

## Royale Furniture Holdings Limited

### Enjoys a premium brand recognition

to summarize...

- Royale Furniture engages in manufacturing and the sales of home furniture business in Mainland China.
- The group has attained a well recognized brand "Royal Furniture" since their sponsorship of the Beijing Olympic Game in 2008.
- For 1H FY12/10A result, the group's turnover recorded an YoY increase of 54% to HK\$545.1m from HK\$354.5m in 1H2009. Profit attributable to equity holders increase 175% YoY to HK\$60.0m from HK\$21.9m in 1H FY12/09A.
- Sales from franchisee represented 87.1% of the total sales, an increase from 80.5% in 1H2009. Revenue from self-operating stores represented 12.9% of the total sales, a decrease from 19.5% in the previous year, on sales channel mix changes
- Going forward, the company will continue to capture the fast growing market of the low-tier cities, third, fourth and beyond. The group will establish logistic hubs across China to improve distribution efficiency.

**Description:** Royale Furniture engages in manufacturing and the sales of home furniture business in Mainland China. It's sales of home furniture business operates in two segments, the self-operating shops segment and the franchise operation segment. As of June 30th, 2010 the group's sales channel comprised of 100 self-operating shops and 1,538 franchise outlets. The group has a diversified product portfolio that can satisfy a wide range of customer demands. It's product mixture range from practical to high-end sophistication, and a well balance of mixture between the traditional Chinese to the Modern Western.

**Table 1. 1H FY12/10A results**

6 months to June	Turnover (HK\$m)	Gross Profit (HK\$m)	Gross margin (%)	Pre-tax profit (HK\$m)	Tax rate (%)	Net profit (HK\$m)
1H FY10	545.1	159.4	29.3	69.9	3.2	60.0
1H FY09	354.5	112.5	31.7	24.1	4.8	21.9
HoH(%)	53.7	41.7		20.0		173.9

Source: Company data

**Group History:** The group was officially established in 1997 in the Pearl River Delta. The group originally engaged in manufacturing of wooden panel furniture, and later expanded into the production of solid wood furniture and upholstery products. It's main production facility is in Guangzhou Shitan and have other smaller plants with total size of approximately 300,000 square meters, employing over 4,000 workers. In 2002, the group was listed on the Main Board of Hong Kong Stock Exchange. During the 2008 Beijing Olympics Game, the group was selected as the official home furniture exclusive supplier for the Games in which they produced 23,259 set of bedroom furniture and 14,000 set of sofas.

**Brand Recognition:** Since their sponsorship of the Beijing Olympic Game in 2008, the group has attained a well recognized brand: "Royal Furniture", which projects a premium quality image with affordable price range that can fit a wide range of market sector demands. The success of its brand recognition led them to winning the bid for the exclusive supplier in home furniture for the 26th Summer Universiade Game to be held in Shenzhen, China in 2011. With this mandate, the group is currently working along with the Universiade official to develop suitable products that will meet the standard set for the event.

Ticker	1198 HK
Rating	NR
Price (HK\$)	2.68
Target Price (HK\$)	-
12m Price Range (HK\$)	1.00-2.70
Market cap. (US\$m)	192.5
Daily t/o (US\$m)	0.3
Free float (%)	55.3

#### Financial summary

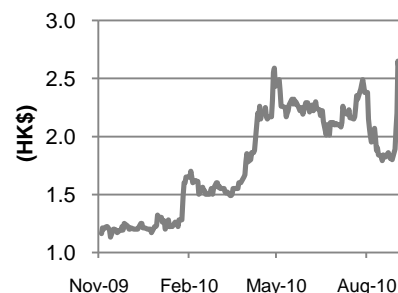
Year to Dec	07A	08A	09A	1H09A	1H10A
Turnover (HK\$m)	651.0	790.9	688.4	354.5	545.1
Net Profit (HK\$m)	50.4	(89.5)	130.5	21.8	60.0
EPS (RMB)	0.170	-	0.295	0.098	0.222
P/E (x)	15.7	-	9.1	27.3	12.1
P/B (x)	1.49	1.88	1.92	2.33	1.89
EV/EBITDA (x)	10.0	-	6.3	26.7	14.4
Yield (%)	1.4	0.8	4.1	0.6	0.6
ROE (%)	14.8	-	24.4	3.9	9.4
ROCE (%)	16.4	-	26.5	4.8	11.9
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Source: SBI/Bloomberg

1H09 figures have been adjusted to reflect the reclassification of non-core product income

#### Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	34.3	10.8	140.2
Actual price changes (%)	45.7	19.6	155.2



