

## Speeding up China expansion

## Hong Kong Retail

**Lifestyle (1212 HK, HK\$14.92)**

**BUY (unchanged)**

**Target price: HK\$17.5 (+17.2%)**

**Results highlights.** 1H FY12/06 net profit rose 30.3% to HK\$305.4m, which was above market expectations. Turnover increased 22.1% YoY to HK\$1,181.4m, which was mainly driven by strong comp-store-sales growth of 8.3% in the flagship CWB stores and a 52.5% sales growth from Shanghai Jiu Guang. An interim DPS of 14.5 HK cents was declared. Dividend ratio was up slightly to 40.2%, from 39.8% a year ago.

**Margin improvement.** Operating margin reached 32.8% while it was only 30.3% in 1H05. Net margin expanded to 25.8% in 1H06 (24.2% in 1H05).

**Table 1: Interim results**

Six months to Jun	Turnover (HK\$m)	Gross profit (HK\$m)	Gross margin (%)	Pre-tax profit (HK\$m)	Tax rate (%)	Net profit (HK\$m)	EPS (HK\$)	DPS (HK\$)
1H06	1,181.4	635.3	53.8	361.3	18.3	305.4	0.361	0.145
1H05	967.9	518.0	53.5	278.5	16.2	234.3	0.314	0.125
YoY (%)	22.1	22.6		29.7		30.3	14.9	16.0

Source: Company data

**Table 2: EBITDA margin by store 1H04 to 1H06**

EBITDA margin (%)	1H04	1H05	1H06
Overall	36.3	36.5	38.6
SOGO CWB	36.3	41.7	44.4
Shanghai Jiuguang	na	(17.8)	10.2
SOGO TST	na	na	8.6

Source: Company data

**Market share expansion.** The company's market share in the Hong Kong department store segment amounted to 19.9% as at 30 June 2006 (18.5% in 1H 05), equivalent to around 2% (2005: 1.8%) of total Hong Kong retail sales.

**CWB flagship store.** Its SOGO CWB shop (82.5% of turnover) reported encouraging results in terms of 1) same-store-sales growth rate (+8.3% YoY), traffic flow (+1.5% YoY) and per ticket sales value - HK\$430 (+11.7% YoY).

**TST store.** TST store (7.5% of turnover) started to deliver a HK\$3m net profit in 1H06 with an average per ticket sales of HK\$259. The new store has already achieved cash flow breakeven after three months since its

**Table 3: 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 %
04A	414.1	0.621	n.a.	24.0	6.22	22.3	1.8	23.1	18.2	Cash
05A	539.4	0.694	11.7	21.5	3.52	16.0	2.0	21.2	15.3	Cash
06F	684.0	0.808	16.4	18.5	3.36	14.0	2.2	19.4	16.6	Cash
07F	817.1	0.965	19.5	15.5	2.95	11.7	2.6	20.3	18.6	Cash
08F	991.3	1.170	21.3	12.7	2.57	9.6	3.1	21.6	20.6	Cash

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opening in late-Sep last year. Its product mix of focusing on younger generation customers is paying off, and customer flow growth has been in line with management expectations.

**Shanghai store on track.** Shanghai's store growth rate reached 52.5% in 1H06 and contributed 10% to the company's total turnover in 1H06. Management expects the contribution will be increased to 20% in two years' time. Shanghai store still reported a net loss of around HK\$7m in 1H06. Management expects Juiguang store will break even by the end of 2006.

**Table 4: Operating figures**

Six months to Jun	SOGO CWB	Shanghai Jiuguang	SOGO TST*
Average daily traffic (persons)	91,100 (+1.5% YoY)	36,900 (+27.2% YoY)	n.a.
Per ticket sales	HK\$430 (+11.7% YoY)	RMB222 (-3.5% YoY)	259

Source: Company data

\* TST store opened in Sept 2005

**Positive guidance for July 06.** We also saw encouraging comp-store-sales guidance for the month of July. CWB stores achieved a 10% YoY growth while the Shanghai store posted a 40% YoY growth in July 2006.

**China expansion.** Management indicated that the company would like to identify prime locations in cities such as Beijing, Guangzhou, Hangzhou and Tianjin for the opening of a second Jiu Guang store. Moreover, management expects to open two to three stores in China by the end of 2006. Initially the plan was to open only one new store each year before 2008. A special dividend can only be paid if management cannot find new projects in the medium term.

**Financials.** As at 30<sup>th</sup> June 2006, the company had HK\$2,083.8m cash on hand and a net cash position of HK\$898.1m. If the new store projects are going to come through, each new store will require approx. RMB1b capex. According to company, it is in talks with several major banks regarding future debt financing. The company aims at a gearing ratio of < 20%.

**Peer comparison.** The counter is trading at 18.5x FY12/06F P/E and 15.5x FY12/07F P/E, while its closest listed peer Aeon Stores (984 HK) is trading at 16.5x FY12/06 F P/E and 13.7x FY12/07F P/E.

**Valuation.** Business outlook for Lifestyle remains strong, as Hong Kong retail sentiment will improve further given the positive wealth effect from the robust stock market. Any future corporate action such as new store openings in China will provide new catalyst to share price.

We maintain our BUY rating with a target price of HK\$17.5, equivalent to a 25% discount to our appraised NAV of HK\$23.3 or an implied 22x FY12/06F P/E. The last closing price of HK\$14.92 represented a 36% discount to our appraised NAV of HK\$23.3.