

## Bauhaus: Deep value play

### Recommendation: BUY (initiating coverage)

### Hong Kong Retails

Price	HK\$1.07	Year to Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gear.	
Target price	HK\$1.60 (+50%)	Mar	HK\$m	HK\$	Δ %	x	x	x	%	%	%	
12 mth range	HK\$0.75-1.15	05A	46.6	0.191	13.9	5.5	1.82	6.3	-	32.5	36.7	Cash
Market cap.	US\$48.1m	06A	50.9	0.150	(21.4)	7.0	1.23	7.5	10.5	24.7	27.1	Cash
Daily t/o, 3 mth	US\$0.04m	07F	56.8	0.168	11.6	6.3	1.24	4.8	4.8	20.4	23.2	Cash
Free float %	26.4%	08F	69.4	0.205	22.3	5.2	1.01	5.1	5.8	21.6	24.9	Cash
Ticker	0483.HK/483 HK	09F	84.9	0.251	22.3	4.2	0.97	4.6	7.1	23.3	27.0	Cash

Relative to Hang Seng Index (1 mth, 3 mth, 12 mth): +13.4%, +12.7%, -5.4%

Actual price changes (1 mth, 3 mth, 12 mth): 21.6%, +13.8%, +8.1%

Consensus EPS (07F-08F): HK\$0.180, HK\$0.214

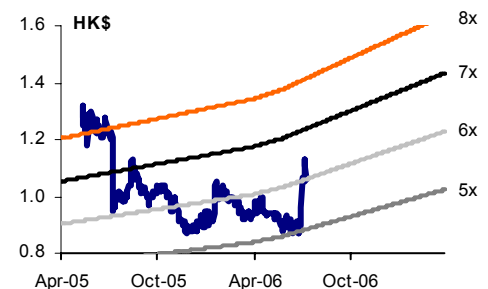
### Key points:

- A niche retailer of trendy casual wear and accessories for youngsters in Greater China regions.
- More flexibility in pricing and resistance to rental pressure.
- Strong top-line growth is expected for FY3/07-09F, reinforced by fast expansion in the PRC franchisee network, a rebound of the Taiwan market and a modest Hong Kong market growth.
- Orders-on-hand from the PRC market have increased >100% YoY.
- Same-store-sales growth in Taiwan rebounded by 6% YoY in June, compared with -2.5% YoY for Apr-May, 2006.
- ASP continues to improve with fewer markdowns.
- >30% dividend payout is expected in FY3/07F, with a net cash of HK\$136m (c.HK\$0.40/share) in FY3/06 and limited capex requirement going forward.
- Bauhaus is trading at 5.1x ex-cash FY3/07F P/E, compared to an industrial average of 12.5x. Our target price is HK\$1.6, based on 8x FY3/07 P/E.

### Why Bauhaus, not the others?

- ❑ **Flexibility in pricing and product mix.** Unlike other casual wear retailers targeting the mass-market, Bauhaus focuses on young consumers who are fashion-conscious. Offering a unique line of trendy and fashionable casual wear and accessories, Bauhaus sees greater flexibility in pricing, greater product diversification and better merchandising mix, which differentiate itself from other casual wear retailers such as Giordano (709 HK), Bossini (592 HK) and Hang Ten (448 HK). Retail unit prices of Bauhaus ranges from c. HK\$100 to HK\$4,000 with an ASP of c.HK\$400. Gross margin is at the high-end of the market peers.
- ❑ **Brand originator not carriers.** A majority of products sold in Bauhaus' stores belongs to its self-owned brands. Own-brand sales accounted for 65% of total turnover, while third-party brands took up 35% in FY3/06. Bauhuas expects sales from self-owned brand against 3<sup>rd</sup>-party brands to increase further to 75%/25% in FY3/07F. The benefit of own brands allows Bauhaus to enjoy a higher gross margin since they generally command a much higher price premium than that of 3<sup>rd</sup>-party brands. This differentiates Bauhaus from I.T. (999 HK), with an only 50.7% sales from in-house and licensed brands in FY2/06.
- ❑ **Prudent management.** Most Hong Kong retailers have been hit by surging rental and labour costs. Some of their earnings dived by 20-40% in their latest results. Bauhaus managed to report an 8% increase in earnings, thanks to the prudent management in selecting store locations. The majority of Bauhaus stores is located in

Chart 1: P/E bands



Source: SBI E2-Capital

Kowloon and New Territories, where rentals hikes are comparatively milder than other prime areas. In FY3/06, Bauhaus successfully renewed 16 out of 20 expiring leases. Rental saw a c.30% rise for street level shops and c.19% for shopping centers. Rental expenses for the Group rose 25% YoY in FY3/06. In FY3/07, Bauhaus is going to renew 27 expiring leases and the expected rental increase will be <30%. It will add 4 outlets in Hong Kong, bringing the total number of outlets to 50 in FY3/07F.

