

Tapping the premium brand market

Hong Kong Retails

Bauhaus (483 HK, HK\$1.44)

BUY (unchanged)

Target price: HK\$1.80 (+25%)

- **Top-up placement to increase public float.** Bauhaus announced a top-up placement on 6th Feb. Its major shareholder will place 17.6m old shares, representing 5.02% of its existing issued share capital, at HK\$1.30, at a 3.7% discount to its last closing price, to Galaxy Opportunity Fund. The major shareholder will subscribe to 8.8m new shares, representing 2.45% of the issued share capital, lowering its effective shareholdings to 48.74% from 49.96%, while Galaxy will hold 4.9% of Bauhaus after the placement.
- **HK expansion gathering pace.** We believe there is no immediate need for Bauhaus to raise cash as it was in a net cash position of HK\$111m (HK\$0.32 per share) at end-Sept 2006. The placement is to increase its public float as the counter is tightly held. Apart from that, part of the funds will be set aside for expansion in Hong Kong. The successful debut of "Bauhaus Elite" in Nov 2006, targeting the premium brand market with an average ASP of HK\$2,000-3,000, has increased Bauhaus' appetite for this segment. The company will rent for "Bauhaus Elite" a four-storey retail complex in Yiu Wah Street, Causeway Bay, which will start operation in April 2007. The retail complex comprises a total GFA of c.6,000sq. ft., with an average rental cost of only HK\$50/sq.ft per month. With the renovation cost of about HK\$2-3m the company expects to breakeven in the first one to two months. Bauhaus Elite carries mainly third-party brands on top of its own brands.

Our take

- **Right move into the premium brand market.** We believe the company is right to diversify into the upper end segment in order to grow in Hong Kong. As a niche market retailer, Bauhaus does not face much pricing pressure. However, it also means that market breadth is pretty narrow. It is difficult to achieve remarkable top-line growth in a mature market like Hong Kong. We see Bauhaus' venture into the premium brand market as a vertical upward diversification which will allow it to i) broaden its customer base; ii) enhance brand equity and iii) achieve further economies of scale leveraging on Bauhaus' existing platforms, since Bauhaus has already established good relationships and networks with third-party brands after sourcing them in the past.
- **Downside risk from inability to maintain sales/rental ratio at 20%.** We view the Hong Kong expansion as Bauhaus' most aggressive plan ever which reflects the management's optimism about Hong Kong's retail industry, under the backdrop of the rising GDP, lower interest rates and mild inflation. Since the retail complex covers a sizeable area, we believe the major downside risk to come from Bauhaus's inability to grow its sales so as to maintain the sales/rental ratio at 20%. Bauhaus will continue to keep advertising and promotion expenses at c.1-1.5% of sales.

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	%	%	%	%
05A	46.6	0.134	13.9	10.7	3.52	6.3	0.0	32.5	36.7	Cash
06A	50.9	0.145	8.1	9.9	1.73	7.5	7.5	24.7	27.1	Cash
07F	60.6	0.172	18.7	8.4	1.74	4.5	3.6	21.7	24.8	Cash
08F	74.1	0.205	19.3	7.0	1.41	4.8	4.3	22.8	26.3	Cash
09F	90.8	0.252	22.5	5.7	1.36	4.4	5.2	24.5	28.5	Cash

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Table 2: Operation statistics

Year to Mar	same store sales (%)		sales (%)	
	3Q FY3/07A	1H FY3/07A	3Q FY3/07A	1H FY3/07A
H.K.	+2.0	+7.0	+5.0	+14.50
Taiwan	+60.0	+27.0	+56.0	+59.1
PRC	+15.0	n.a.	n.a.	+75.7
Japan (wholesales)	n.a.	n.a.	+62.0	+69.8

Source: SBI E2-Capital

Operation updates.

- **Hong Kong** Due to the late arrival of cold weather this winter and seasonality, retail sales rose 5% YoY and same-store-sales (s.s.s.) 2% in 3Q FY3/07 compared with a 14.5% YoY and 7% YoY increase in 1H FY3/07, respectively. The weaker growth was mainly a result of an 8% YoY decline in s.s.s. for the month of November alone. It rebounded to +11% YoY in December as the positive impact of raising product mark-ups since Sept 2006 began to take effect.
- **Taiwan.** The exceptional 1H FY3/07 performance carried into 3Q FY3/07, with sales and s.s.s. growth of 56% YoY and 60% YoY respectively, compared with 59.1% and 27.0% in 1H FY3/07, mainly due to the successful takeover of the Taiwan operation by the Hong Kong management team. The counter in Sogo Department Store has just opened this month, which we believe can enhance its brand equity and bargaining power over future concession counters.
- **China.** The pace of franchisee expansion remains on track with an addition of nine franchised stores in 3Q FY3/07 from 20 in 1H FY3/07. We are confident in its full year target of 35 stores in FY3/07. Sales from franchisees re-orders remain strong with c.20-30% increase. However, the company has only one self-own store in China at present, as opposed to its earlier plan to add another two “TOUGH” and one “SALAD” stores in Shanghai in 1Q 2007. However, sales from this self-own store remain robust averaging HK\$500,000 sales per month.
- **Japan.** Sales in 3Q FY3/07, up c.70% YoY, mainly reflected the wholesale of apparel and fashion accessories, as the company’s five-year apparel distribution agreement with IMC a Japanese fashion retail chain store operator, was signed only in September 2006. The first “TOUGH” apparel shop is to open in March this year.
- **Valuation.** While Bauhaus fundamentals remain intact, we believe that the increase liquidity from the placement will be positive to its share price. It is a solid company with exceptional management and a generous dividend payout policy. After the share placement, we estimated net cash to reach HK\$111.1m in FY3/07F. We maintain our BUY recommendation with a target price of HK\$1.80, equivalent to 8.5x P/E in FY3/08F. It is trading at 5.3x ex-cash and 7.0x cum-cash P/E.

Table 3: Peer comparisons

Name	Ticker	Curr	Price (HK\$)	Market Cap. (US\$m)	P/E (x) 1-yr fwd	P/E (x) 2-yr fwd	ROA (%)	ROE (%)	EBIT Margin (%)
Joyce	647	HKD	0.36	75.8	n.a.	n.a.	13.03	17.9	9.5
Bauhaus	483	HKD	1.42	64.7	9.1	7.5	19.54	23.4	13.7
Moiselle	130	HKD	2.1	75.9	n.a.	n.a.	24.85	28.1	23.3
Hang Ten	448	HKD	0.65	83.0	n.a.	n.a.	11.05	21.7	7.3
Veeko	1173	HKD	0.157	33.0	n.a.	n.a.	14.33	17.3	5.0
Bossini	592	HKD	0.46	91.7	16.9	15.7	12.47	18.3	5.7
Giordano	709	HKD	3.75	716.8	15.5	14.0	14.28	19.9	10.9
Glorious Sun	393	HKD	4.2	574.8	16.0	14.3	7.54	15.5	8.0
I.T	999	HKD	1.39	185.2	10.7	9.1	13.81	18.2	9.7
Dickson Concept	113	HKD	9.37	375.9	15.6	12.8	10.51	15.4	8.1
Sasa International	178	HKD	2.6	441.5	16.7	14.4	13.53	20.3	7.8
Lifestyle International	1212	HKD	21.7	2,337.3	26.2	22.4	10.91	21.1	29.4
Aeon Stores	984	HKD	9.85	328.3	20.3	16.8	6.9	21.2	n.a.
Average					16.3	14.1	13.3	19.9	11.5

Source: SBI E2-Capital