

Daphne (210 HK)

Hold (maintained)

Target price: HK\$2.48



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FY14 results in line; 1Q15 SSS still weak

FY14 results in line Net profit fell 47% YoY to HK\$176m. 2H14 net profit came in at HK\$4m, lower than the HK\$19m in 2H13, and in line with the trend mentioned in the company's 4Q14 operational update released on Jan 22. FY14 revenue dropped 1% YoY. SSS declined 3.4% YoY. GM fell 0.5pp YoY to 55.4%. Excluding the HK\$120m inventory provision write-back (vs HK\$245m write-off in FY13), GM would have dropped 4pp to 54.2% driven by aggressive clearance of off-season products. Operating profit plunged 50% YoY due to deleveraging as SG&A expenses ratio increased 2.2pp. No final dividend was announced.

Performance by brand Profit for its core brands slumped 64% YoY to HK\$225m in FY14. This segment reported a HK\$40m loss in 2H14 mainly due to a 2.7pp YoY contraction in GM to 53.3%. We believe some off-season products were sold at very aggressive discounts in 2H14. However, its other brands turned profitable, with profit improving from a loss of HK\$86m in FY13 to a profit of HK\$18m, driven by 15% revenue growth and 7.3pp expansion in GM.

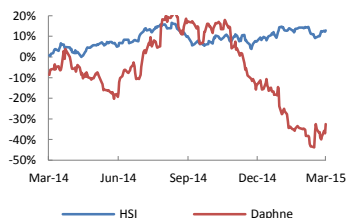
Inventory balance down 14% YoY Inventory turnover days in 2H14 declined 4 days YoY to 194 days (vs 208 days in 1H14). Inventory mix also improved. Off-season product inventories for the spring, autumn and winter seasons are at a healthy level. Net cash balance rose 32% YoY to HK\$752m. Management targets to lower inventory turnover days to less than 180 days by the end of FY15.

FY15 outlook 1) SSS has been weak in 1Q15. We estimate YTD SSS may be in the negative mid to high-single-digit range. Management expect SSS to improve in 2Q15 led by further market segmentation by product series with a wider price range and new celebrity advertising campaigns. 2) Management expects A&P expenses ratio to increase YoY by not greater than 0.5pp, still within 1-2% of revenue. 3) Driven by a healthier inventory mix and lower raw material costs, management expects GM to improve by 1-2pp YoY and a certain portion of GM expansion to pass through to a net profit margin gain. 4) Management targets to add 100-150 new stores in FY15, focusing on lower-tier cities. 5) The company has plans for capex of HK\$300-400m during the year, mainly for new stores and old store renovation.

Maintain Hold and cut TP to HK\$2.48 We revise down our FY15/16 earnings forecasts by 7%/10% on lower SSSG assumptions (from 4%/3% to 2%/3% in FY15/16). We expect GM to expand in FY15 as inventory destocking is almost complete. However, new product sales visibility remains low due to competition from online channels and mass market brands. 2Q15 SSS data will be key as a way of assessing customer response to its further segmented products. Daphne's shares have fallen 22% over the past three months, meaning the weak FY14 results are priced in, in our view. Share purchases by major shareholders or share buybacks would be positive catalysts. We cut our target price from HK\$2.60 to HK\$2.48, based on 0.75x P/B (previously 0.77x), to factor in our lowered FY15 ROE estimate of 5.5% (previously 5.9%).

Upside risks 1) Consolidation of Taobao market as sellers on the platform may be taxed; 2) ASP increase led by improving brand equity. **Downside risks** 1) weaker-than-expected SSS.

Stock performance



Source: Bloomberg

Key data

Mar 25 close (HK\$)	2.26
Shares in issue (m)	1649.142
Major shareholder	Lucky Earn (24.3%)
Market cap (HK\$ bn)	3.7
3M avg. vol. (m)	5.2
52W high/low (HK\$)	4.10/1.86

Source: Bloomberg

Stock valuation

	Turnover (HK\$ m)	Net profit (HK\$ m)	Core profit (HK\$ m)	Core EPS (HK\$)	EPS YoY (%)	Core P/E	Yield (%)	BPS (HK\$)	P/B	ROE (%)
2012	10,529	956	963	0.585	-4	3.9	8.0	2.9	0.8	21.7
2013	10,447	329	358	0.217	-63	10.4	3.5	3.1	0.7	7.3
2014	10,356	176	173	0.105	-52	21.6	1.5	3.1	0.7	3.4
2015E	10,712	286	286	0.173	65	13.0	2.3	3.3	0.7	5.5
2016E	11,078	312	312	0.189	9	11.9	2.5	3.4	0.7	5.8

