

## Shirble Department Store Holdings

### Capturing the affluence and dynamics of Shenzhen shoppers

#### to summarize...

- The counter is trading at FY09A P/E of 20.3x and at ex-cash FY11F P/E of 9.3x, SDSH offers a value-for-money proxy to China consumption boom.
- With per capita GDP exceed RMB92,000, the company's home base, Shenzhen is the most affluent city in China.
- Upon the completion of its expansion plan, the company's number of stores and stores GFA would expand by ~69% and ~49%, respectively.
- The group's net cash of HK\$1.6b would serve as a war chest for M&A and store network expansion
- The introduction of value-for-money private label products would differentiate the company among its competitors.
- With 13 department stores under its operation, the company is enjoying economy of scale.
- Shirble brand is well recognized and it has been recognized and awarded by different institutions and government bodies in China for its superior services and brand establishments.
- With FY07A-FY09A net earnings CAGR of 18.0% and annualized growth in 1H FY10A earnings of 71.8%, the company demonstrated a proven track record.

**Company background:** Founded in 1996, Shirble Department Store Holdings (SDSH) is a leading department store chain based in Shenzhen, China. All of its stores are operating under the “岁宝百货” brand. Currently, the company has 13 stores, of which 11 are located in Shenzhen, one in Shanwei, Guangdong province, and one in Changsha, Hunan province. SDSH listed on the HKEX in November 2010.

**Table 1. Retail stores**

Name of Store	Operations	Gross Floor Area (sqm)	Operating Area (sqm)	Location
	Begin			
Minzhi Store	Dec 2010	30,000.0	24,000.0	Shenzhen
Wanxiang Store	Mar 2003	29,882.7	17,391.0	Shenzhen
Jufu Store	Aug 2005	21,776.4	13,712.0	Shenzhen
Longgang Store	May 2005	20,988.1	12,976.0	Shenzhen
Shajing Store	Aug 2010	19,950.0	13,786.5	Shenzhen
Longzhu Store	May 2009	17,139.5	11,624.5	Shenzhen
Kaifu Store	Jan 2009	16,212.4	10,308.0	Changsha
Hongling Store	Jan 1996	13,092.8	7,248.4	Shenzhen
Jingtian Store	Jan 2002	11,980.0	9,760.0	Shenzhen
Huahoyuan Store	Dec 2005	10,888.2	6,815.0	Shenzhen
Mingxing Store	May 2005	7,920.1	4,608.5	Shenzhen
Hongbao Store	July 2002	6,636.7	4,437.0	Shenzhen
Luhe Store	Aug 2004	2,227.0	1,346.0	Shanwei
<b>Total</b>		<b>208,684</b>	<b>138,013</b>	
<i>New Stores Planned</i>				
Humen	2H 2011	~37,000		
Humen	2H 2011	~13,000		
Yitian	2012	17,500		

Source: Company data

**Sources of revenues:** The company has three major source of revenue. They are direct sales, commission income from concessionaire and rental income from subleasing of their store area.

Ticker	0312 HK
Price (HK\$)	1.68
12m Price Range (HK\$)	1.61-2.20
Market cap. (US\$m)	538.5
Free float (%)	25.9

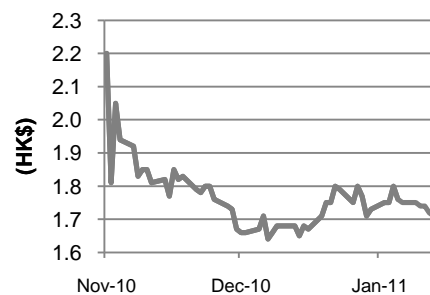
#### Financial summary

Year to Dec	07A	08A	09A
Turnover (RMB)	1,068	1,159	1,233
Net Profit (RMB)	100.7	89.5	140.3
EPS (RMB)	0.05	0.05	0.07
P/E (x)	28.3	28.3	20.3
P/B (x)	12.46	8.67	15.27
EV/EBITDA (x)	27.5	23.4	21.8
Yield (%)	-	-	-
ROE (%)	-	24.3	41.6
ROCE (%)	-	30.6	53.6
N. Gear. (%)	Cash	Cash	Cash

Source: SBI/Bloomberg

#### Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	(1.2)		
Actual price changes (%)	0.6		



Source: Bloomberg

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- Direct sales – The company sources merchandises from suppliers and sells items directly to customers. Most of the merchandises in supermarket and electrical appliance division are sold under this mode.
- Commission income – A certain percentage of sales revenue generated from the concession counters are charged as commission, subject to a minimum irrespective of sales volume. Most of its concessionaries sales are for jewellery, cosmetics products, apparel, footwear, suitcase and small electrical appliances. At end-Jun 2010, there were 2,094 concessionaries' counters in total.
- Rental income – Some of store space are leased to third parties who provide complementary services.

