnover growth in emerging markets (starring PRC) constitutes the major upscale, and the Nirvana of Europe section also extends our market pie.
2. The fractioned sectors represents HFIC's increasing EBITDA-to-sales ratio. Through efficiency improvement, cost reduction and currency risk hedging measures, HFIC will achieve its target EBITDA-to-sales ratio of 20%.

The 5-year implementation plan gives a detailed roadmap for HFIC to climb up from the business trough, regain its dignity in Europe and spread its footprint in broader emerging markets. With the wit and efforts from every member in HFIC family, the ideal output of this “time box” is a brand-new, top-tier industry player with larger global market share and outstanding profitability ratios (**Figure 14**).

V. ETHICAL CONUNDRUM

Figure 15

The American Accounting Association (AAA) seven-step model is adopted to analyze the ethical conundrum (**Figure 15**). Kenneth Chan (Chairman of board) is faced with the dilemma whether to take actions against Chris Lee (COO)’s insider dealing behavior, and whether to consult the two stakeholders who meanwhile have close personal connections with Kenneth. Our analysis outlined the following main ethical issues:

Chris’ insider dealing falls into the category of market misconduct under Securities and Futures Ordinance, which has both a civil and a criminal regime once investigated by the Securities and Futures Commission.

Kenneth is obliged to take actions against Chris to uphold integrity, objectivity, professional competence and due care; and comply with the Ordinance and the Model Code in the Listing Rules.

Mary should not be consulted beforehand, as she should not be granted prior access to price sensitive information over other shareholders. Neither should Kenneth consult **Jian Jiang** due to his position as a SEHK enforcement officer.

There are several alternative decisions for Kenneth to choose from:

(1) By directly reporting and disclosing Chris’ behavior, Kenneth will uphold integrity and objectivity. However, without consultation, Kenneth may fail to maintain due care in terms long run planning and internal control.

(2) By consulting the two individual before making further decision, Kenneth will fail to uphold his integrity and objectivity, which will further result in the breach of law and regulations from SFC. However because of the consultation, Kenneth might fulfill his due care.

(3) By not taking any actions against Chris, Kenneth's decision will still result in the breach of not only the three ethical principles concerned, but also laws and regulations from SFC. He will also fails to meet his obligations to shareholders, employees, and potential investors.

(4) Kenneth needs to have a fourth alternative, by which he would be able to uphold integrity and objectivity, and fulfill his due care at the same time. He will also be able to maintain his compliance to laws and regulations from SFC.

Balancing the consequences against the primary principles, rules and values, it is recommended that Kenneth take the fourth alternative solution. We recommend that Kenneth discuss the issue with the board, report to authority and consult the professional legal service team instead. To guard the company against market misconduct, the board should focus on long-run internal control and conduct more effective financial due diligence when reviewing M&A deals.

VI. CONCLUSION

In this highly competitive apparel industry, volatile topline and inefficient supply chain management (SCM) are lethal to any enterprise. Blue-blood HFIC needs a revival and holistic metamorphosis, for which we have designed a roadmap of SCM improvement, horizontal expansion and vertical integration to help HFIC solve current problems, enhance corporate value and achieve sustainable growth.

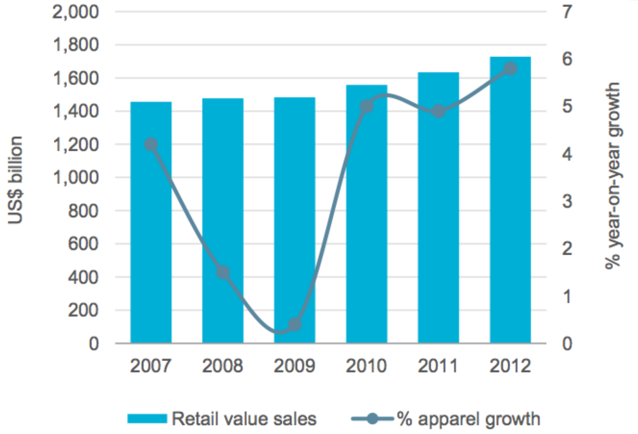
VII. APPENDICES

Appendix 1

Peer Companies of HFIC

Abercrombie & Fitch Co.
Esprit Holdings Ltd.
Etam Developpement SA
Fast Retailing Co., Ltd.
French Connection Group PLC
Giordano International, Ltd.
GUESS ?, Inc.
Hennes & Mauritz AB
Industria De Diseno Textil (Inditex) SA
SuperGroup Plc, Cheltenham
The Gap, Inc.

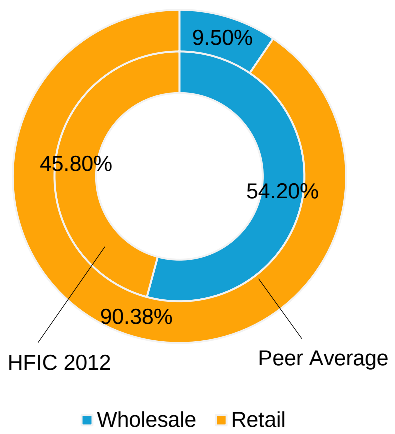
Global Apparel Market 2007-2012



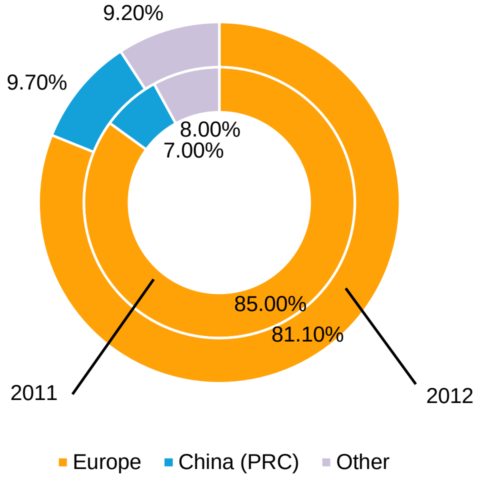
Peer selection criteria: we use 164 companies from Primary SIC Code 5600 and Mergent Industry Code1.4. By targeting primary business nature as designing/distributing of affordable fashion clothing, taking scale of turnover and global footprint into consideration, and eliminating 2 companies with missing financial data, the list is then narrowed down to 11 companies.

Appendix 2

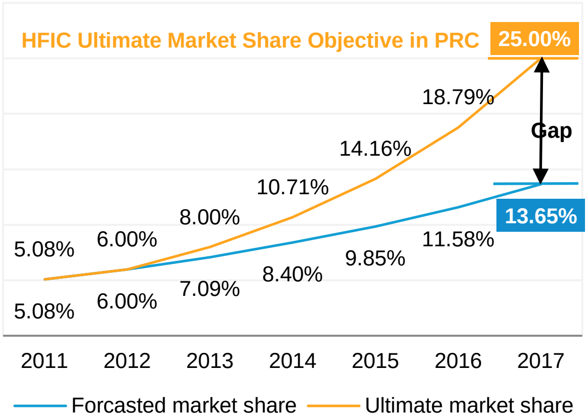
Distribution Channels as % Total Sales



Regional Sales as % Total Sales



Appendix 3
HFIC PRC Market Share Gap Analysis



Appendix 5
HFIC Same Store Sales (SSS) 2011-2012

(Million HKD)	2011	2012
Europe Retail Sales	17,213	16,836
POS-retail	725	800
SSS	23.74	21.05
Adjusted POS-retail	650	700
Adjusted SSS	26.48	24.05
% change in SSS		-9.18%

Appendix 3 Forecasted HFIC market share line (i.e. projected momentum line), is based on two assumptions: i) constant existing strategies and ii) constan reaction pattern to external events. The ultimate market share target is 25%, with sales function $y = S(1+x)^5$, where S is the total sales in 2012. PRC market size is estimated based on projected real-term growth rate from Economist Intelligence Unit. HFIC's strategic gap is thus the shortfall between the ultimate target and the current forecast.

Appendix 4
Valuation for Acquisition

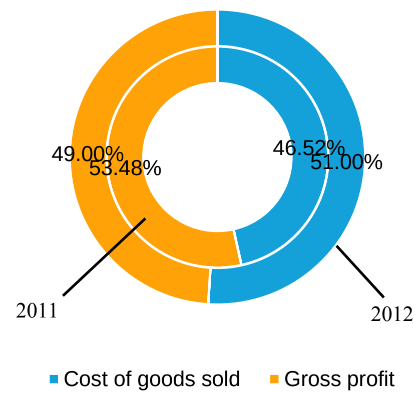
Peers	Sales on Equity
French	2.98
Intidex	2.00
HM	2.74
GAP	-
Fast Retailing	2.64
A&F	2.41
Gior	1.97
Supergroup	1.78
Etam	-
Guess	2.31
Esprit	1.90
HFIC	**3.08**
Average	**2.30**

Market share in 5 years without acquisition	13.65%
Target market share before acquisition	25.00%
Gap (as percentage of PRC sales)	0.83
Gap (as volume of PRC sales)	$2,504.48
Sales on Equity of Comparable Companies	2.3
Estimated Acquisition of Equity (in millions of HK$)	$1,088.91
Adjusted Acquisition Valuation (in millions of HK$)	$1,415.58
Cash at year end	5,170
Acquisition	27.38%

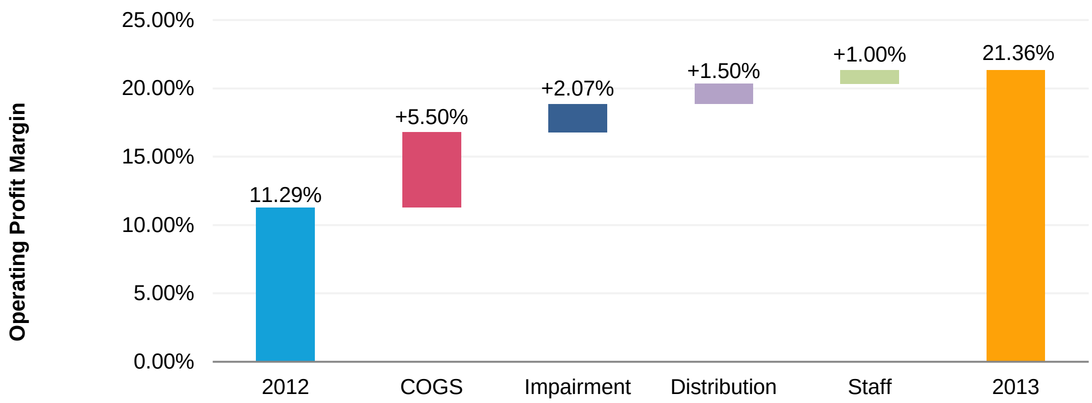
Notes:
1. The sales on equity ratios for GAP and Etam are abnormally high and are treated as statistical outlier.
2. Fair acquisition value of this brand is estimated based on this turnover expectation and a 2.30 sales-on-equity ratio. This valuation is further adjusted by adding a control premium of 30% to reflect the upward potential of the PRC apparel market.

Appendix 6
Global Jeans Market Performance

Appendix 7
HFIC Sales Turnover Components



Appendix 8
HFIC Predicted Operating Magin for 2013



Appendix 9
MoSCoW Rules Prioritization

Decision Item	Relative Importance to the Organization	Relative Satisfaction with the Existing State (-)	Approximate Time in Relative Scale to Implement or Complete (-)	Approximate Expense In Relative Scale (-)	Relative Viability (taking into account short & long-term usefulness)(+)	Score
Expansion in PRC						
Acquisition of Glamour new brand	5	2	1	2	4	**4**
Currency risk hedging	4	1	2	2	4	**3**
Distribution channel						
E-shop	4	2	1	2	4	**3**
Optimizing retail-wholesale ratio	4	1	3	2	3	**1**
Product development						
Sustainable & Eco-friendly	3	4	3	3	2	**-5**
Denim	3	2	3	3	4	**-1**
Swimwear & Sunglasses	2	2	2	2	4	**0**
Supply chain management						
Reduce number of suppliers by 50%	5	1	3	1	3	**3**
Vertical integration	3	2	4	4	1	**-6**
Overall cost reduction	4	2	2	2	4	**2**
M/S commerce	2	3	3	3	2	**-5**
Working capital management	3	3	1	1	4	**2**
Cash dividend ratio reduction	3	1	2	3	2	**-1**

Note:
1-No discernible value, 2-low, 3-medium, 4-high, 5-A value that is beyond “high” or “off-the-chart”

VIII. BIBILOGRAPHY

1. David Simchi-Levi, P.K., Edith Simchi-Levi, *Designing and Managing the Supply Chain: Concepts, Strategies, and Case Studies*. 2009: McGraw-Hill Irwin.
2. China, D., *China Mergers & Acquisitions Playbook*, 2011, Deloitte Financial Advisory Services.
3. PwC(Shanghai), *Fashion Apparel Retail Sector Report*, 2012.
4. PwC, *2013 Outlook for the Retail and COnsumer Products Sector in Asia*, C. Yu, Editor 2012: Hong Kong.
5. Consultants, O.C.S., *Fashion Re-Designed: China Apparel 2020*, 2012.
6. HKICPA, *Qualification Programme Learning Pack - Module B*. 2012.
7. International, E., *Apparel Routes to Market*, 2012, Passport.
8. Kurumlu, E.S., *Esprit Holdings Equity Research*, in *Asia Pacific Equity Research*2012, J.P.Morgan: Hong Kong.
9. China, D., *China's Consumer Markets: A closing window of opportunity*, 2012: Shanghai.
10. Angela Moh, R.G., Dustin Wei, *Esprit Holdings: Rights Issue Suggests Still Chellenging Outlook*, 2012, Morgan Stanley.
11. Andrew Underwood, S.A., *Supply Chain Agility: Managing Change-A study of supply chain maturity*, 2012, KPMG.
12. 11 Peer companies' annual reports. 2007-2013.

