

A big bargain

Hong Kong Retails

Bauhaus (483 HK, HK\$1.16)

BUY (unchanged)

Target price: HK\$1.60 (+38%)

We see the macroeconomic landscape in H.K. as increasingly favorable for retailers like Bauhaus, since: 1) domestic income is higher, 2) both interest rate and rental cost are stabilizing and 3) inflation is coming back but in a moderate way. In 1H FY3/07, Bauhaus recorded an impressive sales and same-store-sales (s.s.s.) of 15% and 6% from the H.K. market, compared with only a 1.1% s.s.s. by Sasa (178 HK). For the other markets, performance from direct retailing in Taiwan and wholesaling in Japan beat our expectation. In Taiwan, s.s.s. turned from a loss in Apr-Jun to +25% in 1H FY3/07 because the H.K. operation team has taken over the Taiwan operation completely. Sales from Japan surged 70% in 1H FY3/07, thanks to product range expansion.

New store openings to fuel further growth in the H.K. market. Sales and s.s.s. rose 15% (1Q07: +16%) and 6% (1Q07: +6%) respectively in 1H FY3/07. Bauhaus has just opened two new stores in Causeway Bay under “TOUGH” and Tsim Sha Tsui under “Bauhaus” in Oct. The Causeway Bay store is located on Kai Chiu Road, a hot spot with strong traffic flow and sizeable GFA of 1,500 sq.ft.. It will open another new store under “SALAD” in Nov. We expect these new stores to fuel further top-line growth in 2H FY3/07. The strong sales growth recorded in 1H is caused by a 6% increase in average selling price (ASP), representing a net increase of 3.8% after discounting a 2.2% inflation during the period. Our previous forecast of 15% sales growth in FY3/07F looks too conservative, we are revising it up to 20%. In 1H FY3/07, rental costs accounted for 24% of sales but it is expected to fall below 20% in FY3/07F.

Taiwan sales rebounded despite political instability. Sales surged 64% in 1H FY3/07 (1Q07: +33%), c.23% came from ASP hike. The s.s.s. in 1H FY3/07 recorded +25%, compared with a loss from Apr-Jul, thanks to the successful takeover of the Taiwan operation by the H.K. operation management team. More incentives are provided in a bid to drive the performance of the sales team.

Sales doubled from its 1st self-owned store in Shanghai. Previously under franchisee operation, Bauhaus saw sales doubled from RMB200,000 to RMB400,000 in a month after they took back the operation from the franchisee. We believe the self-owned operation model allows Bauhaus to have higher flexibility in terms of product selection and inventory management. It can offer more than 100 SKUs in these shops, which is larger than its franchisees. It is also easier for them to adjust the product mix according to the preference of customers in different locations. It targets to add two more self-owned stores mainly in 1st-tier cities and expect these shops to contribute c.10% of total sales in FY3/07F.

Sales from wholesaling in Japan surged, while the Europe market is undergoing a consolidation. Product diversification from personal accessories to include apparels has led to a 70% sales surge in Japan. The performance of Europe market is pretty flat in 1H FY3/07 since it is under consolidation. It has recruited an

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	0.191	13.9	6.1	1.99	6.3	0.0	32.5	36.7	Cash
06A	50.9	0.150	(21.4)	7.7	1.35	7.5	9.6	24.7	27.1	Cash
07F	57.1	0.169	12.3	6.9	1.36	4.7	4.4	20.5	23.4	Cash
08F	70.6	0.209	23.6	5.6	1.11	5.0	5.4	22.0	25.3	Cash
09F	85.3	0.252	20.8	4.6	1.06	4.6	6.5	23.4	27.1	Cash

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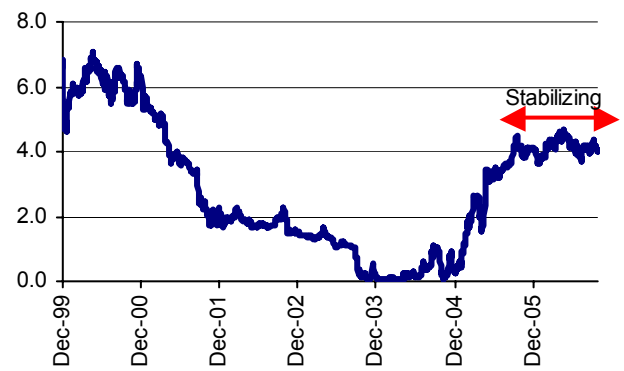
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ex-management from GStar and set up an office in U.K. mainly for the distribution of products in Europe. We believe the Europe market is for brand building currently.

Valuation. We have fine-tuned our earnings forecast to reflect higher sales growth from H.K. and Taiwan. We expect a net cash position of HK\$87m in FY3/07F. Dividend payout should be able to maintain well above 30%. It trades at only 7x FY3/07F P/E, which is very cheap compared to 12x, 16x and 17x for I.T (999 HK), Giordano (709 HK) and Sasa (178 HK). We maintain our BUY recommendation, with a target price of HK\$1.6, equivalent to 7.7x FY3/07F P/E.