**Table 2. Gross Sales Proceeds of Individual Stores (RMBm)**

Name of Store	2007	2008	2009	1H2009	1H2010	1H2010 vs 1H2009
Wanxiang Store	284.2	307.7	279.2	140.5	142.0	+1.07%
Jufu Store	227.2	246.6	270.2	123.0	139.9	+13.70%
Longgang Store	107.9	121.6	140.9	64.5	74.9	+16.10%
Shajing Store	-	-	-	-	-	-
Longzhu Store	-	-	81.6	18.4	62.4	+239.10%
Kaifu Store	-	-	71.3	32.7	39.2	+19.90%
Hongling Store	262.1	259.8	235.1	131.7	132.4	+16.10%
Jingtian Store	430.2	465.7	443.2	231.9	234.5	+1.10%
Huahoyuan Store	120.8	140.3	141.2	70.8	72.9	+2.90%
Mingxing Store	70.6	69.8	73.1	35.7	37.7	+5.6%
Hongbao Store	93.5	102.0	94.9	53.1	52.2	-1.70%
Luhe Store	15.3	25.1	24.0	12.8	13.8	+7.8%
Minzhi Store	-	-	-	-	-	-
Total	1,611.8	1,738.6	1,854.7	915.1	1,001.9	+9.5%

Source: Company data

**Business environment in Shenzhen:** According to Statistics Bureau of Shenzhen Municipality, as at the end of 2009, Shenzhen had ~9m permanent residents. Between 2001 and 2009, the city's per capita GDP increased at 13% CAGR while per capita annual dispose income increased at 6.2%. Correspondingly, retail sales amount rose 19%+ p.a and hit RMB260b in 2009.

**One-stop shopping destination:** SDSH positions itself a one-stop shopping experience provider for the middle to upper income group who dwells in mass residential projects. Thus, most of its stores are adjacent to mass residential area. In order to cater to diverse range of shoppers' need, all stores offers extensive merchandise portfolio and are embedded sizeable supermarket and electrical appliance sections (except the new *Mingxing store, which targets on young consumers*).

**Chart 1. Shirble Department Store offers a wide range of quality brands and have won numerous accolades**

Source: Company data

**Strong brand recognition and high customer loyalty:** SDSH was ranked No. 1 by shoppers in Shenzhen in terms of loyalty and pleasant shopping experience, according to survey from Shenzhen Retail Business Association. The company's customer loyalty system includes Shirble member card, co-brand card (with banks such as ICBC or CCB) and pre-paid gift card. Cardholders are entitled to certain shopping privileges and can enjoy discount ranging from 2% to 12% when making purchases. While using the card shopper can accumulate purchasing points, which can be redeemed for gifts or cash rebate up to 6% of the product price for future purchases. This loyal customer group made up to 65.6% of the company's gross sales in 1H FY12/10A. As at end-Jun 2010, there were over 400,000

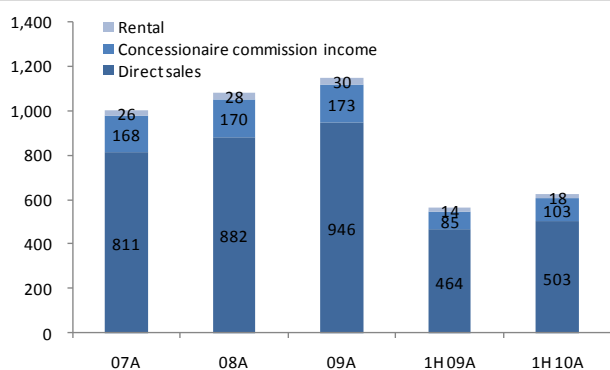
Shirble member card holders.

**Other competitive strength:** Other than locating in a geographically concentrated of affluent Shenzhen shoppers and a well-designed customer loyalty system, we identified another three competitive advantages for SDSH.

- Economic of scale – The clustered 11 stores in Shenzhen brings in economy of scale in terms of bargaining power during procurement and concessionaire negotiation. Meanwhile, centralization allows effective management, marketing and logistics.
- Predictable income from corporate customers – Apart from individual retail customers, SDSH has been developing corporate client base comprising of government entities as well as private enterprises. A special market services department is dedicated to serve such customers. Usually an annual contract is reached between a corporate client and SDSH, under which the latter offers discounts in exchange for the prior's purchase commitment.
- Private label merchandises – Private label merchandises differentiate the company from its competitors. SDSH introduced a private-label includes tissues and toilet paper. This new business contributed RMB1.0b+ gross sales in 1H FY12/10A.