Key Database: Bloomberg, Wind, Reuters, Factiva, Hoovers, Passport, Economist Intelligence Unit, ISI emerging markets, Business source complete.

参考2

HFIC’s

Strategies & Decisions

QP 2013

Executive Summary

This report conducts a corporate appraisal of HFIC based on external and internal analysis, and recommends a set of strategies and an integrated implementation plan for the company to realize greater profitability and improve operating efficiency in five years. Ethical issues and suggesting solutions will also be covered in the report.

Methodology of analysis includes Porter's Five Forces Model, SWOT analysis, adjusted Ansoff Matrix, indicator and scenario analysis, and Balance, Cash Flow and partial Income Statement projection in five years. Results of analyzed data show that HIFC has a satisfactory performance in profitability and solvency, yet facing environmental and operational challenges, which require corresponding managerial actions. Strategic recommendations provided in this report include:

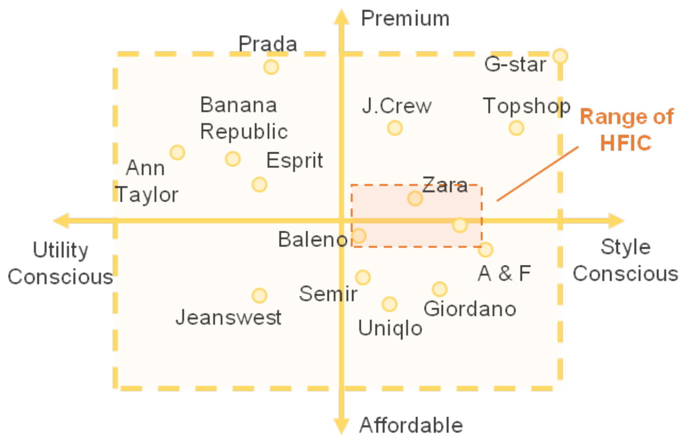
- Financial Consolidation
- Aggressive expansion in PRC while remain usual in Europe
- Denim goods as the new product range development
- Multichannel distribution
- Strategic sourcing and production optimization
- Improve Just-In-Time (JIT) efficiency

There are some limitations in this report's analysis and evaluation. Forecasting figures may not be precise due to the absence of detailed data.

Table of Contents

1. Introduction

High Fashion International Company Limited (HFIC), a Hong Kong-based company listed in 2007, specializes in high-fashion, self-designed, ready-made, and medium-to-top ranked garment retail market (see the industry positioning map). Its corporate values respect social and environmental responsibility. With its global footprints in Europe, the U.S., Japan, and PRC, it provides affordable, stylish and reliable apparel products for both female and male customers aged from 3 to 40 year-old. Currently major problems facing it are inefficient asset management, rising production and operation cost, feeble growth impetus in Europe. This 5-year proposal aims to bring HFIC's current **net income to HKD 7,463 million,** and **EBITDA/Sales,** namely **operating efficiency, to 20.44%.**



2. External Analysis

2.1 Industry Overview

As a trend-driven industry with fluctuating growth (forecasted CAGRs 4.0% in 2012-2017)[1] , the global apparel market is fragmented by numerous competitors without a sole market leader. Under the previous economic crisis, a trend of fast fashion has risen recently. Successful competitors must deliver products to the market rapidly, meet customers' needs correctly, keep costs under control and

[1] From Companies and Markets.com

facilitate global collaboration. However, quality, stylish outfit, and brand personality are emphasized, since more popular apparel companies tend to incorporate the most updated ideas originated from runway shows into affordable high-street designs.

To look into the details of global external environment, analysis in Porter's Five Forces Model (see Appendix 1) indicates a **moderate level of rivalry**. **Supplier power is low** since majority of manufacturers are labor-intensive SMEs. Low barriers to entry, low capital requirement, low switching cost and low level of product differentiation contributes to **high threats from new entrants**.

2.2 Upstream Analysis

Generally, apparel industry suffers from rising production cost pressure. Prices of raw materials differ divergently across geographical origins, but scattered small-sized manufacturers are unable to optimize raw materials procurement. Remarkably, world cotton price decreases enormously in 2013 and will continue to decline slightly in next decade[2]. In terms of labor cost for garment production and tariff preference, southern and south-eastern Asian countries gain advantages[3] over PRC, making **strategic sourcing**[4] more important.

Comparison of Divergent Cotton Price

Country	HKD/lbs
Pakistan	7.34
Spain	7.41
India	7.53
China	11.33
US	6.78

From: Fibre2fashion.com

2.3 Downstream Analysis

Though Europe obtains large market value in the apparel industry, its growth remains feeble (CAGRs of 1.3%) under slow economic recovery, while **PRC (CAGRs**

2 From "OECD-FAO Agricultural Outlook for 2013-2022" by oecd.org
3 Hourly wage (HKD): India 5.04, Bangladesh HKS1.63, China HKD7.2122. From Institute for Global Labor and Human Rights
4 **Strategic Sourcing** is an institutional procurement process, conducted by 3rd party sourcing agent, such as Li & Fung, APL Logistics, that continuously improves and re-evaluates the purchasing activities of a client company.

of 23%) [5] becomes the growth engine. PRC will outperform Europe in macro-economy in five years (see Appendix 2). In PRC, the middle-and-affluent-class consumers and the post-1980 generation become the pillar in clothing purchase[6]. Online shopping in China, compared to that in Europe, is booming rapidly yet under-exploited, in which apparel is the most popular category.

A cost-and-benefit analysis indicates that, ceteris paribus, investing in PRC is more profitable than in Europe and will realize EBITA/Sales target in 2016.

Projected Income Comparison between Investing in PRC and Europe							
China	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Turnover	2,363	3,012	7,410	13,671	21,486	27,576	35,332
COGS	(1,099)	(1,536)	(3,631)	(6,699)	(10,528)	(13,512)	(17,313)
Operating Expense	(737)	(1,084)	(2,797)	(5,163)	(8,164)	(10,474)	(13,493)
Operating Profit	527	392	982	1,809	2,793	3,590	4,526
EBITA/Sales	24.40%	15.65%	16.90%	18.10%	19.24%	**20.33%**	**21.37%**
Europe	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Turnover	28,687	25,181	39,326	53,834	66,349	69,606	72,936
COGS	(13,346)	(12,842)	(19,270)	(26,379)	(32,511)	(34,107)	(35,739)
Operating Expense	(10,073)	(10,275)	(16,467)	(22,101)	(26,707)	(27,226)	(27,744)
Operating profit	5,268	2,064	3,589	5,354	7,131	8,273	9,453
EBITA/Sales	20.48%	10.82%	12.32%	13.75%	15.11%	16.40%	17.64%

Cost-Benefit Analysis	PRC	Europe
Present Value of Total Capital Expenditure in (HKD million)	22,374	23,253
Annual Income Growth Rate	**60.23%**	**35.25%**

3. Internal Analysis

3.1 Financial Analysis

According to the indicator analysis below, HFIC manages well in solvency and profitability compared to industry average, yet problems arise in following aspects:

1) Excessive net working capital (NWC) might damage HFIC's potential profits

[5] From fibre2fashio.com News Desk, October 19, 2012
[6] From National Bureau of Statistics of China, 2011

and increase risks. The Just-In-Time (JIT) system has not efficiently reduced the inventory level; high receivables from wholesale stores result in liquidity risk; thus cash conversion cycle of HFIC is relatively long.

2) Net operating cash flow is insufficient to cover capital expenditure and current liability. Though HFIC is at satisfactory cash position, its excessive cash dividend payout retards future expansion.

Moreover, bad debt expense in the early three years will be high due to economic recession in Europe and closure of wholesale stores which are not performing well. Additionally, the adverse exchange rate movements may cause loss.

	HFIC		**Average**[7]	**Difference** (2012)
	2012	2011	(2012)	(HFIC v.s. Average)
Short-term Solvency				
Cash ratio	1.10	0.98	0.91	21.18%
Long-term Solvency				
Total debt ratio	0.41	0.31	0.31	31.63%
Profitability Measures				
Profit margin	7.26%	15.13%	8.95%	-18.84%
Return on asset (ROA)	13.31%	32.72%	15.59%	-14.61%
Operation Efficiency	11.29%	20.75%	14.79%	-23.68%
Operating Cash Flow Management				
Current liability coverage	0.03	N/A	0.58	**-95.18%**
Capital Asset Ratio	0.14	N/A	1.84	**-92.39%**
Asset Management				
Days' sales in inventory	70.00	64.09	73.83	**-5.19%**
Days' receivable outstanding	32.07	27.78	16.43	**95.23%**
Cash conversion cycle	16.32	9.56	15.88	**59.10%**

3.2 Qualitative Analysis

We approach HIFC's internal performance by conducting SWOT analysis (see Appendix 3). HFIC's **strong** design team, international outsourcing capacities and global reputation of quality and social responsibility enable it to provide most-updated,

[7] Average is calculated from 5 homogeneous companies: Giordano, Uniqlo, H&M, GAP, and Ann Taylor

diversified and reliable products. It also enjoys strong bargaining power over small-sized manufacturers. However, lack of characterized brand image may obstruct it to be differentiated. Unsatisfactory JIT system performance and **weak** control of outsourcing manufactures hinder its growth. **Opportunities** facing HFIC include expansion in China, multichannel sales (online and franchising stores), more motion-and-personality-aware customers[8], and the increasingly welcomed denim trend. Under sluggish economic recovery, the durable yet fashionable denim products will reach $56 billion by the year 2018 at a CAGR of 5.5%[9]. Meanwhile, HFIC needs to cope with **threats** of rising production cost, intensifying competition in fast-fashion, and currency risk.

4. Strategies Evaluation and Recommendations

Based on the appraisal above, we recommend HFIC a financial strategy, an expansion strategy to grasp profitability potentials, and a consolidation strategy to reduce cost and improve efficiency.

4.1 Financial Strategy

The following financial recommendations aimed to solve overwhelming NWC, insufficient net OCF, and adverse exchange rate movements.

1) HIFC should reduce NWC in terms of inventory by enhancing just-in-time system, and receivables by shutting down wholesale stores of bad credibility rating to reach a receivables turnover of 16.07 in 2017 (see Appendix 4).

2) HFIC should replenish net operating cash flow by increasing net income and decreasing dividend payout. The saved dividends should be utilized to cover surging

[8] *"Dressing Up"*, Boston Consulting Group Publications, 2011
[9] FARMINGTON, Conn., Dec. 6, 2012, RNewswire-iReach

capital expenditure.

Moreover, bad debt loss can be reduced via credibility rating method mentioned above. Also, HFIC should hedge adverse exchange risk with Eurodollar futures.

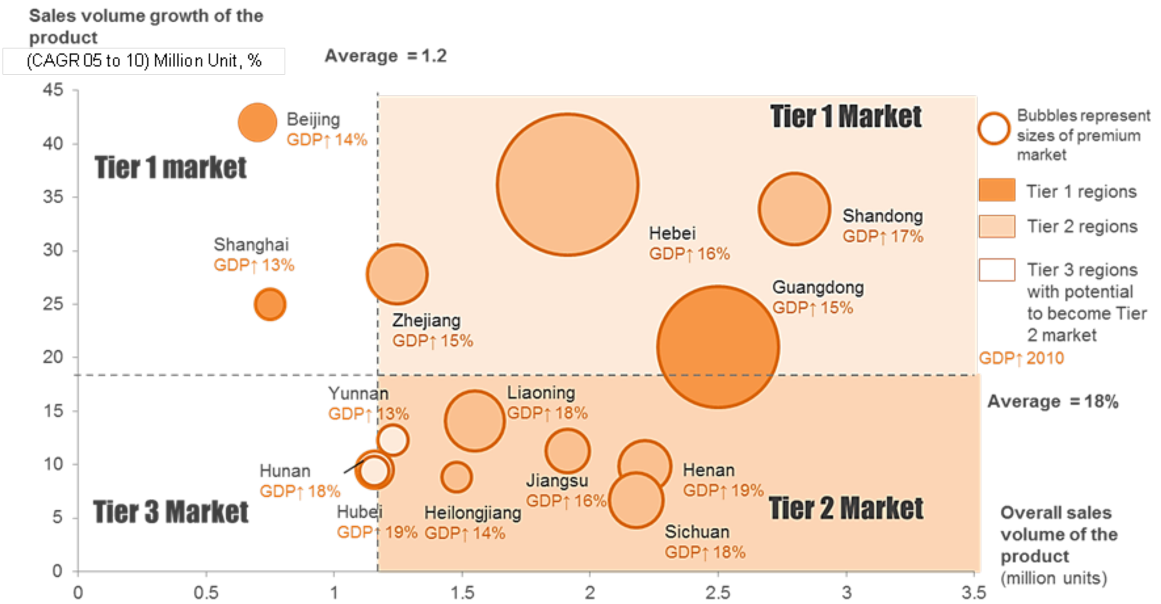
4.2 Growth by Strategic Expansion

4.2.1 Aggressive Expansion in PRC

According to the comparison between investing in PRC and Europe above, it is recommended that HFIC should expand in PRC aggressively, while maintain its previous strategies and stable growth in Europe till further economic recovery.

4.2.1.1Penetration in different city tiers in PRC

Chinese Different Tier Provinces with its GDP Growth and CAGR of Apparel Industry



Source: Value Partners analysis

HFIC should both strengthen its market exposure in Tier 1 cities, and penetrate into lower-tier cities to seize potential market shares. The Chinese apparel market centers on the fastest growth in Tier 2 and Tier 3 cities[10].

