

Mossberg's Investor Digest

Best Idea Profile

China 3C (OTCBB: CHCG)

DESCRIPTION:

Headquartered in Hangzhou, China 3C is a wholesale distributor and retailer of consumer electronics in Eastern China. The company gets its name from its focus on 1) computers, 2) communication products and 3) consumer electronics. The company operates over 1,000 "store-in-store" locations, which differs from the typical U.S. model, but is more common in China. The company operates four reportable segments including:

- 1) Yiwu Yong Xin, (290+ stores, 20% of revenue) focuses on fax machines and corded phone products.
- 2) Hangzhou Wang Da, (250+ stores, 33% of revenue) focuses on mobile phones and related products.
- 3) Hangzhou Sanhe, (230+ stores, 22% of revenue) focuses on home electronics.
- 4) Shanghai Joy & Harmony, (220+ stores, 24% of revenue) focuses on MP3 players and related products.

At the time of its 2008 10k filing, the company had 1,807 employees.

KEY INVESTMENT CONSIDERATION:

Significant growth – The company has enjoyed considerable growth in the past few years, more than doubling sales since 2006. The "store-in-store" business model, allows for rapid expansion as there is no capital outlay for real estate and the in-store build is less. While recent growth trends have slowed (2008 revenue grew 12%), the company has ample growth opportunities. The company has recently launched a franchise model to serve smaller cities in Eastern China, with plans to open 30 stores in 2009 and 100 in 2010.

Inventory turnover is key in this business – With the "store-in-store" model, China 3C assumes the inventory risk and hires and manages employees who work at the location. This model allows for specialization in product categories, similar to "category killers" such as Best Buy in the United States. With specialization, the company is able to mitigate merchandising risk, which is particularly important given the rapid rate of obsolescence in consumer electronics. China 3C turns inventory 24 times per year. By way of comparison, Best Buy turns inventory 7 times per year, RadioShack 4 times, and Wal-Mart 9 times. The model does require working capital in the form of receivables from the retailers that host the company's stores, however, return on assets for 2008 was still North of 30%...quite impressive.

RISK:

Operating in China carries its own set of risks, including potential weakness in the Chinese economy and its affect on the Chinese consumer. In addition, laws and regulations can be rapidly changed at the whim of the government.

China 3C's stock is traded OTC Bulletin Board, which is a less efficient market than Nasdaq, or other national exchanges. In addition, there is limited trading volume. Both of these factors lead to greater stock price volatility and inefficient pricing.

VALUATION:

CHCG shares trade at just 2x earnings and 1x EV/EBITDA. This valuation multiple is very attractive for a rapidly growing business with above 30% returns. There are added risks to Chinese-based operations and there will be a discount applied to the shares until the company is able to gain a U.S. exchange listing. However, there is a considerable margin of safety to help offset these risks. The company has \$29 million in cash and no debt. Also, at the current level, shares are trading at a 20% discount to tangible book value.

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Investment Data (as of 5/29/09)

Recent Price	\$1.08
52-Week Range	0.37 - 2.42
Fiscal Year End	December
Dividend	N/A
Yield	N/A
Shares Outstanding	52.8 MM
Average Trading Volume (3 mos)	150,000
Market Capitalization	57 MM
Cash	29 MM
Long Term Debt	0
Enterprise Value (EV)	28 MM
LT Debt/ Equity	0
Tangible BV/ Share	1.34
TTM Revenue	320 MM
P/ Revenue	0.2x
TTM EPS	0.47
P/ EPS	2.3x
EBITDA	31.4 MM
EV/ TTM EBITDA	0.9x

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