

JPM-pp1

Asia Pacific Equity Research

17 March 2015

## Ajisen China Holdings Ltd (538 HK)

Overweight

Price: HK\$4.28

16 Mar 2015

Price Target: HK\$6.00

PT End Date: 31 Dec 2015

FY14 Preview - Reporting on 18 March 2015

Ajisen China Holdings is expected to report FY14 result on 18 March, 2015 after market close. The company will hold its briefing at 10:00am on 19 March, 2015, Hong Kong time.

- Margin improves on cost structure optimization and direct purchasing.** We expect Ajisen to report c5% earnings growth in 2H14 vs 5% decline in 1H14 as we expect to see GPM margin improvement. Ajisen's share price has corrected c20% YTD (vs HIS +4%) due to weak sales performance which we had highlighted as the key short term risk during our upgrade as the company was cycling high comps in 2H14. The stock now trades at an attractive 15x FY15E earnings with improving ROIC profile. We reiterate our OW call as we expect: 1) GPM margin expansion opportunities from further optimization of its cost structure, direct purchasing, stable input costs and fewer promotions to continue in 2015, 2) more disciplined expansion (focus on smaller stores and productivity); we forecast ROIC of 20.9% by FY16E (vs 16.3% in FY13), and 3) we regard new sales initiatives/increased brand building efforts positively.
- 2H14 preview:** We expect Ajisen to report c2% sales growth in 2H14 with restaurant sales up c2.2% y/y. We are looking for 190bps GPM improvement during 2H14 thanks to cost structure optimization, direct purchasing and stable input costs. On the back of this we are looking for c11% y/y increase in EBIT which is similar to 1H 14 EBIT growth rate of 13%. We expect Ajisen to report HK\$149mn net profit in 2H14, up c5% y/y which is slower than EBIT growth due to higher tax rate this year.
- 2015 outlook.** We expect Ajisen's GPM improvement to continue in 2015 due to better cost control and fewer promotions. In addition, more disciplined expansion with a focus on smaller stores and productivity should help ROIC (we forecast ROIC of 20.9% by FY16E vs 16.3% in FY13). We are optimistic on the company's new sales initiatives and increased brand-building efforts. Although the key risk in the short term is that China's eating-out market may take some time to recover because of the more frugal activity of consumers, we believe the current valuation has already factored this in. We assume 5% y/y sales growth in FY15, and expect c12% earnings growth in FY15.
- Key issues to look out for during results briefing:** 1) Recent sales performance in light of new initiatives 2) Further plans on costs structure and direct purchasing 3) Store opening plans.

Table 1: JPM's estimates of Ajisen's 2H14E and FY14E results

HKD mn	2H13	2H14E	% chg y/y	FY13	FY14E	% chg y/y
<b>Turnover</b>	<b>1,672</b>	<b>1,711</b>	<b>2.4%</b>	<b>3,241</b>	<b>3,323</b>	<b>2.5%</b>
Gross profit	1,134	1,194	5.3%	2,184	2,303	5.5%
Other income	25	26	3.5%	61	66	8.8%
- Staff costs	-377	-389	3.0%	-749	-788	5.2%
- Rental costs	-241	-248	2.6%	-482	-495	2.7%
- A&P	-50	-80	59.9%	-74	-114	54.5%
SG&A	-978	-1,018	4.1%	-1,904	-1,987	4.4%
<b>EBIT</b>	<b>181</b>	<b>202</b>	<b>11.2%</b>	<b>340</b>	<b>382</b>	<b>12.3%</b>
Net interests	15	15	3.3%	30	27	-8.8%
Pre-tax profit	196	217	10.7%	370	409	10.6%
Tax	-44	-60	36.3%	-80	-115	42.6%
Minority	-10	-8	-21.4%	-18	-18	1.7%
<b>Net profit attributable to shareholders</b>	<b>142</b>	<b>149</b>	<b>5.0%</b>	<b>272</b>	<b>276</b>	<b>1.7%</b>
<b>Margins</b>						
Gross margin	67.9%	69.8%	1.9%	67.4%	69.3%	1.9%
EBIT margin	10.9%	11.8%	0.9%	10.5%	11.5%	1.0%
Net margin	8.5%	8.7%	0.2%	8.4%	8.3%	-0.1%
Tax rate	-22.5%	-27.7%	-5.2%	-21.7%	-28.0%	-6.3%
<b>Cost ratio</b>						
- Food	-32.1%	-30.2%	1.9%	-32.6%	-30.7%	1.9%
- Staff costs	-22.6%	-22.7%	-0.1%	-23.1%	-23.7%	-0.6%
- Rental costs	-14.4%	-14.5%	0.0%	-14.9%	-14.9%	0.0%

- A&P -3.0% -4.7% -1.7% -2.3% -3.4% -1.2%

Source: Company reports. Source: Company data, Bloomberg and J.P. Morgan estimates.

## Investment Thesis

We maintain OW on Ajisen due to: 1) GPM margin expansion opportunities from further optimization of its cost structure and direct purchasing; GPM should also benefit from stable input costs and fewer promotions into 2H and 2015, 2) more disciplined expansion (focus on smaller stores and productivity); we forecast ROIC of 20.9% by FY16E (vs 16.3% in FY13), and 3) we regard new sales initiatives/increased brand-building efforts positively. Key risks in the short term: the company is cycling higher comps in 2H and sales growth could decelerate from 1H levels, and consensus earnings still remain relatively high. We are assuming 2.5% sales growth in 2H14 vs c3% in 1H14 and now expect a 14% earnings CAGR for 14-16E.

## Valuation

Our Dec-15 PT of HK\$6 is based on 21x FY15E P/E (1 standard deviation below mean on lower growth relative to historical levels). The PT cut is because of changes to our earnings estimates and multiple.

## Risks to Rating and Price Target

Key downside risks to our rating and price target include a sudden surge in food price costs and further deterioration in sales growth.

Key upside risks to our rating and price target include better-than-expected sales momentum.

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Consumer

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Date	Rating	Share Price (HK\$)	Price Target (HK\$)
03-Aug-07	UW	8.33	7.20
05-Sep-07	UW	8.55	7.40
27-Apr-08	UW	10.10	8.50
23-Sep-08	UW	4.33	3.70
09-Jan-09	UW	3.64	2.85
20-Apr-09	UW	4.45	3.62
15-Sep-09	UW	5.49	4.95
31-Mar-10	N	7.60	8.10
19-Aug-10	N	9.89	10.00
24-Mar-11	N	12.98	14.00
26-May-11	N	16.18	17.00
17-Aug-11	OW	9.74	13.00
12-Oct-11	OW	9.88	12.00
13-Feb-12	N	8.90	8.00
23-Mar-12	N	10.84	9.00
02-Jul-12	N	5.33	6.00
23-Aug-12	N	5.01	5.00
16-Jan-13	N	6.44	7.00
13-Mar-13	N	5.35	5.60
22-Aug-13	N	7.74	7.50
11-Apr-14	N	7.00	6.50
14-Jul-14	N	5.71	5.30
24-Sep-14	OW	6.40	7.30
25-Feb-15	OW	4.71	6.00

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