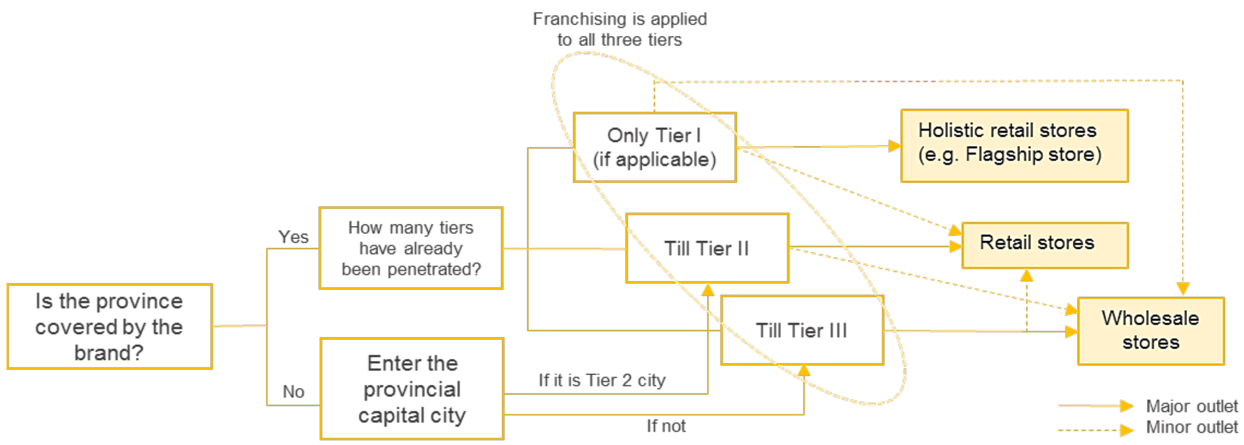
In the process of penetration, HFIC should organize its multichannel distribution strategically, supported with corresponding marketing activities to increase customers'

[10] *Capturing the Dynamics of China's Fashion Growth*. Boston Consulting Group.

exposure to fashion in lower-tier cities. A comparison of wholesale, retail and franchising stores indicates that HFIC should selectively open different type of shops in relevant tiers.

		Wholesale store	Retail store	Franchising store
Advantages		• Small investment	• High gross profit & low receivables • Enhance customer experience	• Low cost • Rapid market share growth
Disadvantages		• High receivables	• Heavy investment	• Higher receivables
Recommendations	**Tier 1**	• Open few stores	• Mainly large holistic stores (i.e. flagship)	
	Tier 2	• Open stores subject to credit rating	• Mainly medium-size retail stores	All three tiers applied
	Tier 3		• Small stores with limited product category	

Based on the features of different tiers and outlets, a comprehensive **decision model** is provided below.



HFIC is recommended to set up 1) holistic retail stores and flagship stores in Tier 1 metropolies; 2) retail and wholesales stores in Tier 2 cluster centers; 3) smaller outlets in Tier 3 cities. In addition, franchising stores, due to its flexibility and low investment requirement, should be widely opened in all three tiers.

HFIC should also expand its **online platform** to incur more direct sales and facilitate promotion towards more price-sensitive customers, such as discounted sales of past-seasoned products and premium-priced sales of special collections.

4.2.1.2 Entry Mode: Form an equity joint venture with major competitor

	Joint Venture with Glamour (or alternative local partner)	Merge & Acquire a Local Partner	Self-owned Subsidiary
Cost			
Start-up Cost	Moderate	High	Moderate to High
Restructuring Cost	Moderate	High	Low
Political Risk	Moderate (bears partial risk)	High	High
IPR Risk	Moderate to High	Low (full control)	Low (full control)
Benefit			
Entry into Market	Fast (benefits from local partners' connection& local practices)		Slow (grow business from scratch)
Return on Investment	Moderate (returns shared by both parties)	High	High
Market Presence	Moderate to Strong (direct access, or direct presence)	Strong	Strong
Control Over Strategy	Moderate to High (subject to the % of shares holding)	High	High
Overall Acceptability	★★★★★	★★☆☆☆	★★★☆☆

By evaluating three alternative entry modes, it is recommended that HFIC should negotiate with Glamour to form a medium-to-long term **equity joint-venture (EJV)** in PRC. Though the return may be lower than fully-controlled subsidiary or acquisition, EJV enables HFIC to enter the market more cheaply and faster, and enjoy a sharing of liability and risks (market fluctuation, government interference, etc). The core strategic alliance lies in Glamour' strong intention of entering into the medium-to-top ranked segment emphasizing more on design and quality, and HFIC's aggressive China-expansion strategy.

	HFIC	Glamour
Contribution	● Professional experience in new product design (without sacrifice the core and rooted IPR) ● Advanced JIT system ● Mature experience in high-quality branding operations	●Distribution channels ● Local markets first-hand information and surveying capabilities ●Well-established with local governmental departments and regulatory laws

Benefit	● Glamour's distribution channels ● Greater market share, yet low market entry costs ● Diminished political risks	● Diversification in products and market (from low to medium-to-top rank) ● Increased profitability ● Advanced management experience
Mutual Sharing	● Shared liability, shared risks, shared costs and resources	

To form an effective EJV, HFIC should consider a variety of relevant issues, including capital contribution, ongoing financing needs, profit distribution, and management control in the negotiation, as well as balance between both parties' benefits and bargaining power. Some of the major concerns are listed below.

EJV Participation Consideration	Recommendation to HIFC
Maintenance of control	● Hold majority of shares (>50%) ● Establish China Sales Division and appoint local managers
Maintenance of brand image	● Insist the control of brand name of the new shops, and the label of the products (amounts to "buying the naming right")
Possible exposure of intellectual property	● Draft provisions related to the sharing of intellectual property in details, and provide terms on protection against IPR in the contract ● Contribute more via license rather than assignment
Lack of motivation by Glamour	● Consider provide Glamour with veto power with respect to specifically delineated "extraordinary" decisions

In case either one or both parties agree to terminate EJV in the future, a context for future negotiation on "an appropriate exit" should be prepared. HFIC should repurchase the shares of EJV instead of selling it to a third party. Alternatively, if negotiation with Glamour fails, HFIC could try other companies in a different segment, but wishing to expand presence in medium–to-top ranked fashionable casual wear.

4.2.1.3 Maintain the current pricing strategy

It is recommended that HFIC should maintain its current pricing strategy, instead of positioning itself as a "cheap brand", especially under global rising production cost pressure and increasing purchasing power in PRC. As other foreign brands generally have a higher gross margin than local players, HFIC should maintain its reputation and image to be differentiated from local brands by enhancing pleasant shopping experience (e.g. store decoration, staff-training), design and quality.

Gross Margin Comparison: Selected Foreign & Domestic Brands

Type	Foreign Brands				Local Brands		
Company	HFIC	Ann Taylor	Giordano	H&M	Baoxiniao	Metersbonwe	Semir
Gross Margin	49.00%	54.82%	58.72%	59.50%	41.10%	43.90%	30.37%

4.2.1.4 Acceptability of the PRC Expansion Project

We evaluate the acceptability of the expansion project in PRC by scenario analysis based on the projected income in Part 2.3. The worst-case scenario is still within HFIC's risk tolerance.

Operating Profit	527	392	982	1,809	2,793	3,590	4,526
Best Case	527.	392	1,360	2,506	3,889	4,997	6,328
Worst Case	527	392	604	1,112	1,698	2,184	2,724
Efficiency	24.40%	15.65%	16.90%	18.10%	19.24%	20.33%	21.37%
Best Case	24.40%	15.65%	20.00%	21.09%	22.13%	23.12%	24.07%
Worst Case	24.40%	15.65%	11.80%	13.00%	14.14%	15.23%	16.27%

4.2.2 HF| Denim: New Product Range Development

4.2.2.1 Internal Positioning and Brand Image Consolidation

HFIC should establish a formal mission statement, and consolidate its product-mix by clarifying existing brands' images. Afterwards, it should launch denim products as the new product range based on this.

Mission Statement	To inspire our employees' innovation and personal advancement; To create values to our customers with considerate services and reliable products; To take responsibility for the stakeholders and sustainable development.			
Adjusted Ansoff Matrix				
HFIC Product Mix	Existing market			
	25-35 year-old mature ladies	30-40 year-old mature men	18-25 year-old young adults	3-10 year-old kids
Market penetration & Consolidated brand image	Women's fashion:	Men's fashion:	HF Star:	Kids' fashion:
	Smart, fashionable inspirational, elegant	Relaxed, mature, terse, reliable	Affordable, stylish high-street, trendy colorful, young	Cute, comfortable, safe, fashionable.
New Product Range Development	**Denim**: Casual, fit, comfortable, easy-going, classic, all-purpose, durable			

4.2.2.2 External Positioning

It is recommended that HFIC position the HF|Denim in the style-conscious range at an affordable price. To grasp new profit growth out of this classical type of product, HFIC should emphasis on the innovative and fashionable designs, especially introducing functional features (e.g. water resistance, wrinkle resistance, moisture wicking), and other forecasted trends in 2013[11].

Denim Product Positioning Map

4.2.2.3 Feasibility and Acceptability of the HF|Denim

Considering feasibility, over 50% of global denim production is based in Asia (majorly China, India, Pakistan and Bangladesh)[12], where are exactly HFIC's outsourcing destinations. Also, given the positive NPV of HKD 598 million (basic case), it is financially acceptable (detailed cash flow projection see Appendix 5).

	Basic Case	Best Case	Worst Case
NPV (HKD million)	286	425	147
WACC	13.31%	13.31%	13.31%
IRR	31%	36%	24%
Payback Period	3.98 years	3.64 years	4.16 years

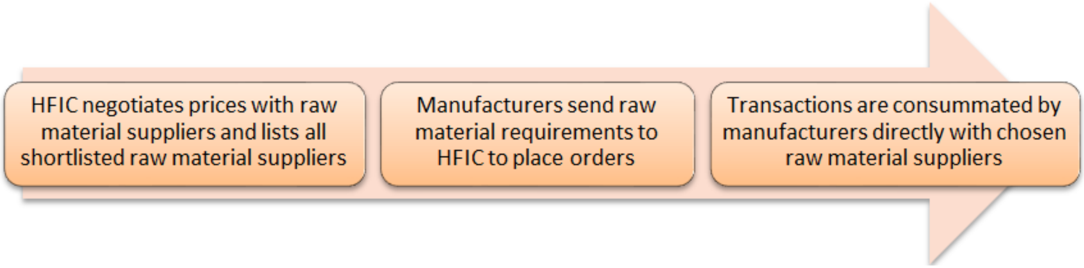
4.3 Cost Reduction by Operation Consolidation

4.3.1 Raw Materials Acquisition and Production Optimization

While continuing its past policy of contracting production with large number of small-sized manufactures to spread the risk of supply shortage and insolvency, HFIC

[11] FARMINGTON, Conn., Dec. 6, 2012 /PRNewswire-iReach/
[12] Source: Cotton Incorporated.

should transfer production from China to southern and south-eastern Asia. Moreover, to help SMEs optimize materials acquisition at lowest cost, HFIC may cooperate with an apparel sourcing agent, such as Li & Fung, for centralized Strategic Sourcing glob



4.3.2 Integration of Supply Chain for JIT Efficiency

To increase inventory turnover and better fulfill lead-time orders, HFIC should consolidate company structure and IT systems[13] (use SAP Apparel and Footwear System, i.e., SAP-AFS, as examples) to increase efficiency in supply chain.

Company Structure (See Appendix 7)	Manufacturing: Establish small-sized **procurement offices** near outsourcing destinations, to test sample garments immediately, ensure production quality and manage efficient purchase of finished goods.
	Distribution: Assign "**regional centralized warehouse**" as distribution center to sales-dense location, to implement centralized inventory management and allocation for covered stores within the region.
	Sales: Set up **China sales division** for regional management; Merge Germany division, France division and the rest of Europe division into **Europe sales division** for integrated control; Establish **Denim product division** focusing on developing new product range
IT Systems	Manufacturing: **Manufacturing Resource Planning (MRP) System** plus **Processing Operations Externally** (i.e., granting external manufacturers permission to partial system) to ensure manufacturing orders to be placed just in time
	Distribution: **Allocating Run (ARun) System** to improve logistics and distribution efficiency by collaborating relevant departments; to feed right volume of inventory (efficiency improved 25%) by automatically allocating stock
	Sales: **Wholesale Store Relationship Management (CRM) System** to place and execute short lead-time orders from wholesaler, and to recommend wholesale stores about current season's best-sellers so that they will order in advance accordingly

[13] Total **estimated investment** in PPE HKD 15 million, proposed by SAP

4.3.3 Improvement in Efficiency of Other Operations

HFIC should improve efficiency in the overall operation. From back-office level, it should use IT systems, such as SAP-AFS Business Intelligence module, to reduce manual and duplicate operations to control staff costs. From sales level, especially in retail stores, HFIC should enhance sales effectiveness by improving customer experience to increase average unit of purchase per try-on and sales per store.