Sources: Company data, GF Securities (HK)

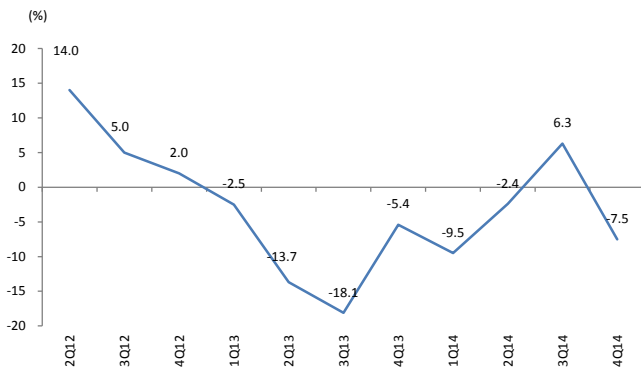
Note: Core profit excludes fair value change of financial assets and derivatives, impairment loss of intangible assets

Figure 1: Results review

Y/E Dec (HK\$ m)	FY14	FY13	% change	2H14	2H13	% change	1H14	1H13	% change
Revenue	10,356	10,447	-1%	5,275	5,278	0%	5,081	5,168	-2%
Cost of sales	(4,618)	(4,608)	0%	(2,403)	(2,453)	-2%	(2,215)	(2,155)	3%
Gross profit	5,738	5,838	-2%	2,872	2,825	2%	2,866	3,013	-5%
Other income	84	95	-11%	41	58	-29%	42	36	18%
Selling and distribution expenses	(5,042)	(4,875)	3%	(2,617)	(2,537)	3%	(2,425)	(2,338)	4%
Administrative expenses	(492)	(480)	3%	(247)	(230)	8%	(245)	(250)	-2%
Operating profit	287	578	-50%	49	117	-58%	238	461	-48%
Finance costs	(34)	(53)	-36%	(12)	(27)	-55%	(22)	(26)	-16%
Other net gains/(losses)	(25)	(58)	-57%	(27)	(47)	-42%	3	(11)	-125%
Associates and JVs	(7)	(3)	129%	(5)	(4)	22%	(3)	1	-486%
Profit before tax	221	464	-52%	5	39	-87%	216	425	-49%
Tax expense	(39)	(130)	-70%	2	(21)	-111%	(42)	(109)	-62%
Profit after tax	182	334	-46%	7	18	-59%	175	316	-45%
Non-controlling interests	(6)	(5)	18%	(4)	1	-484%	(2)	(6)	-60%
Net profit	176	329	-47%	4	19	-81%	172	310	-44%
EPS (HK\$)	0.11	0.20	-47%				0.10	0.19	-44%
DPS (HK\$)	0.04	0.08	-56%				0.04	0.06	-42%
Margin & Ratio (%)									
Gross margin	55.4	55.9	(0.5)	54.4	53.5	0.9	56.4	58.3	(1.9)
Adjusted gross margin (excluding write-down/write back of inventories provisions)	54.2	58.2	(4.0)	52.7	56.6	(3.9)	55.8	59.8	(4.0)
Operating margin	2.8	5.5	(2.8)	0.9	2.2	(1.3)	4.7	8.9	(4.2)
SG&A expenses ratio	53.4	51.3	2.2	54.3	52.4	1.9	52.6	50.1	2.5
Net margin	1.7	3.2	(1.5)	0.1	0.4	(0.3)	3.4	6.0	(2.6)
Effective tax rate	17.7	28.0	(10.3)	(49.2)	54.4	(103.6)	19.2	25.6	(6.3)
Payout ratio	32.8	40.1	(7.3)				61.7	60.2	1.5
	FY14	FY13	change	1H14	1H13	change			
Inventory days	194	198	(4)		208	209	(1)		
A/C receivables days	12	12	0		13	14	(1)		
A/C payable days	103	79	24		114	89	25		
	FY14	FY13	change	1H14	FY13	change			
Core brands	6,402	6,319	1%		6,234	6,581	-5%		
Net cash (HK\$m)	752	568	32%		614	589	4%		