**Table 1: Recent results for Hong Kong retailers**

Stock	Ticker	Operating profit YoY (%)	Net profit YoY (%)
Joyce	647 HK	35.8	21.0
<b>Bauhaus</b>	<b>483 HK</b>	<b>8.3</b>	<b>8.1</b>
Dickson	113 HK	5.6	2.4
Moiselle	130 HK	(6.1)	4.0
Hang Ten	448 HK	(13.4)	(15.0)
Veeko	1173 HK	(58.0)	(32.8)
Bossini	592 HK	(37.9)	(42.0)
Gay Giano	686 HK	(87.4)	(84.6)
I.T Ltd	999 HK	(0.8)	9.8

Source: SBI E2-Capital

### Franchising in the PRC

- **Low risk and fast expansion under the franchise model.** Bauhaus has gained a wider presence in the PRC market under the “TOUGH” brand. The number of franchise outlets increased to 25 in June 2006, compared with only 8 in FY3/05. It plans to add 18 outlets in FY3/07, bringing the total number of outlets to 35. Bauhaus is prudent in choosing its store locations. It adopted the same strategy in Hong Kong by selecting most store locations in shopping malls in the first/second-tier cities, such as Shenzhen, Gunagshou and Shanghai. (refs. to chart 2: Map of PRC franchised outlets) The accretive PRC expansion plan reflects management’s clear vision of its niche market position and bottom-line growth.
- **Orders-on-hand already saw a >100% rise.** Bauhaus usually receives orders from franchisees for the Fall/Winter and Spring/Summer seasons in June and December every year. Bauhaus’s orders-on-hand have already increased over 100% year to date. Although, the PRC and Macau markets together only represented 4% of total Group sales in FY3/06, we expect they will account for c.10% in FY3/09F.
- **PRC expansion marks a right strategic move.** The fast expansion into the PRC market slightly eroded its gross margin in FY3/06, since franchise operation commands a lower margin than direct retailing. However, the unit retail price in the PRC is c.15% higher than in Hong Kong, offsetting margin pressure. We believe the expansion into the PRC market is a right move in view of a saturated domestic Hong Kong market. The capex outlay is minimal under the franchise model. Most of the capital including decoration, rental deposit and stocks totalling c.RMB80-100k per store, is committed by franchisees.

**Table 2: Peer comparison**

Stock	Ticker	Mkt cap (US\$m)	Inventory days	P/E (x)		Gross margin (%)	Operating margin (%)	ROA (%)	ROE (%)
				06A	07F				
<b>Department store operators</b>									
Lifestyle International	1212.HK	1,596	17.1	21.3	19.0	53.1	29.4	10.9	21.1
Dickson Concept	113 HK	347	121	12.8	13.0	46.0	7.5	10.7	15.4
<b>Mass-market fashion retailers</b>									
Giordano	709 HK	726	58.9	13.8	14.4	50.8	10.3	14.3	19.9
Bossini	592 HK	109	71.1	8.1	6.5	46.6	6.3	12.2	17.9
Hang Ten	448 HK	97	72.2	6.5	n.a.	54.3	9.8	16.3	36.3
<b>Fashion retailers</b>									
Glorious Sun	393 HK	500	94.2	15.6	14.0	42.8	8.0	7.5	15.5
I.T LTD	999 HK	173	84	10.8	10.0	58.9	9.7	13.8	18.2
Moiselle	130 HK	76	166.7	7.5	n.a.	75.8	24.3	23.0	26.3
Bauhaus	483 HK	51	173	5.4	6.5	63.6	14.1	15.6	14.5
Veeko	1173 HK	45	170.3	7.0	n.a.	63.6	9.4	13.4	16.7
Gay Giano	686 HK	4	175.3	13.1	n.a.	69.9	9.0	23.7	32.6
<b>Cosmetic retailers</b>									
Sa Sa International	178 HK	467	89.5	19.4	16.9	43.7	7.8	13.5	20.3
Bonjour	653 HK	27	74.6		n.a.	36.0	(4.0)	(14.9)	(42.1)
<b>Average</b>				<b>12.0</b>	<b>12.6</b>	<b>54.2</b>	<b>10.9</b>	<b>12.3</b>	<b>16.4</b>

