

## No surprise, sell into strength

## Hong Kong Retail

### Giordano (709 HK, HK\$4.55)

### SELL (unchanged)

#### Target price: HK\$3.80 (-16%)

#### Results review

**Giordano's 1H FY12/06 results came below market expectations.** Sales fell 6.1% YoY to reach HK\$2,021m. Net profit fell 19.3% YoY to reach HK\$151m, below the median forecast of -13% YoY by the market. EPS amounted to HK\$0.101. DPS remained at last year's level of HK\$0.065. (interim/special DPS: HK\$0.045/HK\$0.02).

**Gross and operating margin both declined** to 50.5% (1H05: 50.9%) and 9.1% (1H05: 11.4%) in 1H06. Gross margin fell by a smaller extent, thanks to the modifications in merchandising mix to uphold its ASP, despite promotional discounts. Nonetheless, higher operating costs ate into margins. Inventory turnover also increased from 30 days to 34 days.

**Table 1: Interim results**

Six months to June	Turnover (HK\$m)	EBIT (HK\$m)	EBIT margin (%)	Pre-tax profit (HK\$m)	Tax rate (%)	Net profit (HK\$m)	EPS (HK\$)	DPS (HK\$)
1H FY2006	2,021	184	9.1	261	19.9	151	0.101	0.065
1H FY2005	2,152	246	11.4	192	18.8	187	0.128	0.065
YoY (%)	(6.1)	(25.2)	-	35.9	-	(19.3)	(21.1)	-

Source: Company data

#### Operational review

##### 1) Retail & distribution

**Disappointing sales.** Segment sales and operating profit fell 4.3% YoY and 23.4% YoY to reach HK\$1,869m and HK\$164m. Overall comp-store-sales fell 5.3% YoY. The major disappointment came from Taiwan, Singapore, S. Korea and other SE Asia markets because of poor weather, lackluster market conditions, intense competition and weakening consumer confidence. Comp-store-sales in Taiwan, Singapore and S.Korea fell 13.7%, 15.7% and 9.6% respectively. However, performances from these markets improved in 2Q06 compared to that of 1Q06.

**Stellar sales from PRC in 1Q06.** Sales from the PRC, the largest market only managed to edge up 1.7% YoY due to poor weather condition, while comp-store-sales rose 7.2% YoY. Sales from Hong Kong, the second largest market rose 1.9% YoY, while comp-store-sales rose 4.4% YoY.

**Table 2: Financial summary**

Year to Dec	Net profit HK\$m	EPS HK\$	EPS Δ %	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
05A	406.0	0.275	3.0	16.5	3.1	10.5	5.8	19.1	23.3	Cash
06F	370.0	0.249	(9.6)	18.3	2.9	10.1	5.8	16.3	26.5	Cash
07F	398.0	0.267	7.6	17.0	2.7	9.2	5.6	16.6	26.8	Cash
08F	433.0	0.291	8.8	15.6	2.6	8.3	6.2	16.9	27.7	Cash
09F	480.0	0.322	10.9	14.1	2.4	7.2	6.9	17.4	28.6	Cash

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**Table 3: Retail & distribution operation highlights**

	Sales (YoY%)	Comp-store-sales (YoY%)	No. of outlets
PRC	1.7	7.2	714
Hong Kong	1.9	4.4	99
Taiwan	(17.6)	(13.7)	230
Singapore	(7.3)	(15.7)	50
S. Korea	(0.8)	-9.6	150
Middle East	18.6	5.8	111
Australia	5	n.a.	55
Malaysia	(13.8)	n.a.	54
Indonesia	11.5	n.a.	72
Thailand	(2.3)	n.a.	59
Japan	(3.4)	n.a.	20

Source: Company data

## 2) Garment trading & manufacturing

**Higher price competition.** Sales and operating profit from this segment fell 7.7% YoY and 37.5% YoY to reach HK\$480m and HK\$20m. The major disappointment came from price competition and higher costs arising from relocating its plant from Guangdong to lower costs area in Shandong.

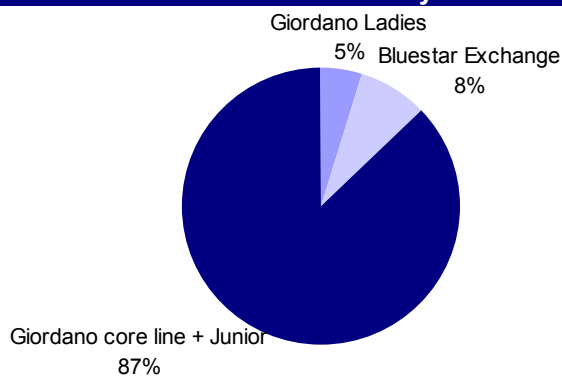
### Outlook & valuations

**Giordano expects overall operating environment to improve in 2H06.** Its business strategy will focus in 1) driving brand differentiation by setting up more Giordano Concept Store, targeting Concept Stores to make up 15% of its total number of stores by 2008; 2) adding 50 outlets globally in 2H06 (PRC: 20; Taiwan: 10-20; Australia: 4; Japan: 2; S. Korea: 10-15), with a majority of them in China. It has a net addition of 4 outlets in 1H06, bringing the total number of outlets to 1,698; 3) accelerating the expansion of Giordano Ladies network. We believe it is the right direction, since Giordano ladies only accounted for 5% of total retail sales. Despite a fall in overall comp-store-sales, Giordano Ladies showed a remarkable comp-store-sales growth of 9.5% , against -5.9% by Giordano & Giordano Junior and -4.3% by Bluestar Exchange.

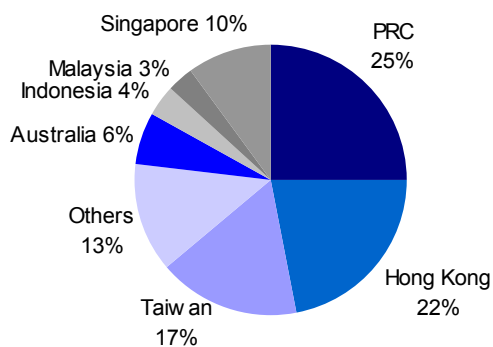
**Tough operating environment due to intensifying competition in mass-market retailing.** Despite stabilizing rental costs, we expect competition will accelerate in the mass-market retailing sector with new players entering the market, such as Zara from Spain. Swiss-based Hennes & Mauritz AB (H&M) will open its H.K. flagship stores in Sept. I.T. (999 HK) will launch a casual wear brand in Nov, targeting the same market segment as Giordano.

**Potential acquisition by Fast Retailing.** Giordano did not disclose any information on the potential acquisition; Historically, Fast Retailing (9983 JP) did several acquisitions at an average EV/EBITDA of 10.2x.

**Sell into strength.** Although the potential acquisition and generous payout will provide support to its share price, business fundamentals are unexciting. We maintain our SELL recommendation with a target price of HK\$3.8, equivalent to 15x P/E FY12/06F.

**Chart 1: 1H06 Sales breakdown by brands**

Source: The Company

**Chart 2: 1H06 Sales breakdown by markets**

Source: The Company