

Rosy outlook intact

Hong Kong Retails

Lifestyle (1212 HK, HK\$24.00)

BUY (unchanged)

Target price: HK\$28.0 (+16.7%)

Results highlights. FY12/06A net profit beat market expectations by c.8% to reach HK\$740.2m, up 37% YoY. Sales rose 21% YoY to HK\$2,534.9m and operating profit 28.3% YoY to HK\$856.5m. EPS amounted to HK\$0.874. The final DPS was HK\$0.21 and interim DPS HK\$0.145, with the total DPS at HK\$0.355 (FY12/05A: HK\$0.305), representing a payout ratio of 40.6%, compared with 43.9% in FY12/05A.

The exceptional results were due to 1) Hong Kong's strong retail sales environment; 2) first time profit contribution from SOGO TST and mild HK\$2m profit from Shanghai Jiuguang store discounting the interest costs from shareholders' loan transfer; 3) investment income of HK\$67.1m from the sale of investment securities but net profit still rose 25.4% YoY disregarding the gain; 4) higher average sales per ticket in China and Hong Kong and 5) margin improvement on the company's higher operating leverage with self-owned premises, an attractive merchandise mix and aggressive sales promotions.

- **Strong retail sales.** Lifestyle's sales rose 21% YoY and sales proceeds 20.8% YoY, outpacing the 8.1% retail sales growth from Hong Kong's department stores in 2006. It captured 20.3% market share of the Hong Kong department store industry, up from 18.7% in FY12/05A. This was due to a same-store-sales (s.s.s.) growth of 11.3% at SOGO CWB (Causeway Bay) and additional sales growth on the first-full year contribution of SOGO TST (Tsim Sha Tsui). Shanghai Jiuguang store's sales rose 48.5% YoY, boosting China's sales contribution from 8.8% of the total in FY12/05A to 10.7% in FY12/06A.
- **Shanghai Jiuguang breaks even.** The store broke even at the start of 2006 on a cash level and achieved a s.s.s. growth of 44.9% YoY in FY12/06A. Its HK\$5.4m net loss was due to the accounting treatment of the transfer of shareholders' loan from the JV to the group, which has led to an interest cost of HK\$8.3m. Netting out the above effect, Shanghai Jiuguang actually made a net profit of HK\$2m in FY12/06A.
- **Margin improvement.** The average sales per ticket at SOGO CWB and SOGO TST rose c.10.1% YoY to HK\$436 and HK\$264, respectively, and 7.0% YoY to RMB230 at Shanghai Jiuguang. The average daily traffic and stay-and-buy ratios in Hong Kong and China have shown promising growth. (refer to table 3). Increases in staff and other operating costs were mitigated by Lifestyle's self-owned store strategy and resulted in high operating leverage for SOGO CWB. Shanghai Jiuguang, with its 20-year long-term lease, is immune to rental pressure. Besides, margins improved across the board (refer to table 4), mainly due to the company's attractive merchandise mix and aggressive sales promotions. Over the past year, the group held several celebratory events, such as the November Thankful Week and the opening of Wa-San-Mai Japanese Restaurant.

Table 1: Financial summary

Year to	Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gearing
Dec	HK\$m	HK\$	Δ %	x	x	x	%	%	%	%
05A	539.4	0.694	11.7	34.6	5.61	25.7	1.3	21.1	16.1	Cash
06A	740.2	0.874	25.9	27.5	5.28	22.6	1.5	20.6	17.4	Cash
07F	896.4	1.058	21.1	22.7	4.64	16.3	1.8	21.8	21.4	Cash
08F	1,078.1	1.273	20.3	18.9	4.01	13.1	2.2	22.8	23.3	Cash
09F	1,325.9	1.565	23.0	15.3	3.44	12.3	2.8	24.2	24.5	Cash

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Table 2: 2006 Sales and net profit contribution

(HK\$m)	Sales	% of total sales	Net profit	% of total sales
SOGO CWB	2,073.6	81.8	726.0	28.6
SOGO TST	195.2	7.7	19.6	0.8
Shanghai Jiuguang	266.2	10.5	(5.4)	n.a.
Total	2,534.9		740.2	

Source: SBI E2-Capital

Table 3: Operation statistics

	06A	05A	YoY (%)
SOGO CWB			
- Average daily traffic (persons)	93,600	92,455	+1.24
- Average sales per ticket (HK\$)	436	396	+10.1
- Stay-and-buy ratio (%)	28.5	28.3	
SOGO TST			
- Average daily traffic (persons)	n.a.	n.a.	
- Average sales per ticket (HK\$)	264	239	+10.5
- Stay-and-buy ratio (%)	n.a.	n.a.	
Shanghai Jiuguang			
- Average daily traffic (persons)	39,600	32,496	+21.9
- Average sales per ticket (RMB)	230	215	+7.0
- Stay-and-buy ratio (%)	34	34	

Source: Company data

Table 4: Margin analysis

(%)	06A	05A	YoY
Gross margin	54.2	53.1	+1.1
EBITDA margin	38.6	35.9	+2.7
Net margin	29.2	25.8	+3.4

Source: Company data

Outlook.

- **Expansion in Suzhou and Shenyang.** Lifestyle announced its acquisition of two sites in Suzhou and Shenyang in December 2006. The Suzhou complex, with a GFA of 168,000 sq.m, will be developed into a department store with entertainment features and should open by end-2008. The Shenyang complex, with a GFA of 320,000 sq.m, will be developed in three phases (Phase I - department store to soft open by end-2009, Phase II - entertainment complex, with hotels and other commercial facilities to open in 2012). In Phase III, Lifestyle will acquire another piece of land nearby which will be incorporated into the earlier phases. The total capex for Suzhou and Shenyang of c.HK\$5b will be split over the next five years. This will bring the total operating area of the Group to exceed 7.5m sq. ft.
- **More projects in the pipeline.** The company is actively studying projects in Tianjin, Beijing and Chengdu, which will come online probably in mid 2007.

Valuation.

- With net cash of HK\$1,234.7m (HK\$1.5/shs) and an estimated operating cash inflow of HK\$1,200m in FY12/07F, the company is well positioned for its mega expansion in China. We revised our earnings forecasts upwards by an average of 8-9% in FY12/07F to FY12/08F to reflect higher sales growth and margins. Our appraised NAV per share is raised from HK\$23.3 to HK\$28.1 accordingly. We maintain our BUY recommendation, with a target price of HK\$28, equivalent to 26.5x P/E in FY12/07F and 22.0x P/E in FY12/08F.

Major risks. 1) Execution risk from its China expansion since it involved huge amount of capex. If the China economy slows down when the complex opens, it will adversely affect the Group and 2) Higher depreciation expenses from the huge capital investment.