Source: SBI E2-Capital & Bloomberg

Chart 2: Location of PRC franchise outlets



Source: Company data

### Direct-retailing in Taiwan

- ❑ **Stronger sales growth with more effective management.** The performance in the Taiwan market was disappointing in FY3/06, mainly due to poor economic environment and under-performing local management. Same-store-sales growth declined by 4.9% in FY3/06. The strategy of localization failed to meet management's expectations, so the Hong Kong operation management team began to take over the Taiwan operation the beginning of 2006. The same-store-sales growth has improved to -2.5% in April-May and +6% in June 2006.
- ❑ **New store in Taiwan.** Bauhaus has successfully leased a POS in the populous Sogo Taipei Department Store in Taiwan, which is scheduled to open in September 2007. We believe this will solidify its footage and brand image in Taiwan.

### Wholesaling in Japan & Europe

- ❑ **Expanding product range.** Currently, the Japanese distributor mainly distributes bags, wallets, belts and personal accessories items under the brandname TOUGH in Japan with c.200 POS. Bauhaus will expand its product range by introducing apparels to the Japan market by the end of 2006. Product diversification will drive sales growth further. We expect at least a 20% YoY sales growth from the Japan wholesale market.
- ❑ **Expand presence in Europe.** Bauhaus targets to increase its presence in the European markets in the coming year. Apart from continuously participating in various fashion trade shows in Europe, it has recently recruited a new local wholesale expertise from U.K. We believe the Europe market is not easy but it is good for enhancing brand image.

**Valuation.** Bauhaus is cash-rich, with a net cash of HK\$136m in FY3/06. Dividend payout should be able to be maintained at >30% in FY3/07F. Capex is estimated at HK\$30m for FY3/07F, which will be used on HK and PRC expansions. Trading at 5.1x ex-cash FY3/07F P/E, together with growing earnings momentum, we initiate

coverage with a BUY and a target price of HK\$1.6, equivalent to 8x FY3/07F P/E.

**Major risks. 1) Inventory risks.** Inventory increased by c.33% in FY3/06, which outpaced sales growth and led to a rise in inventory turnover days to 172.7 from 141.5 in FY3/05A. Management attributed this to the ramp up in the number of retail outlets. Inventory is expected to stay at similar level in FY3/07F. Unlike the mass-market fast retailing stores like Giordano, Bauhaus is a fashion retailer with two main seasons in product offerings, so the inventory level is relatively higher but it is still within the industry range of other fashion retailers, such as Moiselle (130 HK) and Veeko (1173 HK). **2) Rental hikes.** Bauhaus expects rental to rise by <30% in FY3/07F. **3) Quota costs.** Quota is required for the Europe market. Bauhaus has obtained sufficient quota for FY3/07F.

**Corporate governance issues.** 1) Ernst & Young has been the auditor since listing (Apr 2005); 2) The company has started paying dividends since the interim results of 2005. Management indicated that dividend payout will be >30% per year going forward. 3) The founder, chairman and CEO of the Group, Mr. Wong does not have any side-business other than Bauhaus.

**Table 3: Retail outlets breakdown**

Year to Mar	2002A	2003A	2004A	2005A	2006A	2007F	2008F	2009F
<b>Hong Kong</b>								
- Bauhaus	26	27	26	27	30	31	32	33
- TOUGH	6	6	5	6	5	5	6	8
- SALAD	-	-	1	4	6	8	10	10
- 80/20	-	-	-	-	4	6	8	10
- Libre	-	-	-	-	1	-	-	-
<b>Sub-total</b>	<b>32</b>	<b>33</b>	<b>32</b>	<b>37</b>	<b>46</b>	<b>50</b>	<b>56</b>	<b>61</b>
Net additions:		1	(1)	5	9	4	6	5
<b>Taiwan</b>								
- TOUGH	9	11	11	10	12	13	14	15
- SALAD	-	-	-	-	4	5	8	15
- 80/20	-	-	-	-	1	3	8	15
<b>Sub-total</b>	<b>9</b>	<b>11</b>	<b>11</b>	<b>10</b>	<b>17</b>	<b>21</b>	<b>30</b>	<b>45</b>
Net additions:		2	0	-1	7	4	9	15
<b>Total self-owned outlets</b>	<b>41</b>	<b>44</b>	<b>43</b>	<b>47</b>	<b>63</b>	<b>71</b>	<b>86</b>	<b>106</b>
Net additions:		3	(1)	4	16	8	15	20
<b>Franchise outlets</b>								
PRC & Macau				8	18	35	60	80
Net additions:					10	17	25	20
<b>TOTAL</b>	<b>41</b>	<b>44</b>	<b>43</b>	<b>55</b>	<b>81</b>	<b>106</b>	<b>146</b>	<b>186</b>
Net additions:		3	(1)	12	26	25	40	40

