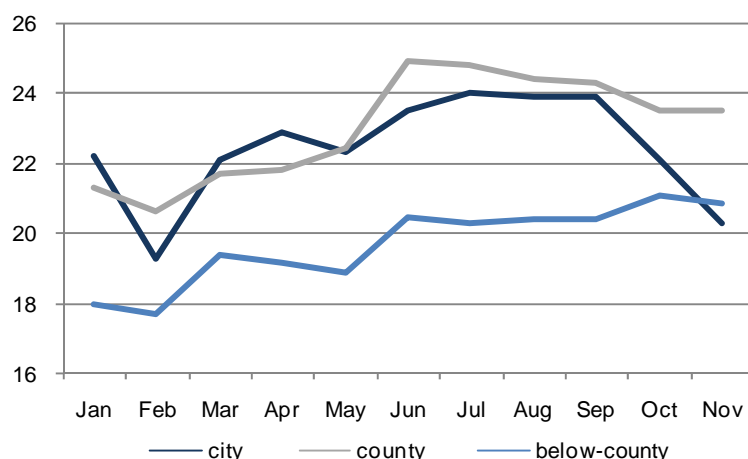


## Value shopping

Not Rated

**Defensive low-end market.** China's lower-end market (second-tier cities, cheap merchandise) appears more defensive during an economic downturn, with total retail sales of consumables still on the rise and growth accelerating in below-county areas, while slowing slightly at the county-level and moderately in cities. Accordingly, we expect Daphne, with its significant presence in tier 4,5 and 6 cities, to prove defensive during the present slowdown. In 1H FY12/08A, its 1,722 sales outlets in non-core cities (of total 3,156), contributed about 52% of total HK\$356.9m operating profit and 35.8% of turnover.

**Chart 1: Growth of retail sales of consumable goods in China (2008) (%)**



Source: National Bureau of Statistics

**Same-store-sales (SSS) growth recovers.** In line with other retailers, the SSS growth of the Daphne brand rebounded to a low single-digit in October & November, from near zero in 3Q, thanks to the improving market sentiment. Its Shoebox, meanwhile, maintained a high-teen growth rate. The difference may mean that the lower-end market has been less affected by the economic gloom or that the current insensitivity of the lower-end market is due to a time lag. If the latter is correct, it could be a major risk associated with the counter. Compared with Belle (1880 HK), which achieved low teen SSS growth in November (mid single-digit in Oct), the Daphne brand's result is less encouraging. We reckon that Belle's more aggressive pricing strategy helped to boost sales. According to the management, Daphne prefers to maintain its selling prices to protect operating margin. The ASP in 4Q was flat YoY for the Daphne brand and up 9-10% for Shoebox.

### China Consumer

Wed, 31 Dec 2008

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### Stock data

Price	HK\$1.24
Target price	n.a.
12 mth range	HK\$1.11-6.20
Market cap.	US\$260.5m
Daily t/o, 3 mth	US\$0.6m
Free float %	52.8%
Ticker	210.HK/0210 HK

### Financial summary

Year to Dec	06A	07A
Turnover (HK\$m)	3,093.1	3,853.6
Net profit (HK\$m)	287.0	384.4
EPS (HK\$)	0.178	0.235
EPS Δ %	13.2	31.9
P/E (x)	7.0	5.3
P/B (x)	2.07	1.48
EV/EBITDA (x)	4.1	3.0
Yield (%)	3.6	4.0
ROE (%)	29.2	32.7
ROCE (%)	23.5	27.0
N. Gear. (%)	5.6	1.1

### Price Chart



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Table 1: SSS growth in 2008

Company	Brands	1H	3Q	Oct	Nov
Daphne	Daphne	16.3%	almost zero	-----low single digit-----	
	Shoebox	29.1%	high teen	-----high teen-----	
Belle – shoe division	multiple brands	-----10%-----		>5%	low double digit

Source: Company data

**Expansion scaled down.** The company has adjusted its expansion plan for FY12/09F, in view of the weak economy ahead. The number of new stores was cut from 400 to 300-350 for Daphne (FY12/08F: 380-400) and from 300 to 250 for Shoebox (FY12/08F: 200-230). Total capital expenditure is budgeted at less than HK\$200m (FY12/08F: HK\$200m).