5. Implementation Plan and Feasibility

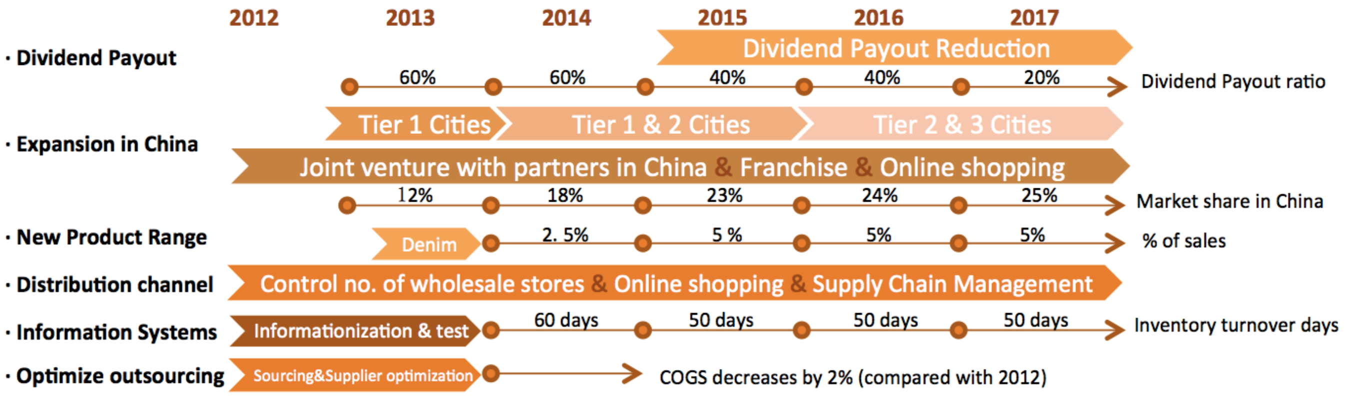
5.1 Financing and Implementation Plan

A strong correlation exists between expansion strategy and cost reduction strategy (strategic sourcing and operation consolidation). We use a combined cash flow projection to approach their financial feasibility (see comprehensive cash flow projection in Appendix 8).

HKD (million)	2013	2014	2015	2016	2017
Operating Cash Flow	5,267	6,728	8,673	10,404	12,489
Investment	(2,221)	(4,600)	(6,064)	(9,020)	(14,045)
Change in NWC	569	756	27	(213)	(325)
Project Cash Flow	3,614	2,883	2,636	1,172	(1,881)
Cumulative Cash Flow	3,614	6,498	9,133	10,305	8,424
Discounted Cash Flow	3,614	2,545	2,053	806	(1,141)
NPV	6,951.23		WACC		13.31%

Three major financing sources will be utilized: former strong cash position, reduction of dividend payout, and bank loans. HFIC can finance projects with retained earnings in the first two years, and repay part of the bank loans in the first three years. Starting from 2015 and 2016 respectively, HFIC should reduce dividend and incur bank loans to finance the surging capital expenditure. The high demand for financing is due to booming market size of China and increasing market share captured by HFIC. However, capital expenditure will diminish under decelerated growth in the overall economy in China subsequently (Chinese government's "soft landing policy").

Based on this financing schedule, an implementation plan is presented below.



5.2 Scenario Analysis and Risk

Strong cash flow projection as HFIC has, we approach its ability to bear possible risks by conducting scenario analysis.

	Basic	Expansion in China		Cost Reduction by Consolidation			
		Revenue		Procuring Optimization (COGS)		Cost Control (Operating Cost)	
Scenario	0%	10.00%	-10.00%	2.00%	-2.00%	5.00%	-5.00%
Profit Margin	11.36%	12.74%	9.84%	9.81%	12.92%	8.03%	12.93%
EBITA/Sales	20.44%	22.00%	18.70%	18.44%	22.44%	16.16%	22.45%
Net Income Growth Rate	27.04%	31.34%	22.07%	23.35%	30.35%	18.51%	30.37%

HFIC should consider potential risks as follows.

Declining dividend payout may cause stock price to drop temporarily. Expansion in China under EJV may not reach market size growth rate, or satisfy expected expansion of market shares. Strategic sourcing largely subjects to the variation in the global price level and future price of cotton and labor. Manufacturing outsourcing may undermine CSR and ethical reputation. Operational cost control (especially of human resources and occupation) is less effective in increasing profitability and operating efficiency. Staff may get unaccustomed to new IT systems provided by SAP.

6. Ethical Issue Analysis

I. Determine the Facts and Define the Issues

Chris Lee, HFIC's COO, had acquired Elite Fashion's shares at low price and then recommended the acquisition to HFIC, without disclosing his interest relation. Thus he made large personal profit. According to Hong Kong Securities & Future Commission, corporate Directors and CEOs must disclose their interest in shares of any associated corporations. Since the trade was conducted based non-public information, Chris Lee was suspected to have involved in internal trading.

II. Identify the Major Principles, Rules and Values

• **Objectivity:** Mr Chan, the chairman, shall make judgement based on unbiased advice and ethical norms, not on friendship with Chris Lee.

• **Integrity**: Mr. Chan should not be associated with any information that contains a misleading statement to avoid conflict of interests.

III. Specify the Alternatives & Evaluate Consequences

Three alternatives facing Mr. Chan are evaluated as follows.

Alternatives	Advantages	Disadvantages
• Warn Chris privately • No disclosure or punishment	• Avoid to frustrate shareholders • Keep an experienced manager	• Violating objectivity & integrity
• Disqualify Chris as CEO candidate • No further disclosure	• Complied with objectivity • Ethical issue being addressed	• Not complied with integrity • Shareholders are ignored
• **Report the issue to Board of directors & auditing committee directly**	• Complied with objectivity & integrity • Draw the future ethical line	• Negative impact on shareholders' confidence • lose an experienced manager

IV. Make the decision

We suggest a direct report to Board of Directors and auditing committee. Stock price and corporate image may be negatively impacted in short run, but it is more important to maintain the ethical code and discipline of HFIC. Mr. Chan needs to consult Mary Leung and identify the seriousness of this issue, while Mr. Jiang should be excluded due to his close relationship with Chris.

References

International Joint Ventures Handbook, Baker & McKenzie. 2006.

OUTLOOK, A. OECD-FAO AGRICULTURAL OUTLOOK. AGRICULTURAL OUTLOOK, 2010, 2019.

Fashion Supply Chain Mnagement: industry and Business Analysis, 2011, T,-M. Choi, Editor, IGI Global, Hershey, PA, pp 1-20.

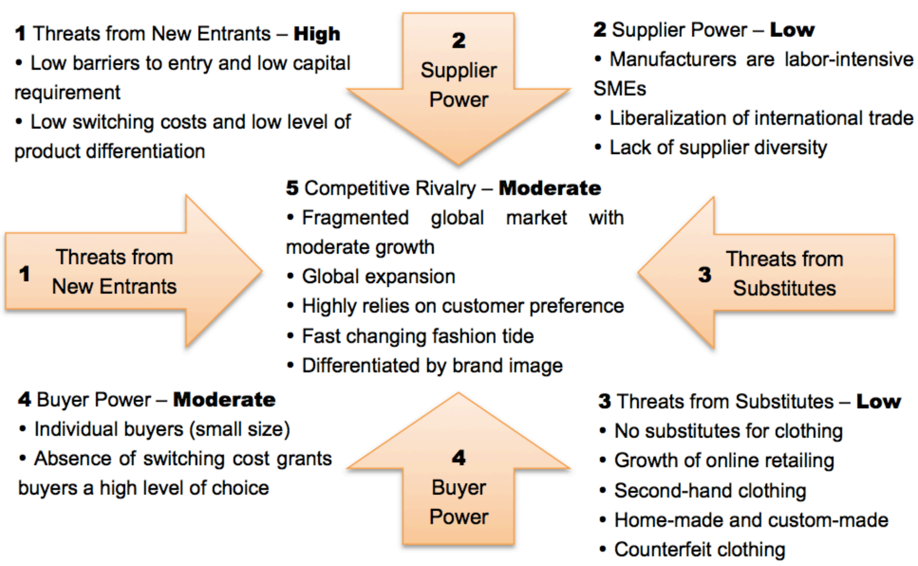
Modes of Foreign Entry: A Transaction Cost Analysis And Propositions. *Journal of International Business Studies*. Anderson, E. & Gatignon, H. 1985.

Strategic Sourcing for Total Cost Management: Turning Suppliers into Partners. ENOVIA MatrixOne. 2006.

Occupier Perspective Global Occupancy Costs – Logistics 2013. *DTZ Research*. 2013.

Appendices

Appendix 1 Porter's Five Forces Model



Appendix 2 Comparison of Macro-Economy between PRC and Europe

	2013	2014	2015	2016	2017
Real GDP Growth Rate (%)					
PRC	7.60	7.25	7.03	7.01	6.97
Europe	-0.34	1.07	1.45	1.60	1.62
GDP based on Purchasing Power Party (PPP) Share of World Total (%)					
PRC	15.43	15.98	16.46	16.93	17.40
Europe	13.21	12.84	12.49	12.15	11.83

Source: IMF World Economic Outlook Data Base, 2013

Appendix 3 SWOT Analysis

Internal / **External**	**Strength** 1.good reputation for affordable, quality and stylish, ethics and values 2.global footprint and diverse products 3.Constant updates of fashion designs	**Weakness** 1.Weak control over outsourced manufacturing 2.Inefficient working capital management 3.Unsatisfactory JIT system performance
Opportunity 1.Burgeoning China market, especially demand of youth 2.Cheaper manufacturing in less developed Asian countries 3.Trend of online shopping	**SO** • Explore high-to-medium ranked apparel market in China • Lead the fashion tide • Apply multiple distribution channels (e.g., broaden E-shopping)	**WO** • Joint venture in China • Transfer outsourcing into less developed countries • Reduce the percentage of wholesale stores appropriately
Threat 1.Aftermath of financial crisis (low purchasing power in Europe) 2.Rising labor and raw material costs 3.Fluacuting global currencies 4.More intensive competition among fast-fashion brands	**ST** • Maintain usual growth in Europe and adopt China-Strategy • Emphasize brand's emotional identification • Strategic sourcing of raw materials	**WT** • Establish procurement offices near outsourcing destinations • Cut down costs by establishing IT systems and consolidation

Appendix 4 Consolidated Receivables Projection

	2011	2012	2013	2014	2015	2016	2017
Receivables	**2,569**	**2,728**	**2,867**	**3,093**	**3,358**	**3,681**	**4,086**
Receivable turnover	13.14	11.38	12.52	13.77	15.15	15.60	16.07
Receivables and prepayments	**3,403**	**3,488**	**3,736**	**4,116**	**4,573**	**5,046**	**5,646**
Bad Debt Percentage	-7.62%	-11.17%	-15.21%	-19.06%	-22.74%	-21.24%	-19.71%

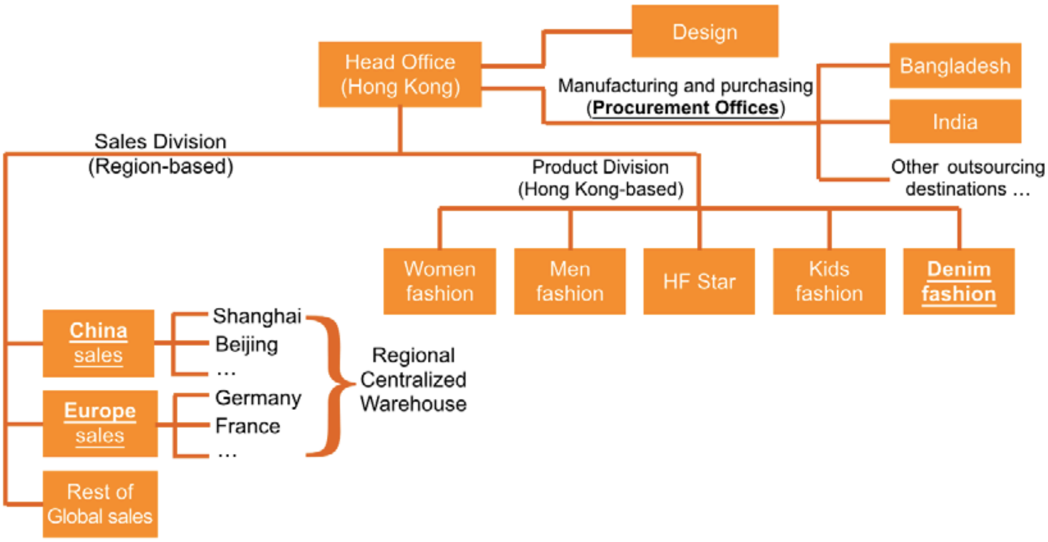
Appendix 5 Cash Flow Projection of HF|Denim

HKD million	2012			2013			2014			2015			2016			2017		
Case	Basic	Best	Worst	Basic	Best	Worst	Basic	Best	Worst	Basic	Best	Worst	Basic	Best	Worst	Basic	Best	Worst
Net Income				86	69	104	223	178	267	277	222	333	324	259	388	373	299	448
Investment	(89)	(89)	(89)	(84)	(84)	(84)	(132)	(132)	(132)	(102)	(102)	(102)	(73)	(73)	(73)	(52)	(52)	(52)
Change in NWC	(183)	(147)	(220)	(125)	(100)	(150)	16	13	19	(102)	(81)	(122)	(31)	(25)	(38)	426	341	511
Projected Cash Flow	(273)	(236)	(310)	(122)	(115)	(130)	106	59	154	74	39	109	219	161	278	747	587	907
Cumulative Cash Flow	(273)	(236)	(310)	(395)	(351)	(440)	(289)	(292)	(286)	(215)	(253)	(177)	4	(92)	101	752	495	1,008
DCF	(273)	(236)	(310)	(108)	(101)	(115)	83	46	120	51	27	75	133	98	169	400	314	486