Source: SBI E2-Capital & company data



Chart 3: Bauhaus, HongKong



Source: Company

Chart 4: PRC franchised outlets



Source: Company

Chart 5: 80/20



Source: Company

Chart 6: 80/20



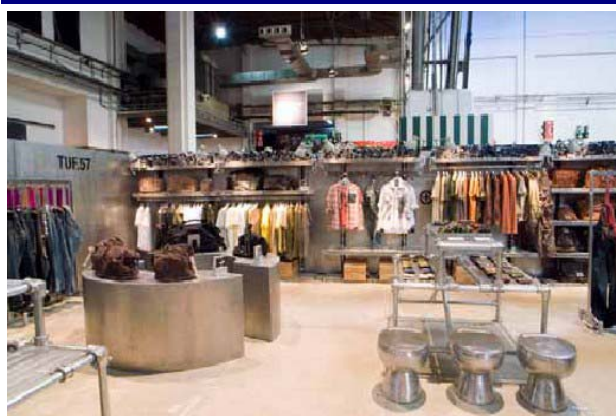
Source: Company

Chart 7: SALAD



Source: Company

Chart 8: Wholesale of "TOUGH"



Source: Company

**Table 4: Interim results**

Six months to Sep	Turnover (HK\$m)	Gross profit (HK\$m)	Gross margin (%)	Pre-tax profit (HK\$m)	Tax rate (%)	Net profit (HK\$m)	EPS (HK\$)	DPS (HK\$)
1H FY05	180.7	116.9	64.7	20.5	17.5	17.6	0.054	0.045
1H FY04	148.7	94.6	63.6	21.4	17.5	17.5	0.071	Nil
YoY (%)	21.5	23.6		4		0.5		

Source: Company data

**Table 5: Earnings model**

Year to Mar (HK\$m)	2004A	2005A	2006A	2007F	2008F	2009F
<b>Turnover</b>						
Hong Kong	254.4	291.7	355.8	410.0	486.7	562.0
Taiwan	22.3	26.0	28.2	36.1	53.3	82.8
PRC	n.a.	7.7	17.7	35.2	61.5	83.6
Japan & others	30.1	17.3	34.2	53.8	80.7	119.6
	<b>306.8</b>	<b>342.7</b>	<b>436.0</b>	<b>535.0</b>	<b>682.3</b>	<b>848.0</b>
% change	-	11.7	27.2	22.7	27.5	24.3
Cost of sales	(120.6)	(122.8)	(158.7)	(198.0)	(255.2)	(318.8)
Gross profit	186.2	220.0	277.3	337.1	427.1	529.2
Other revenue	0.4	1.5	4.2	4.4	4.7	4.9
Operating expenses	(135.7)	(164.7)	(220.0)	(271.5)	(346.3)	(429.5)
Operating profit	50.9	56.8	61.5	70.0	85.5	104.5
Finance costs	(0.0)	(0.2)	(0.4)	(0.4)	(0.5)	(0.5)
<b>Profit before tax</b>	<b>50.8</b>	<b>56.6</b>	<b>61.1</b>	<b>69.6</b>	<b>85.0</b>	<b>104.0</b>
Taxation	(10.5)	(10.0)	(10.2)	(12.8)	(15.6)	(19.1)
<b>Profit after tax</b>	<b>40.3</b>	<b>46.6</b>	<b>50.9</b>	<b>56.8</b>	<b>69.4</b>	<b>84.9</b>
Minority interest	0.0	(0.5)	0.0	0.0	0.0	0.0
<b>Net profit</b>	<b>40.3</b>	<b>46.6</b>	<b>50.9</b>	<b>56.8</b>	<b>69.4</b>	<b>84.9</b>
% change	-	15.5	9.2	11.6	22.3	22.3
Dividends	(51.7)	-	(37.7)	(17.0)	(20.8)	(25.5)

