

Costs pressure

Hong Kong Retail

Bauhaus (483 HK, HK\$1.63)

BUY (unchanged)

Target price: HK\$1.93 (+18.4%)

Hong Kong on track. Retail sales rose 5.9% YoY in 1H FY03/08A and overall revenue 8.8% as a result of increased same-store-sales (up 7.0%) and ASPs (up 8.0%). Hong Kong's operating margin narrowed 1.3pcp to 11.1%. The company opened four stores in 1H FY03/08A and another four since, reaching its target of eight new stores by end-2007. It plans to open six more by end 2H FY03/08F.

Promising China. The company opened two retail outlets in 1H FY03/08A, bringing the total number of outlets to four. China retail sales reached HK\$3.4m, up 17.0 times. Eleven franchise outlets were opened in China and Macau, bringing the total to 46. Franchise turnover surged 60.8% to HK\$20.9m on better "TOUGH" brand recognition in China. The overall operating margin in China narrowed 2.5pcp to 33.8%. We remain confident in China operations, which should generate HK\$60.0–70.0m in turnover in FY03/08F and HK\$100.0m in FY03/09F.

Table 1: No. of outlets

Outlets	FY03/07A	1H FY03/08A	FY03/08F
Self-managed outlets			
HK	44	48	58
Taiwan	18	21	25
China	2	4	8
Macau	0	1	3
Franchise outlets			
PRC & Macau	35	46	56
Total	99	120	150

Source: Company data

More stores in China. The company plans to open 10 franchise outlets and four retail outlets in 2H FY03/08F. It will have 60 self-managed and franchised stores in FY03/08F and 80 in FY03/09F. Bauhaus will open three self-managed stores in Shanghai and four in Beijing by 2008.

Taiwan market. Taiwan retail turnover jumped 56.0% to HK\$26.0m in 1H FY03/08A, with same-store sales up 35.0% and the ASP of about 20.0%. The operating margin widened 12.5pcp to 13.8%. Three stores were opened in 1H FY03/08A and up to five will open in 2H FY03/08F. In the next few years, the company plans to have 15-18 stores for each brand (TOUGH, Salad, 80/20), bringing the total to 50.

Margins. The gross margin widened 2.8pcp to 65.9%, on higher ASPs in Hong Kong (up about 8.0%). In 1H FY03/08A, rental costs increased 27.8% to HK\$57.5m and accounted for 22.6% of total turnover, up 2.1pcp YoY.

Table 2: 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	11.2	1.96	1.9	6.6	23.4	25.7	Cash
07A	57.2	0.163	12.5	10.0	1.73	2.0	6.7	18.4	19.8	Cash
08F	64.2	0.178	9.4	9.1	1.64	1.6	6.9	18.7	19.7	Cash
09F	86.5	0.241	34.9	6.8	1.44	1.1	7.0	23.6	25.4	Cash
10F	105.4	0.293	21.7	5.6	1.25	1.4	7.1	25.4	28.1	Cash

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Staff costs rose 21.3% to HK\$50.1m, accounting for 19.7% of total sales, up 0.9pcp YoY. As a result, the EBITDA margin narrowed 1.0pcp to 12.8%. In 2H FY03/08F, costs should be contained. The net margin shrunk 0.4pcp to 9.1%.

Earnings and target price revision. We have cut our net profit forecasts by 9.8% to HK\$64.2m for FY03/08F, 3.0% to HK\$86.5m for FY03/09F and 2.4% to HK\$106.3m, mainly due to higher operating costs. Currently, the counter is trading at 7.7x P/E FY03/08F and 6.4x P/E FY03/09F. We maintain our BUY recommendation with a new target price of HK\$1.93, based on 8.0x P/E FY03/09F.

Interim results. Turnover grew 15.8% YoY to HK\$254.1m, gross profit 20.9% and net profit 11.1% to HK\$23.1m in 1H FY03/08A, which was below our expectations. Turnover of self-managed retail stores in China rose 1,700.0% and in Taiwan 56.0%, and that of franchise outlets in China and Macau 60.8%. The company's net cash position reached HK\$131.7m. An interim dividend of HK\$0.025 was declared and the dividend payout ratio reached 39.1% of EPS.

Table 3: Interim 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\$)
1H FY03/08A	254.1	167.4	65.9	26.3	11.8	23.1	0.064
1H FY03/07A	219.5	138.5	63.1	24.1	13.7	20.8	0.059
YoY (%)	15.8	20.9		9.1		11.1	8.5

Source: Company data

Table 4: Turnover breakdown by country

Year to Mar (HK\$m)	1H FY03/07A	1H FY03/08A	Change (%)
H.K.	166.1	182.0	9.6
Taiwan	22.6	36.9	63.3
PRC	13.5	23.7	75.6
Japan	10.7	9.2	(14.0)
Others	12.6	13.4	6.3
Eliminations	(6.0)	(11.1)	85.0
Total	219.5	254.1	15.8

Source: Company data

Table 5: Peer comparison

Name	Ticker	Curr	Price (HK\$)	Market Cap. (US\$m)	08P/E (x) 1-yr fwd	09P/E (x) 2-yr fwd	ROA (%)	ROE (%)	EBIT Margin (%)
Joyce	647	HKD	0.28	57.3	n.a.	n.a.	n.a.	n.a.	n.a.
Moiselle	130	HKD	2.47	89.3	n.a.	n.a.	n.a.	n.a.	n.a.
Hang Ten	448	HKD	0.55	69.3	n.a.	n.a.	11.1	21.7	7.3
Veeko	1173	HKD	0.24	53.1	n.a.	n.a.	n.a.	n.a.	n.a.
Bossini	592	HKD	0.39	78.2	10.1	n.a.	n.a.	n.a.	n.a.
Giordano	709	HKD	3.52	673.1	16.9	14.5	6.89	9.98	7.5
Glorious Sun	393	HKD	4.36	592.2	15.0	13.7	7.6	16.0	6.9
I.T	999	HKD	3.02	442.8	18.8	15.3	13.1	15.6	7.8
Dickson Concept	113	HKD	6.50	310.3	10.7	8.5	8.8	13.7	6.4
Sasa International	178	HKD	3.34	589.5	18.4	15.8	13.5	20.3	7.8
Lifestyle International	1212	HKD	19.62	4,288.5	36.3	32.4	12.4	20.6	30.0
Aeon Stores	984	HKD	16.80	560.0	25.2	23.0	6.7	21.4	4.0.
Average					18.9	17.6	12.8	18.9	11.1

Source: Bloomberg, SBI E2-Capital