Appendix 6 Balance Sheet Projection

HKD million	2013	2014	2015	2016	2017	HKD million	2013	2014	2015	2016	2017
Non-current assets						**Non-current liabilities**					
Intangible assets	1,794	2,556	3,053	3,446	3,940	Bank loans	1425	950	475	4000	8000
Property, plant & equipment	4,789	5,734	8,414	13,395	22,243	Deferred taxation	256	256	256	256	256
Total	**6,583**	**8,290**	**11,467**	**16,841**	**26,183**	**Total**	**1681**	**1206**	**731**	**4256**	**8256**
Current assets						**Current liabilities**					
Inventory	2,891	2,859	3,415	3,855	4,408	Payables and accrued expenses	4,131	4,904	5,856	6,611	7,559
Prepayments	808	873	1,031	1,252	1,560	Taxation	655	802	1,040	1,324	1,648
Receivables	2,669	2,652	2,865	3,171	3,582	Bank loans repayable within 12 months	475	475	475	1,475	2,475
Cash and cash equivalents	6,234	5,971	5,912	9,020	10,646	**Total**	**5,261**	**6,181**	**7,371**	**9,410**	**11,682**
Total	**12,601**	**12,355**	**13,223**	**17,298**	**20,197**	**Equity attributable to owners of the parent company**					
						Total equity	**12,242**	**13,258**	**16,588**	**20,472**	**26,442**
Total assets	**19,185**	**20,646**	**24,690**	**34,138**	**46,381**	**Total equity & liabilities**	**19,185**	**20,646**	**24,690**	**34,138**	**46,381**

Appendix 7 Suggested Company Structure



Appendix 8 Comprehensive Cash Flow Projection

HKD million	2012	2013	2014	2015	2016	2017
Cash flow from operating activities						
Profit Before taxation	2,751	4,348	5,634	7,059	8,272	9,576
Depreciation	816	990	1,394	2,090	2,787	3,818
Interest income	(89)	(89)	(89)	(89)	(89)	(89)
Finance costs	28	21	14	7	59	118
Impairment of property, plant and equipment	580	625	673	724	780	798
Impairment of intangible asset	15	26	37	44	50	57
Loss on disposal of property, plant and equipment	22	24	26	27	28	29
Increase in inventory	(280)	146	31	(555)	(440)	(553)
Increase in receivables and prepayments	(85)	11	(48)	(370)	(527)	(720)
Increase in trade payables and accrued expenses	179	411	773	952	755	948
Effect of changes in foreign exchange rates	(84)	0	0	0	0	0
Taxation paid (HK and overseas)	(1,026)	(746)	(1,035)	(1,273)	(1,514)	(1,789)
Total	**2,827**	**5,767**	**7,409**	**8,617**	**10,161**	**12,193**
Cash flow from investing activities						
Net Purchases of PPE	(1,689)	(2,221)	(4,600)	(6,064)	(9,020)	(14,045)
Interest received	89	89	89	89	89	89
Total	**(1,600)**	**(2,132)**	**(4,511)**	**(5,975)**	**(8,931)**	**(13,956)**
Cash flow from financial activities						
Dividends paid	(2,695)	(2,076)	(2,671)	(2,219)	(2,590)	(1,493)
Interest paid	(28)	(21)	(14)	(7)	(59)	(118)
Proceeds from bank loans	2375	-475	-475	-475	4525	5000
Total	**(348)**	**(2,572)**	**(3,160)**	**(2,701)**	**1,877**	**3,390**
Net increase in cash and cash equivalents	**879**	**1,064**	**(263)**	**(59)**	**3,107**	**1,627**
Beginning cash and cash equivalents at the	4,461	5,170	6,234	5,971	5,912	9,020
Effect of changes in foreign exchange rates	-170	0	0	0	0	0
Ending cash and cash equivalents	**5,170**	**6,234**	**5,971**	**5,912**	**9,020**	**10,646**

参考3

Tango Health and Beauty Limited

Vision and Future Development Strategy Report

Expansion through Integration

HKICPA Qualification Programme (QP) Case Analysis Competition 2014

TABLE OF CONTENT

1. EXECUTIVE SUMMARY

This report intends to evaluate Tango's current situation and assess the market opportunities, which exist for it to successfully outperform competitors. Existing challenges are identified and prioritized based on importance and urgency, whereas three potential strategies will be discussed in tackling these issues and helping Tango to become the most expedient option for customers. The implementation plan and financial impact of these strategies will be explicated through different assumptions and financial models. Certainly, the project will involve some risks but contingency plan will be carried out to remedy the situation. Moreover, Tango's corporate governance and the ethical issue regarding SlimFit will be revealed, which indicates that some internal policies can be enhanced to further improving the organizational structure of Tango.

2. VISION & MISSION

Vision

Tango strives to be Asia's leading health and beauty player. We rest on the skills of our employees to provide quality customer service and maximize shareholder value.

Mission

- Offer comprehensive and quality services and products to our customers
- Inspire our employees to be the best they can be with quality training and support
- Nurture a winning network of customers and suppliers
- Be a highly effective and fast-moving organization
- Maximize long-term return to shareholders while being mindful of our overall responsibilities

3. SITUATION ANALYSIS

3.1. Market Overview

In 2012, the market size of Asia-Pacific in the beauty and personal care industry has grown by 5.2%[1]. Owing to the rising income and awareness of personal appearance among Chinese consumers, the PRC is of the highest growth potential[2]. Brisk demand over Beauty and Facial (B&F) treatment and rise of medical beauty are observed[3]. In addition, there is a rising need of qualified manpower[4]. Another two new trends worth mentioning are value chain consolidation and mobile penetration[5].

3.2. 3C Analysis: Company, Competitors and Customers

Company

Currently, 83% of Tango's revenue originates from Hong Kong (HK), while Singapore (SG) and PRC market account for 13% and 4% respectively.

STRENGTHS	WEAKNESSES
High reputation in services and equipment Wide range of services and products Strong cash position Promising dividend payout	High staff turnover High operating cost Imbalanced board composition High leverage ratio
OPPORTUNITIES	**THREATS**
Growing PRC beauty and healthcare market Rapid growth in online retailing Brisk demand of beauty & facial service Technology development on medical beauty	Continuing global economic downturn Risk of medical beauty Competition with other multinational brands

Fig. 1 SWOT Analysis

In view of the growing PRC market and brisk demand of qualified manpower (Fig. 1), Tango is considering 3 major strategies. With our strong cash position (Section 6.2.), these strategies are believed to be effective and feasible.

---

[1] Warangkana Anuwong. (2013). *In-Cosmetics Asia 2013 - Beauty & Personal Care: What the Future Holds.* Retrieved from http://blog.euromonitor.com/2013/11/in-cos-asia-2013-beauty-and-personal-care-what-the-future-holds.html
[2] Euromonitor International. (2014, May). *Beauty and Personal Care in China.* Retrieved from http://www.euromonitor.com/beauty-and-personal-care-in-china/report
[3] The American Society of Plastic Surgeons. (2013, Oct 28). *Plastic Surgeons Should Prepare for 'Globalization' of Cosmetic Surgery, Says Article in PRS Global Open.* Retrieved from http://www.plasticsurgery.org/news/past-press-releases/2013-archives/rise-of-medical-tourism-shows-impact-on-cosmetic-surgery-market.html
[4] Education Bureau. (n.d.). Beauty Industry. Retrieved from http://www.hkqf.gov.hk/guie/SCS_ind_Beauty.asp
[5] Reenita Das. (2014, Jan 31). *Top 4 Healthcare Predictions for 2014 - Asia*. Retrieved from http://www.forbes.com/sites/reenitadas/2014/01/31/top-4-healthcare-predictions-for-2014-for-asia/

Competitors

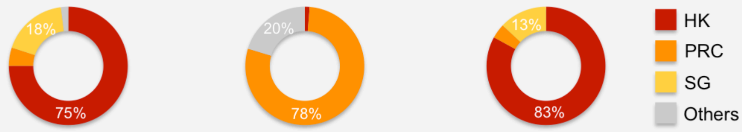
	Modern Beauty (0919.HK)	Natural Beauty (0157.HK)	Tango
Geographic Segmentation			
Dividend Payout	44%	72%	120%
Market Focus	Beauty and Facial Retailing HK Expansion	Service Training (6% of total revenue) Retail & R&D PRC Expansion	Integration of service lines (Refer to section 4) HK & PRC Expansion
Existing/Future Strategies	Training Centre Online Reservation Sole Agency with 8 Brands	Training Centre Online Retailing (Tmall) Owning Retailing Brand Franchise Network	MOSTrategy Tango Academy Tango Club (Refer to section 4)

Fig. 2 Comparison with Major Competitors

Customers

In 2014, Tango's existing markets (i.e. HK, PRC, SG) recorded GDP growth ranging from 2.9% to 7.7%[6]. Due to the changing lifestyles and rising disposable income in these regions, there are higher demands over beauty and health services from wealthy families and professional women. In addition, beauty and healthcare products have received attentions from customers in all regions. However, as for the Slimming and Fitness (S&F) division, customers in HK and SG begin to lose interest.

3.3. Prioritization of Issues

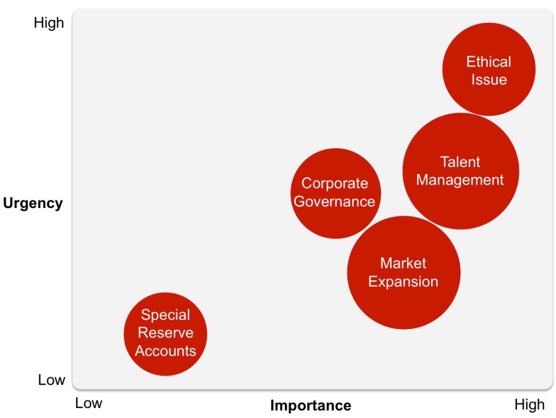


Fig. 3 Prioritization chart

Issues	Reasons
1. Ethical Issue (Section 8.)	Highly important and urgent Examine risk of blood transfusion on customers Affect the decision made by senior management on SlimFit Affect senior management's bonus
2. Talent Management (Section 4.3.)	Very important and urgent Decrease staff turnover and overbooking Decrease employee benefit expenses
3. Corporate Governance (Board Composition) (Section 7.)	Important and urgent Achieve a balanced composition of board members Affect Tango's long term strategic planning
4. Market Expansion (Section 4.1.)	Important but not urgent Expand the business after strengthening Tango's foundation
5. Special Reserve Account	Not urgent Increase deferred revenue but do not affect the realized cash flow

Fig. 4 Supplementary Information – Prioritization of Issue

[6] The World Bank. (n.d.). *GDP Growth (Annual %)*. Retrieved from http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG

4. FUTURE STRATEGY

4.1. Our Business – MOSTrategy

4.1.1. Mainland China Expansion

At present, our revenue from the PRC is relatively low (i.e. 4%). In light of China's growth potential, Tango will:

- **Expand and refurbish our flagship store in Shanghai**: The flagship store will be a one-stop beauty center with Chinese contemporary design in presenting an up-market image and providing a one-stop shopping experience to customers.
- **Integrate Traditional Chinese Medicine (TCM) to our service:** TCM beauty and health services as well as products will be offered in catering to Chinese consumers' preference over herbal and traditional products[7].
- **Extend reach to lower tier cities through Tmall.com and social websites:** In view of the growing online retail sales in China beauty industry[8], a Tmall store will be set up to reach a wider Chinese audience. Tmall is responsible for 45% of Internet retailing value in China[9], featuring authentic and top-quality brands. Tango will also increase its online presence by developing mobile app (Section 4.2.3.) and making use of social websites, for example, Sina Weibo and WeChat for promotion.
- **Franchise S&F centers in PRC in the long run:** In light of the growing health consciousness in PRC and the weight-loss trend among Chinese women[10], S&F centers will be franchised in the long run, after the launch of TPPS (Section 4.2.1.) and establishment of flagship store.

[7] Euromonitor International. (2014, Jul). *Herbal/Traditional Products in HK, China.* Retrieved from http://www.euromonitor.com/herbal-traditional-products-in-hong-kong-china/report
[8] Intertek. (n.d.) *Intertek Taobao Store Offers Quality Assurance for Business to Win in E-commerce Market.* Retrieved from http://www.intertek.com/consumer/news/v105-intertek-taobao-offers-qa-for-business-e-commerce/
[9] Euromonitor International. (2014, Mar). *Internet Retailing in China.* Retrieved from http://www.euromonitor.com/internet-retailing-in-china/report
[10] International Markets Bureau of the Government of Canada. (2011, Feb). Health and Wellness Trends in China (ISSN 1920-6615 Market Indicator Report). Retrieved from http://www.ats-sea.agr.gc.ca/asi/5736-eng.htm

4.1.2. Optimization of Beauty and Facial Division in Hong Kong

In view of the brisk demand for B&F treatments, Tango will:

- Open four beauty clinics in two years to achieve performance optimization
- Establish Tango Academy (Section 4.3.) to improve employee productivity and efficiency

4.1.3. Supply Chain Management

To effectively manage flow of goods, Tango will

- Initiate sole agency relationships with existing suppliers to ensure supply stability and quality
- Collaborate with The Shahnaz Husain Group, one of the world's leading herbal suppliers from India, who is currently seeking distributors from HK and Mainland, for our herbal supply in PRC expansion
- Distribute products in online and offline stores (i.e. Tmall and outlets)
- Implement Enterprise Resource Planning (ERP) System to facilitate information flow among all business functions and manage connections with outside suppliers and distributors, particularly service delivery, marketing and sales, inventory management and shipping payment

4.1.4. Tango's Sustainable Business Growth

Considering the rise of medical beauty, Tango leverages its R&D expertise on medical beauty industry by investing in its in-house laboratory to further a growth in the coming decade. Additional cash flows generated from applied patents can be used to further finance R&D projects.