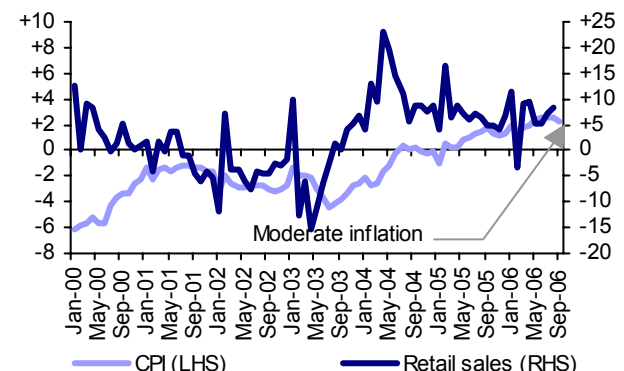
Macroeconomic landscape in Hong Kong.

Chart 1: HK HIBOR – 1 month



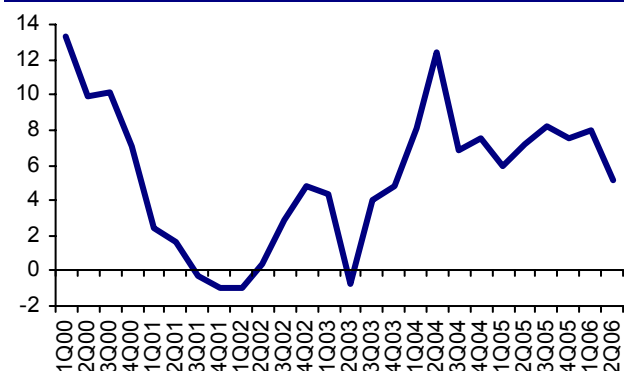
Source: Bloomberg

Chart 2: Composite CPI vs Retail sales



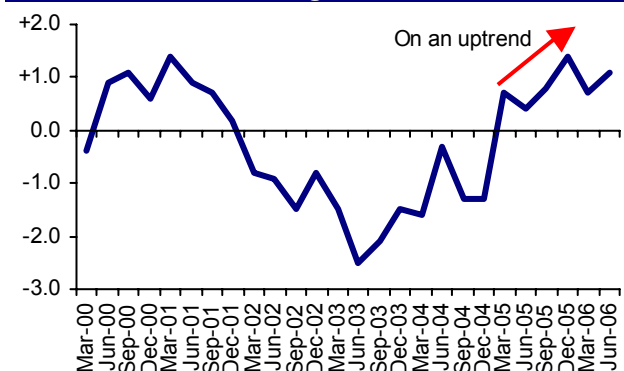
Source:

Chart 3: HK GDP



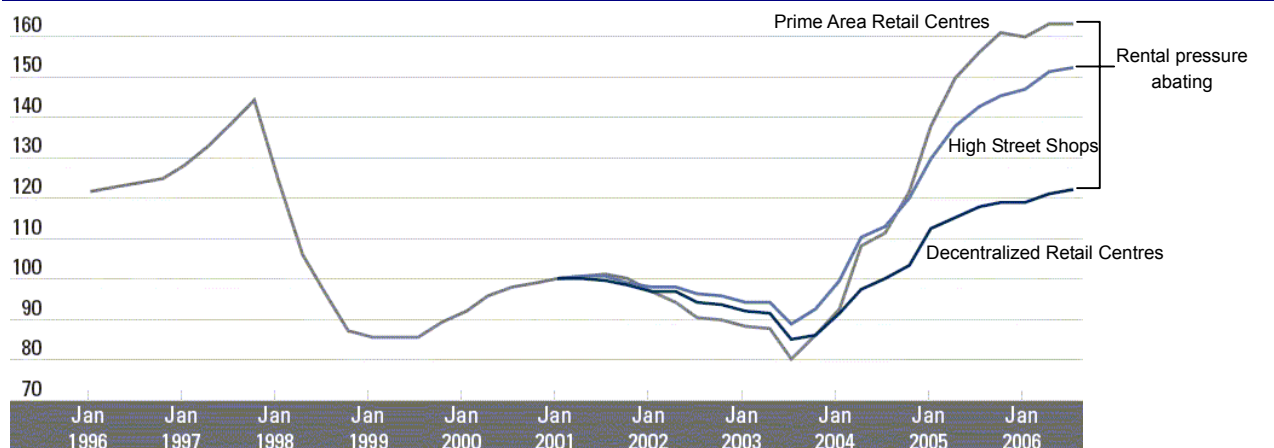
Source: Census & Statistics Department, HKSAR

Chart 4: HK nominal wages



Source: Census & Statistics Department, HKSAR

Chart 5: Retail rental index



Source: Jones Lang LaSalle, Greater China Property Index July 2006