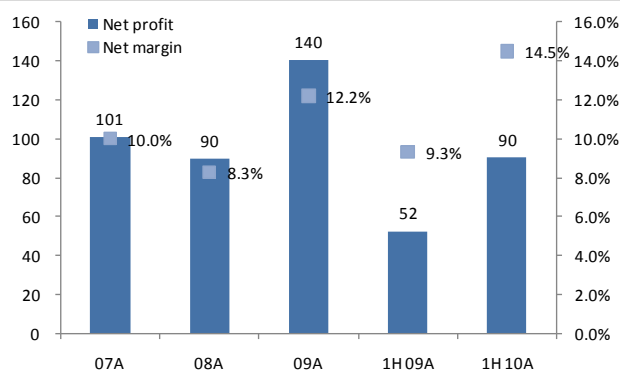
**Financial performance:** Turnover increased at a two-year CAGR of 6.9% from RMB1.0b in FY12/07A to RMB1.15b in FY12/09A. Meanwhile, its net profit increased at a two-year CAGR of 18.0%, from RMB100.7m in FY12/07A to RMB140.3m in FY12/09A. In 1H FY12/10A, turnover and net profit increased by 10.8% YoY and 71.8% YoY, respectively, to RMB623.4m and about RMB90.1m. Gross margin of both direct sales and concessionaire sales (i.e. commission rate) dropped in FY12/08A owe mainly to the global financial crisis,

**Chart 2. SDSH's top line growth**



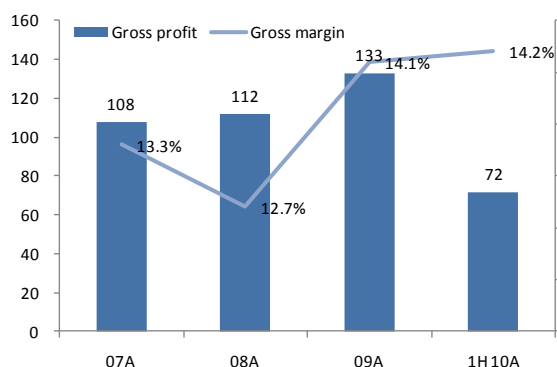
Source: Company data

**Chart 3. SDSH's bottom line growth and net margin trend**



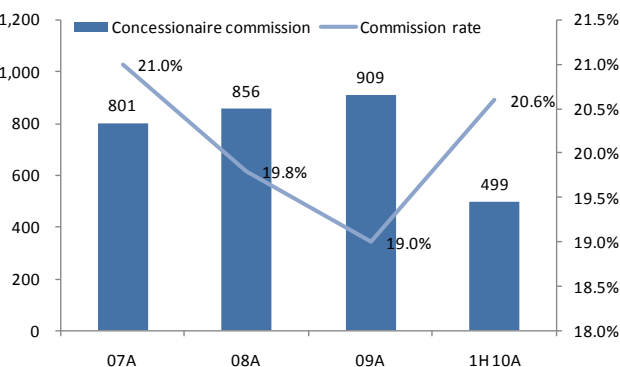
Source: Company data

**Chart 4. Gross profit and margin of direct sales**



Source: Company data

**Chart 5. Commission income and rate of concessionaire**



Source: Company data

which, then, picked up quickly from 2H FY12/09A and kept improving in 1H FY12/10A.

**Developing strategies:** According to the management, multiple plans have been drawn for future growth.

- Expansion in network – The company raised about HK\$1.3b from its IPO in Nov 2010 by offering 625m new shares at HK\$2.20 each. We estimate that it is sitting on a cash pile of at least HK\$1.6b currently. Such cash pile will serve as war chest for new stores development and M&A. SDSH plans to open eight to nine new stores (two to three in Shenzhen, two in Changsha, two in Shanwei and two in Guangzhou) by 2012 with total GFA of ~310,000 sq.m, Upon the completion of new stores, the total GFA will expand by ~48.6%.
- Establishment of a distribution center in Shenzhen – A large scale modernized logistics center and staff training base center has been planned. It will be located in Shenzhen. The size of the logistic center and staff training base are 55,000 sq.m and 5,000 sq.m, respectively.
- Expanding private label product portfolio – Target products includes towels, soap, hangers, shampoo, body soap and detergents, as well as cosmetic products, apparels and electrical appliances. The company is cooperating with suppliers for product development and profit margin improvement. A group of professionals have been deployed to formulate the A&P plan to promote its private label products.

- Pushing up per sq.m. revenue – The company plans to expand its value-for-money merchandise portfolio, in particular its owned brand products, and reiterate its competitive pricing strategy. More renowned brands will be introduced. The company will also expand incentive scheme for its concessionaries.
- Tapping into niche market – The company has tested the focal marketing strategy by launching the Mingxing store. With stylish and trendy image, Mingxing store is targeting youngster and mainly focus on the sale of fashion and accessories. They are also exploring the convenience store plus supermarket model. They have started the test run by setting up convenience store in Minzhi store.
- Upgrading IT system – The company is upgrading its ERP system and customers relationship management system.