4.2. Our Customers – Tango Club

To gain insight into existing and potential customers behavior, Tango Club along with iTango will be launched to strengthen our brand loyalty and to acquire big data.

4.2.1. Tango Point Payment System (TPPS)

Tango Points (TPs) will be used for purchase under TPPS, whereas customers can add TPs to membership cards by cash to credit card. TPs can be used across service lines and regions (except online retailing), providing flexibility to the growing number of high-end customers who often travel between PRC and HK[11]. Extra TPs will be rewarded for bulk purchases. In addition, TPs will be withheld for reserving service package and written off when service is performed.

4.2.2 Tango Club Membership Scheme

Customers with an annual spending of $100,000 will be entitled to be our "Centurion" member and be rewarded with hard and soft exclusive benefits, including experiencing private previews of favourite cosmetic brands, receiving invitations to exclusive events, which found to be effective among Asian consumers[12].

4.2.3 iTango

ITango will be established in view of the digital trend among young and high-end consumers. It allows members to review Tango's products and services as well as checking TPs balance, schedules and bookings. To minimize the associated cost, Software as a Service (SaaS) will be utilized by outsourcing to Salesforce.[13]

---

[11] KPMG International. (2013, Jan). *Global Reach of China Luxury.* Retrieved from https://www.kpmg.com/FR/fr/IssuesAndInsights/ArticlesPublications/Documents/global-reach-china-luxury.pdf

[12] Nielsen Company. (2013, Feb 12). Free and Easy: Loyalty Program Benefits that Matter Most Globally. Retrieved from http://www.nielsen.com/us/en/insights/news/2013/free-and-easy-loyalty-program-benefits-that-matter-most-globally.html

[13] Salesforce Inc. (2014). *Pricing - CRM customer service solutions.* Retrieved from http://www.salesforce.com/crm/editions-pricing-service.jsp.

4.3. Our Employees – Tango Academy

In view of the rising need of qualified manpower, Tango Academy will be introduced for potential talents development and employee retention, which comprises:

4.3.1. Sponsorship arrangement for recruiting potential talents

Tango Academy offers ITEC training programs in collaboration with HK Professional Beauty Therapy & Hairdressing Association (HKBHA) for potential talents. Upon program completion, participants will be offered a two-year employment contract. Half of the program fees will be reimbursed as scholarship subsequent to acceptance of offer.

4.3.2. Incentive scheme for retaining current employees

To save hiring and training costs associated with turnover, a series of employee incentive measures will be adopted to lift employee moral and retain valuable staff, which comprises:

- **Staff Discounts**: offering discounted prices on Tango's products and services to enhance employees' sense of belonging to company[14]
- **On-the-job training**: providing professional trainings and free seminars to maintain employee competencies[15]
- **Career advising**: taking interest in the future path of employees' career through mentoring and coaching, which found to be highly valued by employees[16]
- **Stock option compensation**: granting employee stock option as part of the employees' remuneration to align their individual economic interest with company performance

[14] Entrepreneur.com. (2002, Oct 23). *Low-Cost Benefits That'll Make Your Employees Happy*. Entrepreneur.com. Retrieved from http://www.entrepreneur.com/article/56492
[15] Nadia Goodman. (2012, Jan 9(. *Methods for Building Employee Loyalty.* Entrepreneur.com. Retrieved from http://www.entrepreneur.com/article/225432
[16] Victor Lipman. (2012, Mar 18). *5 Easy Ways To Motivate - And Demotivate – Employees.* Forbes. Retrieved from http://www.forbes.com/sites/victorlipman/2013/03/18/5-easy-ways-to-motivate-and-demotivate-employees/

4.4. Summary of Strategies

All strategies are evaluated to be suitable, feasible and acceptable, highlights are as follows:

	Suitability	Feasibility	Acceptability
PRC Expansion	Boosting sales by expanding in the PRC market in view of its greatest growth potential	- Capital funded with our strong cash position - Existing outlets and reputation in PRC - Inter-dependable with the implementation of TPPS and launch of iTango - Probable of insufficient human capital	- Less dividends will be declared in short term to finance the expansion - Exposing to Infrastructural growth risk (Section 5.2.)
B&F in HK Optimization	Maximizing profit by optimizing the B&F division considering its brisk demand in HK	- Capital funded with our strong cash position	- Probable of insufficient human capital (whereas Tango Academy helps)
Supply Chain Management	Improving operational efficiency by establishing sole agency relationship and partnership	- The Indian supplier is ready to enter the PRC market - Close geographical proximity	- Ensuring supply stability and quality - Extending customer reach through wider range of distribution channels
Sustainable Business Growth	Ensuring sustainable business growth by leveraging R&D expertise considering the rise of medical beauty	- Capital funded with our strong cash position - Existing in-house R&D - Need of a R&D assistant	- Risk of emulation but can be eliminated through patent protection - Return on R&D can be very high
Tango Club	Capturing the thriving digital trend	- Lower cost and more support by outsourcing - Technically feasible with existing payment system	- Customer accustomization
Tango Academy	Resolving the problem of lacking qualified manpower through sponsorship agreement and incentive scheme	- Relatively low cost - Location available, i.e. head office	- Trained potential talents may be poached by other companies

Fig. 5 Summary of Strategies

5. IMPLEMENTATION

5.1. Timeline

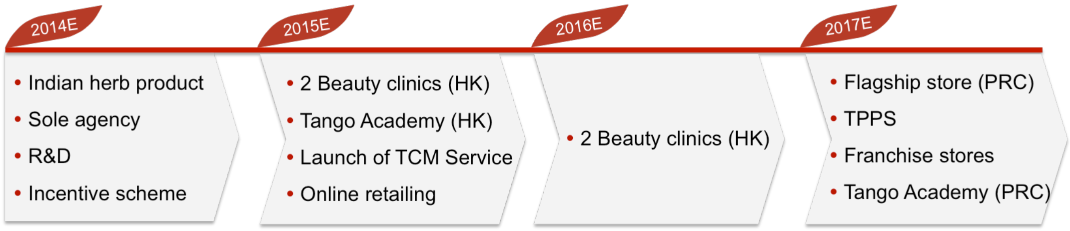


Fig. 6 Project Implementation Timeline

5.2. Enterprise Risk Mitigation

1. Infrastructural Risks of PRC Expansion

While Tango is taking forward to expand its business in PRC (Section 4.1.1.), it is exposed to infrastructural risks including inexperienced staff and weak supply chain management. In light of this, Tango Academy (Section 4.3.) will be introduced for training potential talents and retaining existing competent staff. Supply chain management will also be optimized (Section 4.1.3.) by implementing ERP System and strengthening supplier and distributor relationship.

2. Information Technology (IT) Risk of Tango Club Membership Scheme

IT Security is a risk associated with Tango Club Membership Scheme due to the confidential customer information stored in our database. Off-site disk mirroring and AES encryption are used to secure the storage of data from risk of server malfunction, physical theft or any instances where data has potential of being lost.

3. Health Risk of Blood Transfusion Treatment

There is still health risk associated with blood transfusion[17]. More trials have to be conducted before the approval of blood transfusion for use in all clinics.

[17] American Cancer Society. (2013, Oct). Possible risks of blood transfusion. Retrieved from: http://www.cancer.org/treatment/treatmentsandsideeffects/treatmenttypes/bloodproductdonationandtransfusion/blood-product-donation-and-transfusion-possible-transfusion-risks

6. FINANCIAL ANALYSIS

6.1. Assumptions

6.1.1. Operational Assumptions[18]	2014E	2015E	2016E	2017E	2018E	…	2023E
i. Real growth rate							
Mainland China[19 20]	20.46%	20.51%	20.55%	19.71%	18.96%	…	19.53%
Hong Kong[20 21]	6.69%	6.71%	6.74%	6.56%	6.43%	…	6.41%
Singapore[22]	4.00%	4.00%	4.00%	4.00%	4.00%	…	4.00%
ii. Occupancy cost growth rate[23]							
Mainland China	0.80%	0.80%	0.80%	0.80%	0.80%	…	0.80%
Hong Kong	3.20%	3.20%	3.20%	3.20%	3.20%	…	3.20%
Singapore	0.50%	0.50%	0.50%	0.50%	0.50%	…	0.50%
iii. Floor area - by region (SqFt)							
Mainland China	9,400	9,400	9,400	58,400	99,400	…	184,400
Hong Kong	210,050	220,050	230,050	230,050	230,050	…	230,050
Singapore	30,550	30,550	30,550	30,550	30,550	…	30,550
Total	250,000	260,000	270,000	319,000	360,000	…	445,000
iv. Floor area - by new stores (SqFt)							
Beauty and Facial		10,000	10,000				
Flagship store				20,000			
Slimming and Fitness (Franchise)				24,000	36,000	…	12,000
Tango Academy		5,000		5,000			

Fig. 7 Operational Assumptions

6.1.2. Financial Assumptions[24]	2014E	2015E	2016E	2017E	2018E	…	2023E
i. Tax rate (%)							
Hong Kong	16.50%	16.50%	16.50%	16.50%	16.50%	…	16.50%
Mainland China	25%	25%	25%	25%	25%	…	25%
Singapore	17%	17%	17%	17%	17%	…	17%
Weighted average	16.91%	17.35%	17.35%	17.90%	18.02%	…	18.68%
ii. Real WACC (%)[25]	4.72%	4.72%	4.72%	4.72%	4.72%	…	4.72%
iii. Currency (HKDCNY=X)	0.79	0.79	0.79	0.79	0.79		0.79

Fig. 8 Financial Assumptions

6.1.3. Industry Composition[26]	Stock Code	2013 Market Cap. (HK$ Million)	%
Tango Health and Beauty Ltd	N/A	637.00	23.72%
Modern Beauty Salon Holdings Ltd	0919.HK	667.30	24.85%
Natural Beauty Bio-Technology Ltd	0157.HK	439.40	16.36%
Water Oasis Group Ltd	1161.HK	429.11	15.98%
Perfect Shape (PRC) Holdings Ltd	1830.HK	381.16	14.19%
Sau San Tong Holdings Ltd	8200.HK	131.67	4.90%
		HK$2,685.64M	100.00%

Fig. 9 Industry Composition

[18] **This analysis neglects the fluctuation in real estate price, and assumes that all new areas are rented for simplicity.**
[19] Euromonitor International. (July 2014). *Country Report: Health and Wellness Tourism in China.* Retrieved from http://www.euromonitor.com/health-and-wellness-tourism-in-china/report
[20] HKEx. (2011, November 25). Information Pack - Beauty and Healthcare Industry Overview. Retrieved from http://www.hkexnews.hk/reports/prelist/Documents/EWPOTOHL-20111125-09.pdf
[21] Euromonitor International. (2013, October). *Country Report: Health and Wellness Tourism in HK, China.* Retrieved from http://www.euromonitor.com/health-and-wellness-tourism-in-hong-kong-china/report
[22] Census and Statistics Department, HKSAR. (2014, September 19). 2014/15 Household Expenditure Survey. Retrieved from http://www.censtatd.gov.hk/press_release/pressReleaseDetail.jsp?charsetID=1&pressRID=3595
[23] Jones Lang LaSalle. (2014, September). Retail Cities in Asia Pacific. Retrieved from http://www.ap.jll.com/asia-pacific/en-gb/Research/retail-cities-in-asia-pacific-september-2014.pdf?c745527a-a3a4-4d94-9929-bdc1dd45952e
[24] **The financial projection is expressed explicitly in real terms, assuming that inflation of different regions does not create a huge impact to the financial position.**
[25] **Based on 2013 Figures: E=249, D=627, Re=8.85%, Rd=3.84%, Tc=19.64%**
[26] **A portfolio of HKEx-listed companies in the industry is generated to compare with the financial performance of Tango, neglecting the effect of non-listed companies.**

6.2. Performance Evaluation

1. Employee Benefit Expenses Control: In 2013, Tango recorded a sales growth of 4.9%. However, 51.3% of sales were used to cover employee benefit expenses. With the reward programs in Tango Academy (Section 4.3.2.), we aim to increase the medium length of employment to 5 years as well as to boost labour productivity (Ratio: Return on Labour) to the industry average at 55.0% (Fig.10: R1).

2. A Signal to B&F Expansion: The overwhelming demand on B&F services indicates the 4.7% increase of deferred revenue over 2013. It helps secure our future revenue but at the same time, revealing the need to enhance our service capacity. By expanding our local B&F services by 12%, Tango will capture the market growth (Section 6.1.1.(i)) and introduce more customers. Moreover, decrease in deferred revenue over sales will improve Tango's financial leverage (Fig.10: R2).

3. Strong Cash Position: Tango held $410M cash reserve in 2013 (47.3% of its total assets), which is mainly generated from the deferred revenue to support its future operation. Our strong cash position primarily supports our future development plan. To enhance liquidity in the long term, cash reserve is to be kept at 51.79% of the total assets while quick ratio can be improved to 1.28 in ten years. (Fig.10: R3)

4. Indication of Share Issue: The exceptionally high EPS (Fig 10: R4) indicates an opportunity to issue extra shares to the public in long term, so as to finance new projects while improving the leverage.