Source: SBI E2-Capital

P & L (HK\$m)	05A	06A	07F	08F	09F
<b>Year to Mar</b>					
<b>Turnover</b>	<b>342.7</b>	<b>436.0</b>	<b>535.0</b>	<b>682.3</b>	<b>848.0</b>
% chg	11.7	27.2	22.7	27.5	24.3
Gross profit	220.0	277.3	337.1	427.1	529.2
EBITDA	60.6	63.5	72.5	89.2	109.2
Depre./amort.	(5.4)	(6.2)	(6.9)	(8.3)	(9.6)
EBIT	55.3	57.3	65.5	80.9	99.6
Net int. income/(exp.)	1.3	3.8	4.0	4.2	4.4
Exceptionals	-	-	-	-	-
Associates	-	-	-	-	-
Jointly-controlled entit.	-	-	-	-	-
<b>Pre-tax profit</b>	<b>56.6</b>	<b>61.1</b>	<b>69.6</b>	<b>85.0</b>	<b>104.0</b>
Tax	(10.0)	(10.2)	(12.8)	(15.6)	(19.1)
Minority interests	(0.5)	-	-	-	-
<b>Net profit</b>	<b>46.6</b>	<b>50.9</b>	<b>56.8</b>	<b>69.4</b>	<b>84.9</b>
% chg	12.7	9.2	11.6	22.3	22.3
Dividends	-	37.7	17.0	20.8	25.5
Retained earnings	46.6	88.6	73.8	90.3	110.4
EPS - Basic	0.191	0.150	0.168	0.205	0.251
EPS - F.D.	0.191	0.150	0.168	0.205	0.251
DPS	-	0.112	0.050	0.062	0.075
No. sh.s o/s (m) - W.A.	246.0	246.0	338.0	338.0	338.0
No. sh.s o/s (m) - Y.E.	246.0	338.0	338.0	338.0	338.0
No. sh.s o/s (m) - F.D.	246.0	338.0	338.0	338.0	338.0
<b>Margins (%)</b>					
Gross	64.2	63.6	63.0	62.6	62.4
EBITDA	17.7	14.6	13.5	13.1	12.9
EBIT	16.1	13.1	12.3	11.9	11.8
Pre-tax	16.5	14.0	13.0	12.5	12.3
Net	13.6	11.7	10.6	10.2	10.0

Cash Flow (HK\$m)	05A	06F	07F	08F	09F
<b>Year to Mar</b>					
EBIT	55.3	57.3	65.5	80.9	99.6
Depre./amort.	(5.4)	(6.2)	(6.9)	(8.3)	(9.6)
Net int. paid	1.3	3.8	4.0	4.2	4.4
Tax paid	(10.8)	(10.2)	(12.8)	(15.6)	(19.1)
Dividends received	-	-	-	-	-
<b>Gross cashflow</b>	<b>40.4</b>	<b>44.7</b>	<b>49.8</b>	<b>61.1</b>	<b>75.4</b>
Chgs. in working cap.	(19.1)	(23.7)	(22.1)	(31.0)	(34.9)
<b>Operating cashflow</b>	<b>21.3</b>	<b>20.9</b>	<b>27.7</b>	<b>30.1</b>	<b>40.5</b>
Capex	(27.0)	(30.0)	(30.0)	(25.0)	(25.0)
<b>Free cashflow</b>	<b>(5.7)</b>	<b>(9.1)</b>	<b>(2.3)</b>	<b>5.1</b>	<b>15.5</b>
Dividends paid	(20.2)	(37.7)	(17.0)	(20.8)	(25.5)
Net distribution to MI	-	-	-	-	-
Investments	(16.0)	(27.0)	(30.0)	(25.0)	(25.0)
Disposals	0.1	0.1	-	-	-
New shares	0.0	113.0	-	-	-
Others	18.2	73.6	2.7	58.4	64.7
<b>Net cashflow</b>	<b>(23.6)</b>	<b>113.1</b>	<b>(46.6)</b>	<b>17.7</b>	<b>29.7</b>
Net (debt)/cash - Beg.	46.7	23.1	136.1	89.5	107.2
Net (debt)/cash - End.	23.1	136.1	89.5	107.2	136.9

Interim Results (HK\$m)	04A	05A
<b>Six months to Sept</b>		
<b>Turnover</b>	<b>148.7</b>	<b>180.7</b>
% chg		21.5
Profit from operations	21.5	20.7
Interest expenses	(0.1)	(0.2)
Associates	-	-
Jointly-controlled entit.	-	-
<b>Pre-tax profit</b>	<b>21.4</b>	<b>20.5</b>
Tax	(3.9)	(2.8)
Minority interests	-	-
<b>Net profit</b>	<b>17.5</b>	<b>17.6</b>
% chg	-	0.5
EPS (HK\$) - W.A.	0.054	0.071
DPS (HK\$)	-	0.045