**Exit from the sportswear market.** The company is considering a potential disposal of its sportswear retailing operation. In 1H FY12/08A, it had 161 sportswear stores, generating HK\$188.8m revenue and HK\$6.1m operating profit. We believe the move could be positive, freeing the company to focus on its core women's footwear business. The company also plans to sell its Anhui plant, probably in 1Q FY12/09F. The Anhui plant is one of Daphne's five factories (others: two in Fuzhou and two in Shanghai) with a capacity of 5-6m pairs of shoes per year (total 30m pairs). Remaining four plants will be maintained and gradually shifted to produce self-branded products (current: 70% of capacity for OEM).

**Our view and valuation.** We admit that the counter should have some discount to other defensive players such as consumer staples because: 1) demand for footwear is more discretionary; 2) more observation is necessary to further prove our evaluation of consumption trends in the lower-end market. Nevertheless, trading at 5.3x P/E historically, we believe the present valuation is undemanding against peers. The company's balance sheet is healthy with a HK\$58.1m net debt at end-June.

Table 2: Valuation of peer group

Company name	Ticker	Fiscal Year end	Mkt Cap (US\$m)	His P/E(x)	Curr-Yr Fwd P/E(x)	Nxt-Yr Fwd P/E(x)	ROE (%)
Daphne	210 HK	12/2007	260.5	5.3	4.0	3.4	32.7
Le Saunda	738 HK	02/2008	43.5	3.4	n.a.	n.a.	10.3
Belle	1880 HK	12/2007	3,689.6	12.9	11.8	9.7	27.1

Source: Bloomberg

Table 3: Valuation of some consumer staples

Company name	Ticker	Fiscal Year end	Mkt Cap (US\$m)	His P/E(x)	Curr-Yr Fwd P/E(x)	Nxt-Yr Fwd P/E(x)	ROE (%)
Huabao	336 HK	03/2008	1,975.3	15.3	14.3	11.6	56.9
Hengan	1044 HK	12/2007	3,563.1	23.3	21.7	17.2	24.2
Yurun	1068 HK	12/2007	1,771.7	11.8	12.3	10.5	26.1
Times	1832 HK	12/2007	229.8	12.0	10.3	8.2	14.0
Wumart	8277 HK	12/2007	923.7	20.8	15.3	13.6	15.0
Average			1,692.7	16.6	14.8	12.2	27.2

Source: Bloomberg

Table 4: P&amp;L

Year to Dec (HK\$m)	05A	06A	07A	1H 07A	1H 08A
Turnover	2,622.7	3,093.1	3,853.6	1,750.6	2,348.6
Cost of sales	(1,478.7)	(1,697.9)	(2,023.8)	(903.8)	(1,155.1)
Gross profit	1,143.9	1,395.2	1,829.8	846.9	1,193.5
Other income and net gains	14.4	25.8	48.5	26.7	8.5
Selling and distribution expenses	(689.5)	(836.7)	(1,122.2)	(516.1)	(704.7)
General and administrative expenses	(145.5)	(188.3)	(215.0)	(110.3)	(140.4)
Profit from operation	323.4	396.0	541.1	247.2	356.9
Finance costs	(4.4)	(9.2)	(11.3)	(5.5)	(5.9)
Share of profit of an associated company	0.3	0.2	0.2	0.1	0.1
Profit before taxation	319.2	387.0	530.0	241.8	351.1
Taxation	(63.2)	(96.5)	(141.3)	(54.8)	(91.3)
Profit for the period	256.1	290.5	388.7	187.0	259.7
Attributable to:					
Equity holders of the Company	254.6	287.0	384.4	184.4	258.4
Minority interests	1.5	3.5	4.3	2.6	1.3
EPS - Basic (HK\$)	0.157	0.178	0.235	0.113	0.158
Proposed DPS (HK\$)	0.050	0.045	0.050	0.025	0.025
<b>Sales breakdown</b>					
Daphne	1,574.1	1,979.9	1,586.3	1,140.3	1,586.3
Shoebox	75.2	142.6	261.0	116.5	261.0
Adidas	178.0	193.8	188.0	131.3	188.0
Other brand businesses	0.0	0.0	1,506.1	0.0	1.1
OEM	795.3	776.8	312.2	362.5	312.2
OEM	795.3	776.8	312.2	362.5	312.2

Source: Company data