	Tango (2013)	Industry Average (2013)
R1. Return on Labour	17.13%	55.20%
R2. D/E Ratio	2.61	0.45
R3. Quick Ratio	0.97	1.94
R4. EPS	$0.90	$0.19

Fig. 10 Ratio Analysis (Extract)

6.3. Return on Investment

Flagship Store	Model	Assumption	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
Sales Revenue	Growth rate	Section 6.1.1. (i)				54.21	64.30	76.27	90.46	107.30	127.26	150.95
Less: Increase in Occupancy Cost	Calc	HKD$2,217/SqFt p.a.[23]				44.36	44.71	45.07	45.43	45.79	46.16	46.53
Renovation Cost	Calc	HKD$362/SqFt[27]			14.52							
Advertising & Marketing	% 2013 Division A&M	HKD$1530000				1.53	1.53	1.53	1.53	1.53	1.53	1.53
Employee Benefit Costs	% floor area	Section 6.1.1. (iv)				8.75	8.75	8.75	8.75	8.75	8.75	8.75
Cost of Material	% floor area	Section 6.1.1. (iv)				2.98	2.98	2.98	2.98	2.98	2.98	2.98
Other Operating Costs	% 2013 Other Cost	9.11%				5.25	5.28	5.31	5.35	5.38	5.41	5.45
Depreciation	% 2013 Total PPE	Equipment Cost*12.03%				2.08	2.08	2.08	2.08	2.08	2.08	2.08
Taxation	Tax rate	Section 6.1.2. (i)			0.00	0.00	0.00	2.64	6.09	10.20	15.09	20.91
Incremental Earnings					(14.52)	(10.73)	(1.03)	7.91	18.26	30.59	45.26	62.72
Depreciation						2.08	2.08	2.08	2.08	2.08	2.08	2.08
Less: CapEx (Net)												
Equipment Cost	% 2013 Division PPE	Area(SqFt)*HKD$864				17.28	17.28	17.28	17.28	17.28	17.28	17.28
Less: Investment in net working capital		Deferred Revenue=Cash Received			0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Project FCF			0.00	0.00	(31.80)	(25.93)	(16.23)	(7.29)	3.06	15.39	30.06	47.52
Franchise Network												
Royalties	Calc	0.5% of sales[28], 6.9% growth rate[29]				0.18	0.41	0.50	0.58	0.66	0.74	0.83
Startup Fee	Calc	HKD$2,000,000[28]				4.00	6.00	2.00	2.00	2.00	2.00	2.00
Franchise Fee	Calc	HKD$250,000 p.a.[28]				0.50	1.25	1.50	1.75	2.00	2.25	2.50
Less: Franchisee Training Cost	Startup Fee	HKD$2,000,000				4.00	6.00	2.00	2.00	2.00	2.00	2.00
Advertising & Marketing	% 2013 Division A&M	HKD$1,000,000				1.00	1.00	1.00	1.00	1.00	1.00	1.00
Taxation	Tax rate	Section 6.1.2. (i)				0.00	0.17	0.25	0.33	0.42	0.50	0.58
Incremental Earnings						(0.32)	0.50	0.75	1.00	1.25	1.49	1.74
Less: CapEx (Net)						0.00	0.00	0.00	0.00	0.00	0.00	0.00
Less: Investment in net working capital						0.00	0.00	0.00	0.00	0.00	0.00	0.00
Project FCF			0.00	0.00	0.00	(0.32)	0.50	0.75	1.00	1.25	1.49	1.74
Online Retailing: Tmall												
Sales Revenue	Growth rate	Section 6.1.1. (i)		42.12	45.49	49.13	53.06	57.30	61.89	66.84	72.19	77.96
Less: Cost of Sales	% Sales	Sales revenue*48.72%		20.52	22.16	23.93	25.85	27.92	30.15	32.56	35.17	37.98
Service Fee - Fixed	Calc	RMB¥60,000[5]		0.08	0.08	0.08	0.08	0.08	0.08	0.08	0.08	0.08
Servie Fee - Variable	Calc	Sales revenue*0.5%[30]		0.21	0.23	0.25	0.27	0.29	0.31	0.33	0.36	0.39
Taxation	Tax rate	Section 6.1.2. (i)		5.33	5.76	6.22	6.72	7.26	7.84	8.47	9.15	9.88
Incremental Earnings				15.99	17.27	18.65	20.15	21.77	23.51	25.40	27.44	29.64
Less: CapEx (Net)	Calc	Deposit: RMB¥125,000[30]	0.16									
Less: Investment in net working capital	Days inventory on hand	211.32 Days		(11.88)	(0.95)	(12.91)	(2.06)	(14.10)	(3.35)	(15.50)	(4.86)	(17.13)
Project FCF			(0.16)	27.87	18.22	31.56	22.21	35.87	26.87	40.90	32.30	46.77
New Beauty Salon in HK												
Sales Revenue	Growth rate	Section 6.1.1. (i)		30.41	60.82	65.32	70.15	75.34	80.92	86.91	93.34	100.24
Less: Occupancy Cost	Calc	HKD$2,076/SqFt p.a.[23]		20.76	41.52	42.85	42.85	42.85	42.85	42.85	42.85	42.85
Renovation Cost	Calc	HKD$362/SqFt[27]		7.26	7.26							
Advertising & Marketing	% 2013 Division A&M	HKD$420,000		0.42	0.84	0.84	0.84	0.84	0.84	0.84	0.84	0.84
Employee Benefit Expense	% floor area	Section 6.1.1. (iv)		14.40	28.80	28.80	28.80	28.80	28.80	28.80	28.80	28.80
Depreciation	% 2013 Division PPE	Equipment Cost*7.87%		0.60	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20
Taxation	Tax rate	Section 6.1.2. (i)		0.00	0.00	0.00	0.00	0.27	1.19	2.18	3.24	4.38
Incremental Earnings				(13.03)	(18.80)	(8.37)	(3.54)	1.38	6.03	11.03	16.40	22.17
Depreciation				0.60	1.20	1.20	1.20	1.20	1.20	1.20	1.20	1.20
Less: CapEx (Net)												
Equipment Cost	% 2013 Division PPE	Area(SqFt)*HKD$765		7.65	15.30	15.30	15.30	15.30	15.30	15.30	15.30	15.30
Less: Investment in net working capital		Deferred Revenue=Cash Received		0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Project FCF			0.00	(20.08)	(32.90)	(22.47)	(17.64)	(12.72)	(8.06)	(3.06)	2.31	8.07
Establishment of Tango Academy												
Other Revenue: Training Deposit	No. of students	300 p.a. @HKD$8,500		2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.55	2.55
Less: Occupancy Cost: CN	Calc	HKD$742/SqFt p.a.[23]				3.71	3.74	3.77	3.80	3.83	3.86	3.89
Renovation Cost	Calc	HKD$362/SqFt[27]	1.81		1.81							
HKBHA License Fee	Calc	HKD$16,600 per person[31]		1.99	1.99	3.98	3.98	3.98	3.98	3.98	3.98	3.98
Refund of deposit	% of revenue	75%		1.91	1.91	1.91	1.91	1.91	1.91	1.91	1.91	1.91
Advertising & Marketing	% 2013 A&M	50%		6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Other Operating Cost	% 2013 Figure	9.11%		1.13	1.30	1.65	1.66	1.66	1.66	1.67	1.67	1.67
Taxation	Tax rate	Section 6.1.2. (i)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Incremental Earnings			(1.81)	(8.49)	(10.47)	(14.71)	(14.74)	(14.78)	(14.81)	(14.84)	(14.88)	(14.91)
Less: CapEx (Net)												
Equipment Cost	-	Disposed equipment		0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Less: Investment in net working capital				0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Project FCF			(1.81)	(8.49)	(10.47)	(14.71)	(14.74)	(14.78)	(14.81)	(14.84)	(14.88)	(14.91)
Incentive Scheme												
Benefit from decrease in turnover rate	% Employee benefit expense	5.00%				32.70	32.70	32.70	32.70	32.70	32.70	32.70
Less: Operating Cost (Free service)	% Total Operating Cost	1%	6.05	6.05	6.04	6.04	6.04	6.04	6.03	6.03	6.03	6.03
Compensation Expense (Stock Options)	% shares issued	1% of issued share	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.50
Taxation	Tax rate	Section 6.1.2. (i)	0.00	0.00	0.00	3.61	3.63	3.65	3.68	3.70	3.74	3.77
Incremental Earnings			(12.55)	(12.55)	(12.54)	16.55	16.53	16.51	16.49	16.46	16.43	16.40
Less: Investment in net working capital												
Paid-in Capital Stock options			(6.50)	(6.50)	(6.50)	(6.50)	(6.50)	(6.50)	(6.50)	(6.50)	(6.50)	(6.50)
Project FCF			(6.05)	(6.05)	(6.04)	23.05	23.03	23.01	22.99	22.96	22.93	22.90
TPPS/iTango												
Less: IT administration Cost	Calc	$12000 per user p.a.[13]				12.00	12.00	12.00	12.00	12.00	12.00	12.00
Development Cost	Calc	$12000 per user p.a.[13]		12.00	12.00							
Advertising & Marketing	% 2013 A&M	50%				6.00	6.00	6.00	6.00	6.00	6.00	6.00
Project FCF			0.00	(12.00)	(12.00)	(18.00)	(18.00)	(18.00)	(18.00)	(18.00)	(18.00)	(18.00)
Other Costs												
Less: Hiring a senior lab assistant	Calc	HKD$436000 p.a.[32]		0.44	0.44	0.44	0.44	0.44	0.44	0.44	0.44	0.44
Project FCF			0.00	(0.44)	(0.44)	(0.44)	(0.44)	(0.44)	(0.44)	(0.44)	(0.44)	(0.44)

Fig. 11 DCF Valuation for the Projects (10 Year Forecast)

[27] Turner & Townsend (2012). International Construction Cost Survey 2012. Retrieved from http://www.turnerandtownsend.com/construction-cost-2012/TT_ICC_Report_Single_Pages_j98ul.pdf.file
[28] Anytime Fitness. (2014). *Franchise Info.* Retrieved from http://www.anytimefitness.com/franchise-opportunities
[29] Datamonitor Research. (2013, July 01). Gyms, Health & Fitness Clubs: Global Industry Guide. Retrieved from http://www.datamonitor.com/store/Product/gyms_health_fitness_clubs_global_industry_guide?productid=ML00015-022
[30] Tmall. (2014). *Fee Schedule.* Retrieved from http://about.tmall.com/tmall/fee_schedule
[31] HKBHA. (2014). ITEC Training Course Leaflet. Retrieved from http://www.hkbha.hk/uploads/1/3/1/0/13109875/74c086433_-__.pdf
[32] Indeed.com. (n.d.). *Salary for Clinical Research Assistant.* Retrieved from http://www.indeed.com/q-Clinical-Research-Assistant-jobs.html

参考3

DCF Valuation Summary (in HKD$ million)	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E
Total FCF	(8.03)	(19.19)	(75.43)	(27.27)	(21.31)	6.41	12.60	44.15	55.78	93.66

Fig. 12 DCF Valuation Summary

Due to the robust market demand and mobility of high-end customers across HK and the PRC, the project will provide positive free cash flow starting from the sixth year (Fig.12), with a positive NPV of $1.96 Million and IRR of 4.97% (WACC=4.72%).

6.4. Financial Statements Forecast

Tango Health and Beauty Limited
Cash Flow Statement Forecast (HK$ million)

	Method	**2013A**	**2014E**	**2015E**	**2016E**	**2017E**	**2018E**
Operating Cash Flows							
EBIT (Operating Profit)	Calc	55	56.70	61.97	47.70	90.38	112.57
Depreciation	Implied	26	26.00	26.60	27.20	29.28	29.28
Increase in inventory	Calc	(1)	0.64	(9.86)	0.54	(0.73)	0.76
Increase in receivables, deposits and prepayments	Calc	(33)	19.23	(24.60)	(20.49)	(45.72)	(4.48)
Increase in trade payables and accruals	Calc	5	2.97	7.35	3.65	6.86	2.54
Increase in deferred revenue	Calc	71	1.47	63.80	31.70	59.55	22.10
		123	107.00	125.26	90.31	139.62	162.78
Investing Cash Flows							
Net purchase of property, plant and equipment	Implied	(39)	(40.98)	(53.16)	(80.42)	(84.80)	(86.43)
Financing Cash Flows							
Interest received	Calc	1	1.06	1.13	1.07	1.06	1.11
Tax paid	Calc	(11)	(15.41)	(20.74)	(21.16)	(21.63)	(22.29)
Dividends paid	Calc	(54)	(34.73)	(34.74)	(22.64)	(54.00)	(54.00)
		(64)	(49.07)	(54.35)	(42.73)	(74.57)	(75.18)
Net Increase in cash	Implied	**20**	**16.95**	**17.75**	**(32.85)**	**(19.75)**	**1.17**

Fig. 13 Statement of Cash Flow Forecast (2014-2018)

Tango Health and Beauty Limited
Income Statement Forecast (HK$ million)