Balance Sheet (HK\$m)	05A	06A	07F	08F	09F
<b>Year to Mar</b>					
Fixed assets	29.6	32.6	55.7	72.4	87.9
Intangible assets	1.4	1.3	1.3	1.3	1.3
Other LT assets	33.8	41.1	47.4	54.8	66.0
Cash	30.4	139.7	93.4	111.5	141.6
Accounts receivable	10.5	11.3	14.0	17.9	22.2
Other receivables	5.9	12.5	13.0	16.6	20.7
Inventories	64.5	85.8	107.0	136.5	169.6
Due from related co.s	-	-	-	-	-
Other current assets	19.0	1.5	6.7	6.7	6.7
<b>Total assets</b>	<b>194.9</b>	<b>325.8</b>	<b>338.6</b>	<b>417.6</b>	<b>515.9</b>
Accounts payable	(7.9)	(6.3)	(8.1)	(10.5)	(13.1)
Other payable	(31.7)	(21.2)	(32.9)	(42.4)	(53.0)
Tax payable	(4.1)	(2.7)	(4.3)	(5.3)	(6.5)
Due to related co.s	(0.0)	(0.2)	(0.8)	(0.8)	(0.8)
ST debts	(6.4)	(3.5)	(3.9)	(4.3)	(4.7)
Other current liab.	-	-	-	-	-
LT debts	(1.0)	-	-	-	-
Other LT liabilities	(0.5)	(0.7)	(0.7)	(0.7)	(0.7)
<b>Total liabilities</b>	<b>(51.5)</b>	<b>(34.7)</b>	<b>(50.8)</b>	<b>(64.0)</b>	<b>(78.8)</b>
Share capital	0.1	35.1	35.1	35.1	35.1
Reserves	143.3	234.0	252.8	318.6	339.4
<b>Shareholders' funds</b>	<b>143.4</b>	<b>269.1</b>	<b>287.9</b>	<b>353.7</b>	<b>374.5</b>
Minority interest	-	-	-	-	-
<b>Total</b>	<b>143.4</b>	<b>269.1</b>	<b>287.9</b>	<b>353.7</b>	<b>374.5</b>
Capital employed	150.8	272.6	291.7	357.9	379.2
Net (debt)/cash	23.1	136.1	89.5	107.2	136.9

Shareholding Structure	Shares o/s (m)	%
George Wong, Chairman	251.2	71.6
Baring Asset Management	7.0	2.0
Public	92.5	26.4
<b>Total</b>	<b>350.7</b>	<b>100.0</b>

Background
Established in 1991, Bauhaus is principally engaged in the design, manufacture, wholesale and retail sales of apparel, bags, sacs and accessories under its own brandnames of TOUGH and SALAD as well as sales of apparels under other third-party brandnames such as Levi's, Miss Sixty, Energie, Killah, Fornarina, Religion and G-Star. Its major markets include Hong Kong and Taiwan. It penetrated into Japan in 1999 through wholesaling and Europe through distributors. It is expanding into the PRC market through franchisees in recent years. Apart from the name BAUHAUS, it operates retail counters under the name of TOUGH, SALAD, 80/20 and LIBRE.

Key Ratios	05A	06A	07F	08F	09F
Net gearing	Cash	Cash	Cash	Cash	Cash
NET ROE	32.5	24.7	20.4	21.6	23.3
EBIT ROCE	36.7	27.1	23.2	24.9	27.0
Dividend payout ratio	-	(74.1)	(30.0)	(30.0)	(30.0)
Effective tax rate	17.7	16.7	18.4	18.4	18.4
Net interest cover. (x)	(42.5)	(15.2)	(16.3)	(19.3)	(22.8)
A/R days	9.2	9.1	8.6	8.5	8.6
A/P days	15.1	16.3	4.9	5.0	5.1
Inventory days	141.7	172.7	177.7	174.1	175.2

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**BUY** : absolute upside of >10% over the next six months  
**HOLD** : absolute return of -10% to +10% over the next six months  
**SELL** : absolute downside of >10% over the next six months

SBI E2-Capital ratings distribution: STRONG BUY/BUY: 28(62%), HOLD: 7(16%), SELL: 10(22%) as of 1 July 2006.

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