Source: Bloomberg

#### SBI Research Team

(852) 2533 3700

sbie2research@sbie2capital.com

## Business Model

**High-Tier vs. Low-Tier Cities:** The group's sales growth strategy targets high-tier and low-tier cities. In the high-tier cities which includes first and second tier cities, the group's focus is on their self-operating stores with larger selection of furniture that offers well diversified products lines. This which can accommodate sophisticated tastes of customers in a progressive modern cities. In the low-tier cities which includes third, fourth tier or beyond, the group rely on sales channel of its franchisees. The group works closely with franchise operators to promote more affordable and practically series that can fit the demand of the customers. Going forward, low-tier cities penetration will serve as a growth driver, where the group plans to continuously sign up new franchisees.

**Future Development:** The company plans to continue to capture the fast growing market of the low-tier cities, third, fourth and beyond. The group will establish logistic hubs across China to increase improve distribution efficiency. Their plan is to partner with regional logistic companies to establish an efficient supply chain that will target reduction of transportation costs and delivery time. The initial step in the plan is to pilot it in a few selected region by the end of 2010. Upon successfully implementation and satisfying result, the model will then expand and implement in more regions and eventually covers all strategic regions throughout China by the middle of 2011. Also the group will continue to leverage on its brand recognition by looking for overseas ODM project opportunities and continue to sponsor large events that can secure sizeable bulk orders, such as the Beijing Olympic Game in 2008 and the Universiade Shenzhen in 2011.

## Financials

**Interim Result:** For the six months period ended on June 30th 2010, the group's turnover recorded an YoY increase of 54% to HK\$545.1m from HK\$354.5m in 1H2009. Gross profit had a YoY increase of 42% to HK\$159.4m from HK\$112.5m in 1H2009. Gross profit margin dropped 2.4pcp from 31.7% in 1H2009 to 29.3%. The decline was largely due to increase in raw material cost. Selling and distribution cost as a percentage of revenue decrease to 11.1% from 15.5%, and the administrative expenses as of percentage of revenue decreased to 6.9% from 9.9%. Net profit margin increase 5.9pcp to 12.4% from 6.5% in 1H2009. Profit attributable to equity holders increase 175% YoY to HK\$60m from HK\$21.9m in 1H2009. The increase in profit was largely due to increase in gross profit and operating leverage.

**Sales Breakdown:** The group derived 30% of its sales from Eastern China region, 25% from Northern China, 20% Southern China and 25% from all other regions combined. Revenue from self-operating stores totaled HK\$70.5m a 1.9% yoy increase from HK\$69.2 in 1H2009. Sales from self operating store represent 12.9% of the total sales, a decrease from 19.5% in the previous year. Revenue from franchise totaled HK\$474.6m, a 66.3% yoy increase from HK\$285.3m in 1H2009. Sales from franchisee represents 87.1% of the total sales, an increase from 80.5% in 1H2009. The gross profit margin from self-operating store increase slightly from 46.9% to 47.7%, while gross profit margin from franchise store decreased from 28% to 26.5%.

**Our View:** Royal Furniture is currently trading at 7.5x current year P/E. We believe the growth in sales of home furniture depends largely on the sales growth of the properties market, since purchases of home furniture follows naturally after purchasing of a new property. The Chinese government has introduced austerity measures that are largely targeting the sales growth of the property market, thus resulted in a decline of property sales across China. If the government's policy is to continue to cool off the property market, this can result in a large negative effect to the home furniture sales. However, the government's austerity measure in the past have particular targeted towards the first and second tier cities, the measure was not intended for the properties sales of in the low-tier cities, thus the effect on potential home buyers in the lower tier city tend to be minimal. Given that Royale Furniture's target growth are in the low-tier cities, the austerity measure may not be significantly affected by the continuation in the cool down of the property sector. Also the Chinese government policy will tend to continue to provide incentive for rural-to-urban migration, this in turn can be positive for low-tier cities property sales growth, thus potential benefit in furniture sales.