	Method	**Assumption**	**2013A**	**2014E**	**2015E**	**2016E**	**2017E**	**2018E**
Turnover								
Sales revenue: Hong Kong	Growth rate	Section 6.1.2. (iii)	$528.71	$553.67	$584.07	$614.48	$618.98	$623.82
Sales revenue: Mainland China	Growth rate	Section 6.1.2. (iii)	25.48	26.68	68.80	72.17	134.70	151.71
Sales revenue: Singapore	Growth rate	Section 6.1.2. (iii)	82.81	86.72	90.81	95.10	99.59	104.29
Sales revenue: Total			637.00	667.07	743.69	781.75	853.27	879.81
Other Revenue			-	-	0.6375	0.6375	0.6375	0.6375
Total Turnover			637.00	667.07	744.33	782.39	853.91	880.45
Operating Costs								
Cost of inventory sold			19	19	39.52	41.16	45.91	47.83
Employee benefit expenses			327	327	341.83	356.23	332.28	332.28
Occupancy costs			102	102	122.76	143.52	192.92	193.30
Building management			13	14.81	20.26	36.59	13.00	13.00
Depreciation			26	26	26.60	27.20	29.28	29.28
Advertising and marketing			12	12	18.42	18.84	27.38	27.38
Bank charges			30	30	30.00	30.00	30.00	30.00
Bad Debts			-	14	2	-	-	-
Compensation Expense			-	6.50	6.50	6.50	6.50	6.50
Selling & Administration Expense			-	-	14.28	14.30	20.31	22.33
Other operating expenses			53	59.05	60.18	60.35	65.95	65.98
Total operating costs			582	610.37	682.35	734.69	763.53	767.88
EBIT (Operating Profit)			**55**	**56.70**	**61.97**	**47.70**	**90.38**	**112.57**
Interest income	Starting cash	0.24%	1	1.06	1.13	1.07	1.06	1.11
Profit before taxation	Implied		56	57.76	63.10	48.77	91.44	113.68
Income tax expense	% of taxable profit		11	15.41	20.74	21.16	21.63	22.29
Profit after taxation	Implied		**$45**	**$42.35**	**$42.36**	**$27.61**	**$69.81**	**$91.39**
Dividends	% of net income		54	34.73	34.74	22.64	54.00	54.00
Retained Earnings	Implied		(9)	7.62	7.63	4.97	15.81	37.39

Fig. 14 Income Statement Forecast (2014-2018)

Tango Health and Beauty Limited Statement of Financial Position Forecast (HK$ million)	Method	Assumption	2013A	2014E	2015E	2016E	2017E	2018E
PPE, CapEx and Depreciation								
Net FA								
Opening Bal.	Implied		203.00	216.00	229.31	253.10	301.10	347.33
(+) CapEx	& of Sales	6.12%	39.00	40.98	53.16	80.42	84.80	86.43
(-) Depreciation	% of starting net FA	12.81%	26.00	27.67	29.37	32.42	38.57	44.49
Ending Bal.	Implied		216.00	229.31	253.10	301.10	347.33	389.27
Non-current Assets								
Property, plant and equipment	See PPE calc		216.00	229.31	253.10	301.10	347.33	389.27
Deposits (Long-term)	% of sales	5.39%	32.00	35.99	40.12	42.17	46.03	47.46
	Implied		248.00	265.30	293.22	343.28	393.37	436.73
Current Assets								
Inventory	Days inventory on hand	150.00	11.00	10.36	20.22	19.68	20.41	19.66
Trade receivables	Days of sales	14.00	26.00	2.00	-	-	-	-
Deposits (Short-term)	% of sales	15.86%	101.00	105.77	117.92	123.95	135.29	139.50
Prepayment of rent	% of Occupancy Cost	69.61%	71.00	71.00	85.45	99.90	134.29	134.56
Cash and Bank			410.00	434.54	462.76	440.00	432.64	454.76
Total Current Assets	Implied		619.00	623.67	686.35	683.54	722.64	748.47
Total Assets	Implied		**867.00**	**888.97**	**979.57**	**1,026.82**	**1,116.00**	**1,185.20**
Equity								
Share capital and reserves								
Starting	Implied		249.00	240.00	254.12	268.25	279.72	302.03
(+) Paid-in Stock Options (5Y)			-	6.50	6.50	6.50	6.50	6.50
(+)Increase in retained earnings	Implied		(9.00)	7.62	7.63	4.97	15.81	37.39
Ending	Implied		240.00	254.12	268.25	279.72	302.03	345.92
Liabilities								
Trade payables and accruals	Days of Sales	35 Days	61.00	63.97	71.31	74.96	81.82	84.37
Deferred revenue	% of sales	83.27%	554.00	555.47	619.28	650.97	710.53	732.63
Tax payable	Implied		12.00	15.41	20.74	21.16	21.63	22.29
Total Liabilities	Implied		627.00	634.84	711.32	747.10	813.97	839.28
Total Equity and Liabilities	Implied		**867.00**	**888.97**	**979.57**	**1,026.82**	**1,116.00**	**1,185.20**

Fig. 15 Statement of Financial Position Forecast (2014-2018)

1. Cash outflow of the project: To support our project, the expected cash outflow from 2016 - 2017 will be relatively higher. In 2018, a substantial increase in net cash flow is expected from the launch of flagship store and franchise in PRC. (Fig.13)

2. Profit and dividend payment: With the current business growth, profit after tax will increase to $91.39M in 2018 (a CAGR of 15.22%), sustaining a high dividend payment to our shareholders. (Fig.14)

3. Effect on Financial Ratios: The project will bring positive effect on Tango's management efficiency and leverage, securing Tango's development in long term.

	2013A	2018E	2023E
R1. EPS	$0.90	$1.83	$4.40
R2. Return on Labour	17.13%	34.21%	81.55%
R3. Dividend Cover	0.83	1.69	4.07
R4. D/E Ratio	2.61	2.43	1.11
R5. Quick Ratio	0.97	0.87	1.28

Fig. 16 Financial Ratio Forecast Extract (5 Years & 10 Years)

7. CORPORATE GOVERNANCE

7.1 The Board of Directors

At 31 December 2013, the Board of Directors consisted of three executive directors, including the Chairman (David Chan), the Chief Executive Officer (CEO, Nigel Yip), the Chief Finance Officer (CFO, Jenny Kwok) and six independent non-executive directors. An Extraordinary General Meeting will be held with regard to David Chan's withdrawal to inform members and shareholders about the possible changes of the Board composition. To achieve a balanced composition of Directors, either existing independent non-executive directors (at least one-third of the Board[33]) or new members will be invited to be executive directors. This can enhance operation efficiency and improve the corporate governance of Tango.

7.2. Financial Risk Management – Currency Exposure

To match with our future development plan of PRC expansion, we will increase the proportion of cash held in RMB given that it has a trend to appreciate in value against HKD[34]. Since Tango sources most of its beauty and wellness product from France, Tango may also open an account in Euros. However, given the slow recovery of European economy[35] and ongoing depreciation of Euros[36] in value against HKD, Euros account will not be opened in the short term.

---

[33] HK Exchange and Clearing Limited (2005). Chapter 3 of the Main Board Listing Rules on Authorised Representatives, Directors, Board Committees and Company Secretary. Retrieved from https://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/documents/chapter_3.pdf
[34] Bloomberg. China Renminbi-HK Dollar Exchange rate Chart. Retrieved from http://www.bloomberg.com/quote/CNYHKD:CUR/chart
[35] Charles Forelle (2013). Europe Heads Toward Recovery, but Slowly. The Wall Street Journal. Retrieved from http://online.wsj.com/news/articles/SB10001424127887323838204578654341905240144
[36] Bloomberg. Euro-HK Dollar Exchange rate Chart. Retrieved from http://www.bloomberg.com/quote/EURHKD:CUR/chart

7.3. Accountability and Audit

1. Dividend payout policy

Tango has managed to implement an exceptionally high dividend payout ratio of 120% in 2013. This shows our confidence in both internal operation as well as the external environment. Nevertheless, the dividend payout ratio will be readjusted to a reasonable level of 81.59% in the short term (industry average, Section 6.1.3.) whereas retained earnings will be used for future development plan to maintain sustainable growth for Tango. We care about the interest of our investors; therefore we are doing our best to balance both short-term and long-term development of Tango to ensure sustainable return for investors.

2. Bad debts write-off policy

According to the prudence concept of financial reporting[37], allowance for doubtful accounts should be established to avoid overstating Tango's assets. Accounts receivable aging method will be adopted to estimate the amount of non-collection for accounts receivable based on the amount of time that they have been outstanding. It helps Tango to identify the customers that are regularly late with their payments so that we can restrict credit to these customers and continue to offer credit to customers who pay on time. With TPPS, amount of receivables is expected to be reduced significantly as value can be directly deducted from customer's membership card.

[37] HKICPA. (2014). IASB Discussion Paper of A Review of the Conceptual Framework for Financial Reporting. Retrieved from http://www.hkicpa.org.hk/file/media/section6_standards/standards/FinancialReporting/submission-pdf/

8. EVALUATION ON EXTERNAL ADVISOR'S PROPOSAL

8.1. Overview

In view of the possibility of legal disputes with new investor and ethical issues arise from replacing purchased package, as well as the conflict of interests led by the bonus plan for the senior management, the external advisor's proposal will not be accepted. Suggestions regarding the future development of SlimFit are provided.

8.2. Legal Perspective

With the elements of offer and acceptance[38] in our consumer contracts, it is a Breach of Contract of replacing the purchased package at SlimFit with the blood transfusion therapy from Magic Spa. As what the existing customers accepted is the services provided by the S&F division but not the blood transfusion therapy. Tango undertakes to offer fitness service at the time the contract was formed. If Tango replaces the customers' purchased packages with the new service without customers' consent, it may breach the contract. To avoid involving in litigation with customers, the external advisor's proposal should not be accepted from the legal aspect.

[38] E-lawresources.co.uk. (n.d.). *Contract agreement - offer and acceptance*. Retrieved from http://www.e-lawresources.co.uk/Offer-and-acceptance.php

8.3. Ethical Perspective

There are two ethical issues come upon the shutdown of SlimFit.

1. Client Safety

Clients' health should be of the utmost concern. Since the therapy's safety is unproven (i.e. a human trial on blood transfusion triggered septic shock on a patient) and there is previous case revealing death of woman after receiving this treatment[39], this therapy should only be carried out with adequate researches and until all trials are passed. Employees' prospects should also be considered because any therapist who performed a questionable therapy will face disciplinary action from the Medical Council and criminal charges.[40]

2. Conflict of Interest

Bias occurs since senior management will receive bonus when the original budget (i.e. no refund) is met. The senior management may not consider wisely about the future development of this division in the interest of the shareholders. The principle of professional competence and due care under HKICPA Code of ethics[41] has not been promoted in this case as the senior management may not be able to maintain professional knowledge at the level required to ensure that they make decisions independent of their bonus and shareholders can receive competent professional service. Moreover, the objectivity principle should always be upheld to avoid any conflict of interest or undue influence of others to override professional or business judgment.

---

[39] South China Morning Post. (2012, Oct 6). *Fourth woman in hospital after blood transfusion beauty therapy.* Retrieved from http://search.proquest.com.lib.ezproxy.ust.hk/docview/1086350068/E6708F13959D40DEPQ/3?accountid=29018

[40] South China Morning Post (2012, Oct 11). *Blood therapy doctors could face manslaughter charges.* Retrieved from http://search.proquest.com.lib.ezproxy.ust.hk/docview/1095605955/5476286FE9D749EBPQ/2?accountid=29018

[41] HK Institute of Certified Public Accountants, (Ed.). (2013). Fundamental Principles. In Code of Ethics for Professional Accountants. [PDF version]. Retrieved from http://app1.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumeI/COErevised.pdf

8.4 Suggestions regarding SlimFit

In view of the potential refund and its adverse impact on our corporate image, shutting down the S&F division is not recommended. Suggestions are as follows:

1. Sale of division

Memberships of Tango's customers will be bundled with the sale of division to other fitness centers. Members can continue to enjoy fitness services. Since the growth rate (i.e. 4.9%[42]) of the S&F industry is expected to be higher than WACC (i.e. 4.7%), the division is still profitable so it is not recommended to discontinue the operation of this division. Besides, seeking an appropriate buyer requires time and involves additional costs.

2. Continuation with research and development

The decline of sales may be attributed to the change in consumer tastes. Further research on the trend of fitness industry can help adjust the current strategies and equipment in attracting more customers. However, R&D involves a high cost whereas outcome is uncertain.

3. Establishment of franchise network in PRC (recommended)

With the annual growth rate of 15.9% in the Fitness Clubs industry[43], granting franchise in Mainland China can render additional NPV of $4.64M (Fig.11). This helps increase Tango's profit and expand market growth more quickly (Section 4.2.1.). Moreover, the operational risk will be transferred to the franchisee.

---

[42] HKExnews. (n.d.). Industry Overview (pp.56). Retrieved from http://www.hkexnews.hk/reports/prelist/Documents/EWPOTOHL-20111125-09.pdf
[43] IBISWorld. (2014, Jun). *Gym, Health & Fitness Club in China: Market Research Report.* Retrieved from www.ibisworld.com/industry/china/gym-health-fitness-clubs.html

9. CONCLUSION

Tango, who strives to be Asia's leading health and beauty player, is going to make every endeavor to create value to shareholders. With an exhaustive analysis on Tango's internal situation and the market environment, we have come up with three strategies. For our business, "MOSTrategy" focuses on expanding and sustaining our business to capture a larger market share. Tango Club will be introduced to our customers with a purpose to optimize customer experience. Last but not least, Tango Academy will be launched for talent acquisition and retention. By following the implementation plan, Tango can generate positive free cash flow starting from 2019 (i.e. 6th year), with an NPV of $1.96M, showing a promising return for our project. Also, the project can enhance Tango's management efficiency and leverage, securing Tango's development in the long term. EPS of $1.83 in 2018 and $4.40 in 2023 are expected as compared to $0.90 in 2013. In addition, Dividend Cover is expected to increase from 0.83 in 2013 to 1.69 in 2018 and 4.07 in 2023. Reflecting Tango's belief in the importance of inner beauty, we are aware of the importance of corporate governance and ethical issues with potential legal disputes. Actions are introduced to strive for the highest corporate governance and ethical standards within Tango's internal structure, thus enhancing our operation efficiency.

The combination of years of industry experience together with cutting-edge strategies and technology has Tango poised to claim top spot in the market. With all the evidence proving that the investment in Tango is promising, take this valuable opportunity to become the major shareholder and get in on the ground floor of Tango with unlimited growth potential!

-END-