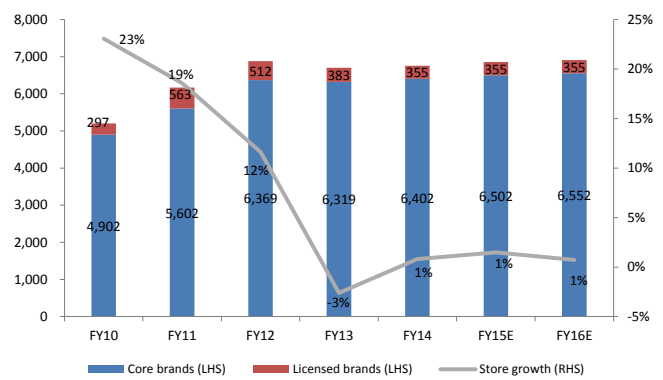
Sources: Company data, GF Securities (HK)

Figure 2: Quarterly SSS



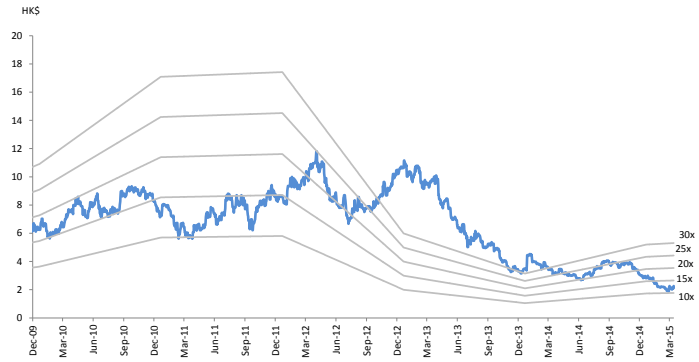
Sources: Company data, GF Securities (HK)

Figure 3: Store growth



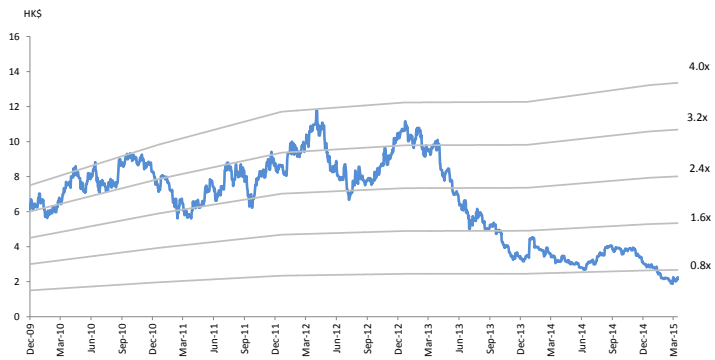
Sources: Company data, GF Securities (HK) estimates

Figure 4: P/E band



Sources: Bloomberg, GF Securities (HK) estimates

Figure 5: P/B band



Sources: Bloomberg, GF Securities (HK) estimates

Figure 6: Key assumptions

(HK\$ m)	FY12	FY13	FY14	FY15E	FY16E
Total revenue	10,529	10,447	10,356	10,712	11,078
growth %	22.8%	-0.8%	-0.9%	3.4%	3.4%
Core brands SSSG (%)	9.0%	-10.4%	-3.4%	2.0%	3.0%
Gross profit	6,229	5,838	5,738	6,113	6,360
Gross margin	59.2%	55.9%	55.4%	57.1%	57.4%
SG&A expenses ratio	47.1%	51.3%	53.4%	54.1%	54.1%
Operating profit margin	12.7%	5.2%	2.3%	3.5%	3.8%
Effective tax rate	25.4%	28.0%	17.7%	25.2%	25.2%
Net profit	956	329	176	286	312
growth %	2.4%	-65.6%	-46.5%	62.3%	9.2%
Core profit	963	358	173	286	312
growth %	-3.2%	-62.8%	-51.7%	65.3%	9.2%
Core profit margin	9.1%	3.4%	1.7%	2.7%	2.8%
Payout ratio	31.0%	40.1%	32.8%	30.0%	30.0%

Sources: Company data, GF Securities (HK) estimates

Rating definitions

Benchmark: Hong Kong Hang Seng Index

Time horizon: 12 months

Company ratings

Buy	Stock expected to outperform benchmark by more than 15%
Accumulate	Stock expected to outperform benchmark by more than 5% but not more than 15%
Hold	Expected stock relative performance ranges between -5% and 5%
Underperform	Stock expected to underperform benchmark by more than 5%

Sector ratings

Positive	Sector expected to outperform benchmark by more than 10%
Neutral	Expected sector relative performance ranges between -10% and 10%
Cautious	Sector expected to underperform benchmark by more than 10%

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