**Valuation and our view:** The counter is trading at FY09A P/E of 20.3x and ex-cash FY09A P/E of 16.3x. Consensus put its net earnings for FY12/10F and FY11F at RMB198.3m (or HK\$0.093 per share) and RMB252.5m (or HK\$0.116 per share), respectively, translating into 18.5x one year forward P/E or 14.8x two year forward (ex-cash: 11.6x and 9.3x, respectively). Compared to its HK-listed peers' average current P/E of 30.9x and one-year forward P/E of 25.7x, SDSH's valuation looks undemanding. The company declared 30%+ payout ratio, which somewhat protects the share price at downside.

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 (%)
<b>Hong Kong listed</b>								
GOLDEN EAGLE RET	3308 HK	5,330.3	21.40	54.5	36.1	27.6	11.2	11.0
PARKSON RETAIL	3368 HK	4,784.9	13.28	33.1	29.6	23.9	7.5	24.7
INTIME DEPARTMEN	1833 HK	2,786.0	11.38	30.6	30.4	24.3	4.6	13.8
MAOYE INTL HLDGS	848 HK	2,280.0	3.46	29.3	26.8	22.5	4.4	15.0
NEW WORLD DEPT C	825 HK	1,294.9	5.99	17.6	14.8	12.8	2.1	12.6
SHIRBLE DEPARTME	312 HK	538.5	1.68	20.3	16.5	13.5	-	41.6
JIAHUA STORES HO	602 HK	83.8	0.63	-	-	-	1.5	(5.4)
<b>Average</b>				<b>30.9</b>	<b>25.7</b>	<b>20.8</b>		
<b>HK listed operates in HK</b>								
LIFESTYLE INTL	1212 HK	4,167.4	19.36	24.6	26.4	23.0	5.0	20.2
WING ON CO	289 HK	615.6	16.26	5.1	-	-	0.6	10.1
AEON STORES HONG	984 HK	536.7	16.10	18.5	14.6	13.3	3.5	15.2
SINCERE CO	244 HK	61.8	0.84	-	-	-	0.8	5.2
<b>Average</b>				<b>16.1</b>	<b>20.5</b>	<b>18.1</b>		
<b>China listed</b>								
BEIJING WANGFUJI	600859 CH	2,278.8	42.56	38.5	35.7	27.3	5.9	15.7
SHANGHAI BAILI-A	600631 CH	2,052.4	14.54	28.0	26.1	23.2	2.7	7.2
WUHAN DEPT STORE	000501 CH	1,077.6	16.57	29.4	27.7	23.0	5.2	17.8
YOUR-MART CO -A	002277 CH	1,018.1	22.74	45.1	35.4	26.7	5.3	15.1
CHENGSHANG GRO-A	600828 CH	734.6	15.67	41.3	37.6	22.7	10.2	29.1
XIAN KAIYUAN-A	000516 CH	506.7	5.54	29.1	23.3	24.1	3.8	10.0
CHANGSHA TONG-A	000419 CH	423.0	9.40	37.9	29.7	20.6	4.1	7.5
<b>Average</b>				<b>35.6</b>	<b>30.8</b>	<b>23.9</b>		

Source: Bloomberg

Table 3. Historical P &amp; L

Year to Dec (RMBm)	07A	08A	09A	1H 09A	1H 10A
Turnover	1,004.5	1,079.9	1,148.0	562.7	623.4
Other operating revenue	63.3	78.9	85.4	40.7	68.4
Other net income	0.5	0.4	0.2	0.3	0.8
Purchase of and changes in inventories	(702.8)	(770.3)	(812.7)	(402.1)	(431.4)
Personnel costs	(88.0)	(101.8)	(87.6)	(43.4)	(45.7)
Depreciation	(32.5)	(30.9)	(34.8)	(17.9)	(15.2)
Operating lease rental expense	(79.1)	(82.2)	(90.2)	(44.4)	(53.7)
Other expense	(65.5)	(69.6)	(70.0)	(32.5)	(34.0)
Profit from operations	100.4	104.4	138.3	63.5	112.7
Finance income	13.8	8.7	37.7	2.6	3.8
Finance costs	(7.1)	(4.4)	(1.2)	(1.1)	(1.0)
Net finance income	6.8	4.3	36.5	1.6	2.9
Profit before tax	107.2	108.7	174.8	65.0	115.7
Income tax expense	(6.4)	(19.2)	(34.5)	(12.6)	(25.6)
Net profit	100.7	89.5	140.3	52.2	90.1

Source: Company data

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**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

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