

Stepping up China expansion

Hong Kong Retails

Bauhaus (483 HK, HK\$1.50)

BUY (unchanged)

Target price: HK\$2.00 (+33.3%)

Hong Kong – growth on track. Retail sales rose 7.8% YoY and same-store-sales (SSS) 5.0% in 1Q FY3/08. The company plans to open eight stores by end-2007. We expect its above-average selling price (ASP) to offset rental expenses, which should account for less than 20.0% of its total turnover. Its ASP rose 5.7% in 1Q FY03/08, above the original target of 5.0%, mainly due to stronger-than-expected retail sales in the territory. A new accessories store was opened in June in Ocean Terminal.

Strong China growth. The company opened 4 franchised stores in 1Q FY3/08 (turnover up 80.0%) stepping up its franchise expansion. We are confident it can achieve its full-year target of 70 self-managed and franchised stores in FY3/08, from 40 in FY3/07, and 100 in FY03/09. It currently operates four self-managed stores in China, which generated HK\$2.7m in FY3/07A. Bauhaus allocated about 2.0% of its total turnover for A&P expenses. China operations should generate HK\$60.0–70.0m in turnover in FY3/08F and HK\$100.0m in FY3/09F.

Targeting large cities. Bauhaus plans to open 3 self-managed stores in Beijing and one in Nanjing by end-2007, as well as about 20 self-managed stores in Shanghai and 10 in the Greater Shanghai area in the next three years.

Taiwan market. Taiwan's strong growth momentum continued in 1Q FY3/08, with sales up 50.0% YoY and SSS 30%, mainly due to an increase in sales volume and a 13.0% hike in the ASP.

Strong financials. The company had HK\$161.1m in net cash as of 31 March 2007 and we expect it to retain its generous dividend policy by maintaining a payout of around 60.0-70.0%.

Earnings and target price revision. We have cut our net profit forecasts by 4.1% to HK\$71.2m for FY3/08F and 1.8% to HK\$89.2m for FY3/09F, mainly due to a slower per store sales of the franchises. We introduce our net profit estimate FY3/10F of HK\$108.9m to reflect stronger-than-expected retail sales growth and faster China expansion. Currently, the counter is trading at 7.5x P/E FY3/08F and 7.1x P/E ex-cash FY3/08F. We maintain our BUY recommendation with a new target price of HK\$2.00, based on 8.0x P/E FY3/09F.

FY3/07A results recap. FY3/07A turnover increased 16.8% YoY to HK\$509.3m. Net profit came in at HK\$57.2m, up 12.4%, after deducting a doubtful debt provision of HK\$3.8m for certain frozen trade receivables in Taiwan. Strong sales growth in self-managed stores in Taiwan (+51.8%), and in China and Macau franchise outlets (+62.1%) as well as wholesale operations in Japan (+130.6%), were the main top line growth drivers. Same-store sales rose 34.0% YoY in Taiwan and 6.6% in Hong Kong, while its overall sales network expanded to 64 retail and 35 franchised outlets

Table 1: Financial summary

Year to	Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gearing
Mar	HK\$m	HK\$	Δ %	x	x	X	%	%	%	%
06A	50.9	0.145	8.1	10.3	1.8	1.9	7.2	23.4	25.7	Cash
07A	57.2	0.163	12.5	9.2	1.6	2.0	7.3	18.4	19.8	Cash
08F	71.2	0.200	22.3	7.5	1.5	1.5	7.5	20.6	23.4	Cash
09F	89.2	0.250	25.3	6.0	1.3	1.4	7.7	24.0	27.5	Cash
10F	108.9	0.305	22.2	4.9	1.3	1.3	7.8	27.5	30.2	Cash

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Special dividend. A final dividend of HK\$0.03 and a special dividend of HK\$0.06 were proposed, which included the interim dividend of HK\$0.11, represents a dividend payout of around 68.7%

Margins. The overall gross margin widened from 63.6% in FY3/06A to 63.8% in FY3/07F because Bauhaus increased the retail price of some of its private label products in 2H FY3/07A. In FY3/07, rental expenses were up 23.5% at HK\$99.8m and represented 19.6% of total sales, up 1.1 pcp YoY. The company said its rental expenses should not exceed 20.0% of its total sales in FY3/08F. Staff costs increased 14.3% to HK\$954.3m. The operating margin narrowed to 16.9% from 18.5% from a year ago. Thanks to stringent cost controls, advertising, promotion and exhibition expenses were kept at 1.5% of total sales, down from 1.7% in FY3/06A.

Risks. 1) Rental hikes and 2) execution risks in new store expansion.

Table 2 : FY03/07 results

Year to Mar	Turnover (HK\$m)	Gross profit (HK\$m)	Gross margin (%)	Pre-tax profit (HK\$m)	Tax rate (%)	Net profit (HK\$m)	EPS basic (HK\$cents)
FY12/07	509.3	324.7	63.8	66.5	14.0	57.2	16.26
FY12/06	436.0	277.3	63.6	61.1	16.7	50.9	15.05
YoY (%)	16.8	17.1		8.8		12.4	8.0

Source: Company data

Table 3 : Turnover breakdown by country

Year to Mar (HK\$m)	FY3/07A	FY3/06A	Change (%)
H.K.	383.6	355.8	7.8
Taiwan	42.8	28.2	51.8
PRC	32.5	17.8	82.6
Japan	25.6	11.1	130.6
Others	24.8	23.1	7.4
Total	509.3	436.0	16.8

Source: Company data

Table 4: Peer comparison

Name	Ticker	Market Cap. (US\$m)	08P/E (x) 1-yr fwd	08P/E (x) ex-Cash	09P/E (x) 2-yr fwd	ROA (%)	ROE (%)
Joyce	647 HK	81.2	n.a.	n.a.	n.a.	n.a.	n.a.
Bauhaus	483 HK	69.1	7.5	7.1	6.0	19.5	23.4
Moiselle	130 HK	90.3	n.a.	n.a.	n.a.	n.a.	n.a.
Hang Ten	448 HK	93.1	n.a.	n.a.	n.a.	11.1	21.7
Veeko	1173 HK	50.8	n.a.	n.a.	n.a.	n.a.	n.a.
Bossini	592 HK	94.8	12.3	12.3	n.a.	n.a.	n.a.
Giordano	709 HK	730.4	18.4	18.0	15.9	6.9	9.9
Glorious Sun	393 HK	499.8	12.6	11.7	11.3	7.6	16.0
I.T	999 HK	226.6	11.4	11.1	9.7	13.1	15.6
Dickson Concept	113 HK	307.5	12.0	n.a.	9.5	8.8	13.7
Sasa International	178 HK	471.1	24.2	23.7	21.2	13.5	20.3
Lifestyle International	1212 HK	4,405.6	38.2	36.7	34.4	12.4	20.6
Aeon Stores	984 HK	443.3	24.0	18.3	20.3	6.7	21.4
Average		581.8	17.8	17.4	16.1	11.1	18.1

Source: SBI E2-Capital