**Table 2. Valuation comparison**

Company name	Ticker	Mkt cap (US\$m)	Last Price (Local)	His P/E (x)	1-Yr P/E (x)	2-Yr P/E (x)	PB (x)	Est ROE (%)
HK-listed								
Fava International	8108 HK	29	0.16	-	-	-	0.8	-
Hing Lee HK	396 HK	40.3	1.57	14.8	-	-	1.2	8.1
JF Household Furn	776 HK	49.6	1.84	15.3	-	-	2.1	13.2
Kasen Int'l Hldgs	496 HK	253.6	1.71	7.1	-	-	0.8	6.8
Samson HLDGS	531 HK	543.2	1.39	12.3	9.0	8.5	1.0	7.4
Man Wah Holdings	1999 HK	1,195.2	9.6	11.3	10.6	8.4	6.0	62.0
Royal Furniture	1198 HK	192.5	2.68	7.5	-	-	2.0	24.4
<i>Average</i>				<i>11.4x</i>	<i>9.8x</i>	<i>8.5x</i>		
China-Listed								
Guangdong Yihu	600978 CH	977.6	7.59	22.3	19.5	15.9	2.5	10.7
Markor International	600337 CH	685.4	10.47	88.5	49.9	33.8	3.8	3.3
<i>Average</i>				<i>41.0x</i>	<i>26.4x</i>	<i>19.4x</i>		

Source: Bloomberg

Table 3. P &amp; L forecast

Year to Dec (HK\$m)	FY07A	FY08A	FY09A	1H09A*	1H10A
<b>Revenue</b>	651.0	790.9	688.4	354.5	545.1
Cost of sales	(446.8)	(549.1)	(452.9)	(242.0)	(385.7)
<b>Gross profit</b>	168.2	241.8	235.4	112.5	159.4
Other income	54.6	59.8	62.3	2.0	7.9
Selling and distribution expenses	(97.9)	(195.1)	(105.9)	(54.9)	(60.4)
Administrative expenses	(63.2)	(68.3)	(57.2)	(35.4)	(37.8)
Other expenses	(6.9)	(10.9)	(2.6)	0.0	0.0
Finance costs	(1.9)	(3.2)	(1.2)	(0.3)	(2.2)
Share of Profit of associates	1.5	0.4	3.4	0.3	3.0
<b>Profit before tax</b>	54.4	(87.2)	134.2	24.1	69.9
Income tax expense	(2.1)	(2.3)	(3.7)	(1.2)	(2.2)
<b>Net profit</b>	50.4	(89.5)	130.5	21.8	60.0

Source: Company data, SBI E2-Capital

\* Figures have been adjusted to reflect the reclassification of non-core product income

---

SBI E2-Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. Find our research on: [sbie2capital.com](http://sbie2capital.com), [thomsononeanalytics.com](http://thomsononeanalytics.com), [factset.com](http://factset.com) and [multex.com](http://multex.com)

**SBI E2-Capital stock ratings:**

**STRONG BUY** : absolute upside of >50% over the next three months

**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

Investors should assume that SBI E2-Capital is seeking or will seek investment banking or other related businesses with the companies in this report.

**Analyst certification:** The views expressed in this report accurately reflect the analyst's personal views of the subject securities and that the analyst has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

**Disclaimer:** This research report is not an offer to sell or the solicitation of an offer to buy or subscribe for any securities. The securities referred to in this report may not be eligible for sale in some jurisdictions. The information contained in this report has been compiled by the Research Department of SBI E2-Capital Securities Limited ('SBI E2-Capital') from sources that it believes to be reliable but no representation, warranty or guarantee is made or given by SBI E2-Capital or any other person as to its accuracy or completeness. All opinions and estimates expressed in this report are (unless otherwise indicated) entirely those of SBI E2-Capital as of the date of this report only and are subject to change without notice. Neither SBI E2-Capital nor any other person, accepts any liability whatsoever for any loss howsoever arising from any use of this report or its contents or otherwise arising in connection therewith. Each recipient of this report shall be solely responsible for making its own independent investigation of the business, financial condition and prospects of the companies referred to in this report. SBI E2-Capital and their respective officers, directors and employees, including persons involved in the preparation or issuance of this report, may from time to time (1) have positions in, and buy or sell, the securities of companies referred to in this report (or related investments); (2) have a consulting, investment banking or broking relationship with any company referred to in this report; and (3) to the extent permitted under applicable law, have acted upon or used the information contained or referred to in this report including effecting transactions for their own account in an investment (or related investment) in respect of any company referred to in this report, prior to or immediately following its publication. This report may not have been distributed to all recipients at the same time. This report is issued only for the information of and may only be distributed to professional investors and dealers in securities and must not be copied, published, reproduced or redistributed (in whole or in part) by any recipient for any purpose. This report is distributed in Hong Kong by SBI E2-Capital. Any recipient of this report who requires further information regarding any securities referred to in this report should contact the relevant office of SBI E2-Capital located in such recipient's home jurisdiction.

Copyright © SBI E2-Capital Securities Limited 2008. All rights reserved.

---