SBI E2-Capital

Corporate Snippet

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Acqusition of retail properties in China — Hong Kong Retails

Lifestyle (1212 HK, HK$26.8) — HOLD (downgraded from BUY)

Target price: HK$28.0 (+4.5%)

The acquisition. Lifestyle resumed trading yesterday and announced its acquisition of four retail properties (ref: table 1) in China for a total of HK$757.5m, representing 0.95x P/B as of end-2006. It will refurbish, renovate and re-position these properties as retail space with a total GFA of 105,500 sq.m under its "lifestyle" department stores or other retail formats. Together with the existing Jiuguang Department Store in Shanghai and two projects in Suzhou and Shenyang, the properties will allow the Group to expedite its expansion in China by extending its presence to seven cities. The move will boost the Group's total GFA to c.6.1m sq.m by the end of 2009 from the current c.1.4m, according to our estimation.

Table 1: Acquisition details

Retail properties	Equity interest (%)	FY12/06A Net loss (HK$m)	NAV (HK$m)	Operation period granted	Remarks
Dalian Co.	100%	(26.8)	237.6	30 yrs	operating a department store since Oct 2003
Tianjin Co.	97.5%	(31.2)	252.9	50 yrs	operating a department store since Nov 2004
Qingdao Co.	100%	(21.2)	152.9	40 yrs	operating a department store since Dec 2003
Harbin Co. *	100%	-	150.6	40 yrs	-
Total		**(79.2)**	**794.0**		

** under construction*

Source: Company data

- **Uncertain turnaround time, risks in penetration into second tier cities.** The acquisition is inline with management's guidance given during its annual result presentation in March. The acquisition price represents a slight discount to NAV but we are concerned about the quality of the acquired assets since all except Harbin (which is being developed into a six-storey commercial building) incurred a total net loss of HK$79.2m in FY12/06A. Although, they can immediately contribute to the Group's top-line, it is obvious that their operation efficiency is low. We expect Lifestyle to incur extra costs in remodelling them and are uncertain about their turnaround. The company's foray into inner areas is fraught with execution risks as purchasing power is lower there.

- **Execution risks.** We believe the expansion plan is justified and in line with the company's strategy to expand its presence in China and with its property ownership model. However, it requires a lot of time and capex (budgeted at HK$5b for Suzhou and Shenyang), which will pressure its resources. With net cash of HK$1.2b, we expect Lifestyle to finance the acquisition internally. While, its core operations in Hong Kong remain sound, we downgrade the counter to HOLD from BUY given that the share price has already rallied and we do not expect any new acquisitions in the pipeline. Our target price of HK$28.0 is pegged to our appraised NAV per share, equivalent to 26.5x P/E in FY12/07F.

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	539.4	0.694	11.7	38.6	6.26	28.9	1.1	21.1	16.1	Cash
06A	740.2	0.874	25.9	30.7	5.89	25.2	1.3	20.6	17.4	Cash
07F	896.4	1.058	21.1	25.3	5.18	18.2	1.6	21.8	21.4	Cash
08F	1,078.1	1.273	20.3	21.1	4.48	14.6	1.9	22.8	23.3	Cash
09F	1,325.9	1.565	23.0	17.1	3.84	13.7	2.8	24.2	24.5	Cash